TC02174

Appeal number: TC/2010/03743

CAPITAL GAINS TAX– tax avoidance scheme – whether Appellant's loan notes were converted to qualifying corporate bonds for the purposes of sections 116 and 117 TCGA 1992 – whether steps taken to reduce the market value of loan notes effective for capital gains tax purposes – purposive construction and the application of the Ramsay principle – error in drafting amendments to loan notes – principles of contractual interpretation – whether HMRC entitled to raise a discovery assessment under section 29 TMA 1970 – whether the officer could reasonably be expected to be aware of the insufficiency – appeal dismissed

FIRST-TIER TRIBUNAL

TAX CHAMBER

WILLIAM BLUMENTHAL **Appellant**

- and -

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

TRIBUNAL: JUDGE GUY BRANNAN
ANNE REDSTON

Sitting in public at Bedford Square, London WC1 on 12 – 14 March 2012 and written submissions on 19 June, 3 July and 16 July

Patrick Way and Michael Jones, Counsel, instructed by Deloitte LLP, for the Appellant

Tim Eicke QC and Imran Afzal, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal by Mr William Blumenthal ("the Appellant") against an assessment dated 15 December 2009 in the amount of £176,515.82. The assessment was a "discovery" assessment made under section 29 Taxes Management Act 1970 ("TMA") and related to the Appellant's self-assessment tax return for the tax year 2003-2004 which was submitted to HMRC (within the relevant time limit) on or before 31 January 2005.

2. The Appellant's 2003-2004 tax return showed, *inter alia,* an allowable loss of £26,379 for the purposes of capital gains tax arising in respect of the redemption of certain loan notes ("the Loan Notes" and holders of those Loan Notes are referred to as "Loan Noteholders") owned by the Appellant. HMRC dispute this loss and argue, instead, that a chargeable gain arose from the redemption.

3. There are two issues in this appeal. First, whether an allowable loss or a chargeable gain accrued to the Appellant in respect of the redemption of the Loan Notes ("the substantive issue"). Secondly, whether HMRC was entitled to raise a discovery assessment under section 29 TMA ("the discovery issue"). The parties disagreed as to the order in which those issues should most conveniently be dealt with. Mr Way, for the Appellant, argued that the discovery issue most naturally came first, whereas Mr Eicke, for HMRC, argued that the substantive issue should be considered first.

4. In the event, we consider that nothing turns on the order in which these matters are considered and this Decision fully explores both issues. In our view, however, 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.

Evidence

5. The written evidence in this appeal was contained in four folders of documents together with certain documents in respect of the consent of other Loan Noteholders to the variation of the terms of the Appellant's Loan Notes. The following witnesses submitted witness statements and gave oral evidence:

(1) the Appellant;

(2) Mr Brian White, formerly a tax partner of Deloitte LLP (in this decision, for simplicity, Deloitte LLP and its affiliated company Deloitte PCS Limited are referred to as "Deloitte") and tax adviser to the Appellant;

(3) Mr Andrew Elliott, an officer of HMRC; and

(4) Ms Mo Paul, a corporate finance specialist adviser in the Strategic Risk Unit of the Large Business Service at HMRC, who gave expert evidence in relation to financial instruments and financial markets pertinent to the appeal.

Statutory provisions relevant to substantive issue – introduction and explanation

Overview of the statutory provisions

6. We have set out in an appendix the relevant statutory provisions (both as regards the substantive and discovery issues) for ease of reference, although we set out later in this Decision some of the most relevant provisions.

7. A short introduction to these provisions and an explanation of their relevance to the substantive issue may, however, be of assistance.

8. The substantive issue in this appeal, in part, concerns the question whether the Loan Notes were converted into "qualifying corporate bonds" ("QCBs") or whether they remained non-qualifying corporate bonds ("NQCBs"). In short, a QCB is a loan stock or loan note issued by a company and denominated in Sterling (the definition is contained in section 117 Taxation of Chargeable Gains Act 1992 ("TCGA")). In very broad terms, a Sterling denominated loan note can be a QCB but a non-Sterling denominated loan note will always be a NQCB.

9. Gains arising on the disposal (which would include its redemption) of a QCB are exempt from capital gains tax. This exemption was originally something of a wolf in sheep's clothing because the real purpose of this exemption when it was introduced in the 1984 was to prevent an allowable loss arising on a QCB, in much the same way that dealings in gilt-edged securities were exempt from capital gains tax. Gains arising from the disposal of an NQCB by an individual (entirely different provisions govern the treatment of loan relationships held by companies) are chargeable to capital gains tax and losses are allowable losses.

10. The capital gains tax code contains provisions which prevent a capital gain being triggered on what is described as a "reorganisation".

11. A "reorganisation" is defined by the legislation to include a number of different types of transaction. For present purposes, the two most relevant types of transactions are as follows. First, where a shareholder transfers shares in exchange for loan notes issued by the acquiring company the exchange will usually be treated as a "reorganisation" (section 135 TCGA). Secondly, a conversion (e.g. by the variation of its terms) of a loan note which is an NQCB into a QCB will also be treated as a "reorganisation" (section 132 TCGA). This second type of transaction is generally known (and, indeed, is referred to in the legislation) as a "conversion of securities", but section 132 TCGA effectively treats it as a "reorganisation."

12. "Reorganisation" treatment is important because, as we have said, a transaction which constitutes a "reorganisation" does not trigger an immediate capital gains tax liability. Instead, "reorganisation" treatment usually involves any capital gain on the original asset being "rolled over" into the new asset. A "reorganisation" does not involve a disposal of the original asset but rather the new or altered asset is treated as the same asset as the original asset (section 127 TCGA). This means that, in most cases, the acquisition cost (frequently referred to as the "base cost") of the original asset becomes the acquisition cost of the new or altered asset for the purposes of

calculating any capital gain or allowable loss arising on the eventual disposal of the new or altered asset.

13. Applying "reorganisation" treatment to transactions involving QCBs would, however, have given rise to scope for tax avoidance. For example, if a shareholder transferred shares in exchange for QCBs, any capital gain inherent in the shares would have been rolled over into an asset (the QCB) which was exempt from capital gains tax on its disposal (e.g. its sale or redemption). Thus, on the redemption of the QCB the capital gain would disappear. Likewise, if an NQCB (which was pregnant with gain) was converted into a QCB, normal "reorganisation" treatment would mean that the gain was converted from being a chargeable (i.e. taxable) gain into an exempt (i.e. non-taxable) gain.

14. Parliament anticipated this problem by enacting special provisions for "reorganisations" involving QCBs. In short, the two types of transactions referred to above are dealt with in the following manner. The original asset (e.g. the shares or the NQCB) is treated as if it had been disposed of for a consideration equal to its market value immediately before the transaction (section 116(10)(a) TCGA). Any chargeable gain or allowable loss that would thereby have accrued was postponed, for tax purposes, until the disposal (e.g. the sale or redemption) of the QCB which represented the original asset (section 116(10)(b) TCGA).

15. In other words, section 116 TCGA has the effect that the gain or loss on the original asset is calculated by reference to its market value immediately before the "reorganisation", but that gain or loss is "frozen" (that is to say that it is not recognised for tax purposes) until the QCB is sold or redeemed. In this Decision, as in the argument before us, we shall on a number of occasions refer to "frozen" gains or losses and it is this market value calculation and deferral of which we speak.

16. Parliament may have prevented avoidance by providing for a "frozen" gain to be crystallised on a reorganisation involving the issue of a QCB, but it gave taxpayers a problem. If, for example, a taxpayer sold his or her shares in exchange for the issue of QCBs in the acquiring company, what would happen if the acquiring company became insolvent before the QCBs were redeemed? In that case, the holder of the QCBs would be taxed on the "frozen" gain even though, in economic terms, he or she had sustained an economic loss when the QCBs turned out to be worthless.

17. To guard against this risk, many transactions which involved a shareholder selling shares in exchange for loan notes were structured so that the loan notes were NQCBs. If the issuer of the loan notes became insolvent before redemption the inherent gain that was rolled over onto the loan notes was reduced or eliminated if the loan noteholder received reduced proceeds on redemption. This was achieved by ensuring that the loan note contained an option permitting redemption of the loan note in a foreign currency fixed by reference to an exchange rate shortly before (but not on) the redemption date. As we shall see, the inclusion of a foreign currency redemption option (provided the rate of exchange was calculated before the date of redemption) prevented a loan note from falling within the definition of a QCB.

18. The sale of shares in exchange for loan notes is a very common type of transaction. Indeed, almost every public company takeover (and many private takeovers) where part of the consideration offered is payable in cash will involve the offer of a loan note alternative. The loan note alternative allows an individual shareholder to defer all part of a gain from one tax year to another. There is nothing objectionable in this practice and, indeed, in many cases clearance from HMRC under section 138 TCGA will have been obtained. In most cases the loan note will be structured as an NQCB for the reasons given above and we believe that we can take judicial notice of this fact. We make this point simply to observe that the question whether a loan note is or is not a QCB is not an abstruse or obscure point of tax law but one which is likely to be encountered by an HMRC officer from time to time.

Relevance of the statutory provisions to the Appellant's transactions

19. In this appeal, again in very broad terms, the Appellant entered into three types of transactions which qualified as a "reorganisation."

20. First, the Appellant sold a holding of shares in a company called Aarco 152 Limited in exchange for shares in companies called Cleversort Limited and Ever 1199 Limited. This was a "reorganisation" so that the Appellant's gain in respect of his Aarco 152 shares was "rolled over" into his new holdings in Cleversort Limited and Ever 1199 Limited. Thus no capital gain was triggered on this transaction. No dispute arises in respect of this transaction.

21. Subsequently, the Appellant's shares in Ever 1199 Limited were exchanged for Loan Notes in a company called O2 (UK) Limited ("O2") – part of the well-known UK-based mobile phone network operator. The Loan Notes comprised £265,950 par value of A Loan Notes and £62,900 par value of B Loan Notes (i.e. a total par value amount of £328,860). In addition, a small amount of cash was received. It is common ground that these Loan Notes were NQCBs because there was an option permitting redemption in a foreign currency calculated at a rate of exchange three days before redemption. As far as the NQCB element of the consideration was concerned, the transaction constituted a "reorganisation" so that any capital gain was once again rolled over into the new NQCB loan notes. To the extent that cash was received, a small capital gain arose and was entered on the Appellant's tax return.

22. So far, the transactions and their tax consequences represent common ground between the parties. We now come to the more contentious transactions.

23. Almost 5 years later, in February 2004, the Appellant entered into two agreements (by “Deeds of Variation”) with the issuer of the Loan Notes, O2, to vary the terms of the NQCB Loan Notes by altering their terms to remove the option to redeem the Loan Notes in a foreign currency, and thus to convert them into QCBs.

24. The Appellant contends that the effect of this agreement with O2 was that:

(1) the market value of the Loan Notes was temporarily depressed immediately before they were converted into QCBs;

(2) the Loan Notes were successfully converted into QCBs;

(3) the "frozen" gain was computed by reference to a low market value for the NQCBs;

(4) in consequence the reorganisation actually produced a loss rather than a gain, and it is this loss which was recognised, for capital gains tax purposes, on the eventual redemption of the QCBs a few weeks later.

25. The Appellant redeemed his Loan Notes on 25 March 2004 for £265,950 and £62,900 respectively (a total of £328,860).

26. HMRC dispute that the Loan Notes were converted in QCBs, and, in the alternative, if the Loan Notes were converted, they say the value was not depressed.

The facts

27. We find the following facts.

28. The Appellant sold a holding of shares in a company called Aarco 152 Limited in exchange for shares in companies called Cleversort Limited and Ever 1199 Limited. The Appellant acquired 2,748 shares in Ever 1199 Ltd in the 1998-99 tax year.

29. Later in that tax year, Telecom Securicor Cellular Radio Ltd, which later became O2, acquired the share capital of Ever 1199 Ltd in exchange for Unsecured Series A Guaranteed Loan Stock 1999/2006 (“A Loan Notes”) and Unsecured Series B Loan Stock (“B Loan Notes”) (together “the Loan Notes”) issued by O2. As a result of the exchange the Appellant received £265,960 A Loan Notes, £62,900 B Loan Notes, and £7,500 cash.

30. The Deed of Variation relating to the A Loan Notes provided by the Appellant stated that he owned £265,960 A Loan Notes, and this is consistent with Deloitte’s letter of 16 March 2010 which stated that the Appellant received £265,960 on redemption of the A Loan Notes. However, the white space of the Appellant’s 2003-04 tax return stated that he owned £338,460 A Loan Notes**.** This appears to have been an error. Although not material to our decision we note the point for completeness.

31. The Appellant’s Loan Notes contained an option which allowed O2 to redeem them in US Dollars at an exchange rate applying three days before redemption. The relevant provisions were contained in Condition 4 of the A Loan Notes and Condition 9 of the B Loan Notes. As already noted, it was common ground that the Loan Notes, at the time of issue, were NQCBs (section 117 TCGA).

32. In November 2003 a tax planning scheme was devised and offered to the Loan Noteholders which envisaged the redemption of the Loan Notes in a tax efficient manner. The scheme involved the steps described below.

33. Two Deeds of Variation, each relating to the Appellant’s A Loan Notes and B Loan Notes respectively, were entered into by him and O2 on 13 February 2004. The two Deeds of Variation, so far as material, were in identical terms.

34. The following terms are taken, for convenience, from the Deed of Variation relating to the B Loan Notes – the Deed of Variation in relation to the A Loan Notes

was for all material purposes identical. Clause 2 contained various definitions which were as follows:

> "*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 Persons* means… [various specified Loan Noteholders] and William Blumenthal [i.e. 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."

35. Thus, the Deeds of Variation provided for a clause to be inserted into the Loan Notes which would vary the terms of the option to redeem in US Dollars if a Relevant Event occurred. If during the **First Relevant Period** (16 February 2004 to 17 March 2004) the **Relevant Event** occurred, i.e. the Sterling-US Dollar exchange rate moved by 1.5% or more, then any redemption in US Dollars would have to be at the exchange rate applicable at the time of redemption. The amendment to the foreign currency redemption option (described below) would happen automatically on the occurrence of this contingency (the Relevant Event). The contingency was designed, as Mr White made clear in his evidence, to be wholly outside the control of the Loan Note Holders.

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.

37. The Deeds of Variation also inserted a clause into the O2 Loan Notes which, first, was designed to depress their market value, for a limited period and, secondly, to accommodate a requirement of O2 which is discussed further below. The clause was only applicable during the **Second Relevant Period** (16 February 2004 to 21 March

2004). For the sake of clarity, we set out the original Condition 9 of the B Loan Notes – again, the terms of the A Loan Notes were for all material purpose identical - with the amendments introduced by the Deed of Variation in italics. Condition 9 provided as follows:

> "9 US DOLLAR REDEMPTION OPTION
>
> 9.1 The Company [02] may at any time not more than three months and not less than one month prior to the date on which the Loan Stock is due to be repaid under clause 3.1 Schedule III (the "Redemption Date") give notice in writing 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 case the provisions of clause is 9.2 to 9.6 shall apply.
>
> 9.2 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").
>
> 9.3 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-point spot rate for the purchase of US Dollars as stated in the first London edition of the Financial Times on the Redemption Date.
>
> 9.4 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 a notice under 4.1 [sic] has not been given.
>
> 9.5 Payment of the Redemption Amount made in US Dollars pursuant to this clause 4 [sic] shall constitute a full discharge to the Company of the Redemption Amount.
>
> 9.6 Any interest payable on the Redemption Date shall be payable in Sterling, notwithstanding that the principal amount may be payable in US Dollars.
>
> *9.7 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 9 shall apply with the following modifications:*
>
> *i) in clause 9.1 the words from "the provisions of clause 9.2 to 9.6 shall apply." to the end of clause 9.4 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 9.2 and 9.3 and 9.4 above shall be deleted in their entirety.

9.8 The provisions of this clause 9.8 shall apply during the Second Relevant Period and not otherwise.

9.8.1 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 9.8 to apply in relation to such Note(s).

9.8.2 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 9.8 to apply in relation to such Note(s).

9.8.3 If this clause 9.8 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."

38. Thus, the first part of the clause applied if, at any time in the Second Relevant Period (16 February 2004 to 21 March 2004), a Noteholder was *not* a **Relevant Noteholder** and O2 gave notice that it should apply. Relevant Noteholders were defined as any registered holders of the notes at 31 December 2003 (including their personal representatives), with the exception of certain named individuals that did not include the Appellant. Therefore, the Appellant was a Relevant Noteholder because he held loan notes at 31 December 2003. Thus, the first part of the clause did not apply to the Appellant but would apply to someone purchasing the O2 Loan Notes from him. The clause, if it applied, provided that the amount payable on redemption of the Loan Notes would be 3% of par value. The intention, therefore, was that the right of O2 to repay only 3% of par value on redemption would reduce the market value of the Loan Notes during the Second Relevant Period to 3% of their par value, because this is the amount for which a third party would receive from O2, if O2 elected to apply on redemption.

39. There was, on the evidence, no indication that there was any likelihood that any Relevant Noteholder intended or was likely to transfer the Loan Notes during the Second Relevant Period. The intention was simply temporarily to drive down the market value of the Loan Notes at the time when they were converted from NQCBs to QCBs. In other words, the purpose of the amendment in the first part of the clause was therefore entirely tax-driven.

40. The second part of the clause applied if at any time in the Second Relevant Period a Noteholder was a Relevant Noteholder. This also allowed O2 to redeem the loan notes at 3% of par value, but only if more than three of the Relevant Persons (i.e. a list of six named persons including the Appellant) died during the Second Relevant Period. In the event, this condition was not satisfied. We accept Mr White’s evidence that this “Four Dead Men clause” was inserted at the insistence of O2,in order to

ensure that O2 had some (albeit very small) chance of being able to redeem the Loan Notes at 3% of par value.. Mr White accepted that it was unlikely that more than three of the Relevant Persons would die within the Second Relevant Period, but did not consider that it was impossible. In our view, there was only a very remote possibility that at least four out of six Relevant Persons would die in the five week period from 16 February 2004 to 21 March 2004. In fact, none of them died in the period. We consider that there was no practical likelihood that O2 would be able opt to redeem or repay the Loan Notes under the Four Dead Men clause and that its effect on valuation would be minimal.

41. Furthermore, the Deed of Variation provided, in respect of the B Loan Notes (identical alterations were made in respect of the A Loan Notes), as follows:

> "After clause 1.2 of Schedule III there shall be inserted:
>
> 1.3 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 Condition 1 of Schedule III, notwithstanding the relevant notice set out in clause 1.2 above."

42. Clause 1. 2 of Schedule III to the B Loan Notes required that early redemption by a Loan Note Holder would have to occur on a "Quarter Day". The clause provided as follows:

> "A Non-cancellable Series B Stockholder may require the Company to repay the whole or any part of his Non-cancellable Series B Loan Stock… on any Quarter Day… by giving the Company… a written notice (a "repayment notice") not less than 30 days prior to the repayment date specified in the repayment notice provided that such repayment date must be a Quarter Day or the next following Business Day …."

43. It will be noted that the first Quarter Day after the date on which the Appellant sought to convert his Loan Notes from NQCBs to QCBs was 25 March 2004. However, as drafted, both Deeds of Variation expressed the ability to redeem at 3% of par as being applicable only during the Second Relevant Period, which expired on 21 March 2004. We shall return to this point later in this Decision.

44. The Conditions of the B Loan Notes provided in Condition 14.1 (Condition 13 was in identical terms as regards the A Loan Notes):

> "The terms hereof shall not be subject to amendment in any respect say with the sanction of an extraordinary resolution at an extraordinary general meeting of Series B 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 consisting of not less than three-fourths in principal amount of the Series B Loan Stock for the time being outstanding and the provisions of Schedule 1 shall apply to any such extraordinary general meeting."

45. Paragraph 19 of Schedule 1 (an identical provision existed in respect of the A Loan Notes) provided:

> "A resolution in writing signed by holders 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."

46. O2 wrote to the Loan Noteholders 9 February 2004 in the following terms:

> "I am writing to inform you that O2 (UK) Limited has received a request from a number of the Series [A/B] 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/B] 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/B] 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/B] Loan Note Stock holders in relation to the proposed variation."

47. Each of the A and B Loan Holders signed and returned to O2 the following letter (the letters were identical, *mutatis mutandis*, in respect of the A and B Loan Notes):

> "I confirm that I am a holder of Series [A/B] 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/B] 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/B] Loan Stock.

> 2. I consent to the proposed variation, as set out in the Deed of Variation, of the terms of the Series [A/B] Loan Stock held by all holders who wish to participate in the proposed variation.
>
> …
>
> *Please delete as applicable."

48. A letter in these terms was signed and returned by every A and B Loan Noteholder.

49. Although not expressed as a resolution, we consider that the letters signed by the A and B Loan Note Holders have the effect of a resolution within the meaning of paragraph 19 of Schedule 1 to the Conditions of the B Loan Notes (and the corresponding provision in respect of the A Loan Notes).

50. We note that it was envisaged, in our view correctly, that by amending the terms of the A and B Loan Notes, the participating Loan Noteholders would thereafter hold classes of Loan Notes which were separate from the A and B Loan Notes held by non-participating Loan Note Holders.

51. The Appellant, on 15 February 2004, entered into two Deeds of Covenant with a charity (one in relation to each series of Loan Notes). The charity was The Children's Hospital Appeal Trust, of whom Mr Brian White (the Deloitte tax partner advising the Appellant) was a trustee. The covenants provided that if the Appellant were to acquire Loan Notes for less than par he would pay double the difference to the charity. The covenant remained in force until the final redemption of all Loan Notes by O2. The purpose of the charitable covenants was to remove the Appellant from the potential field of purchasers of the Loan Notes when assessing their market value on conversion from NQCBs to QCBs. According to Mr White, some Loan Note Holders did give money to the charity, but not under the covenant. All the Relevant Loan Note Holders entered into similar Deeds of Covenant.

52. In her evidence, Ms Paul concluded in relation to the Deeds of Covenant that they restricted the choice of the Loan Noteholder whether to sell above, at or below par and could not be associated with a commercial transaction. We accept her evidence on that point.

53. The Relevant Event occurred on 27 February 2004. The foreign currency option was therefore amended on that date, thereby (the Appellant contends) turning the Loan Notes from NQCBs into QCBs at a time when their market value was depressed.

54. The Appellant redeemed his A and B Loan Notes on 25 March 2004 for £265,960 and £62,900 respectively (a total of £328,860).

55. In his 2003-04 tax return the Appellant claimed an allowable loss for CGT purposes. The information was provided in a space in the CGT section of the tax return (paragraph 8.22), referred to as the “white space”, as follows:

> "The chargeable loss shown in box 8.2 of this tax return arose as a result of my redemption of £328,860 Loan Notes in O2 (UK) Limited on 25 March 2004.
>
> During the year 1998/99, I received 2748 shares in Cleversort and 2748 shares in Ever 1199 in exchange for 2748 shares in Aarco 152 Ltd. Clearance under section 138 TCGA 1992 was obtained.
>
> The shares in Ever 1199 were exchanged for £338,460 "A" loan notes £62,900 "B" loan notes and £7,500 in cash on 28th February 1999. The disposal of the cash element was reported on my tax return for the year ended 5th April 1999.
>
> 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 £9,866. 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."

56. Paragraph 8.2 of the return showed a loss an allowable loss of £26,379. The proceeds on redemption of the loan notes were not explicitly stated on the face of the return. Mr Way directed us to the Appellant's tax return on page on page CG6 in the section headed "Other Disposals" which referred to "MMO2 Unsecured Series A Guaranteed Loan Stock 1999/2006 (£265,950) and "MMO2 Unsecured Series B Guaranteed Loan Stock 1999/2006(£62,900)". Mr Way argued that this was connected with the white space disclosure which mentioned the redemption of £328,860 (ie £265,950 plus £62,900).

57. Mr Way submitted that the redemption proceeds could be inferred from the values set out above, namely that the loan notes could be expected to be redeemed at par. We return to this point below.

58. Mr White stated that in his experience very few tax returns contained any entry in the white space and he considered the Appellant's disclosure on his tax return to be "fulsome." He also considered that there was enough detail in the white space disclosure to trigger questions from HMRC. His evidence, which we accept, was that the same disclosure on the tax return of another taxpayer had triggered an enquiry by HMRC.

59. An enquiry into the tax return, pursuant to section 9A TMA 1970, could be opened until 31 January 2006.

60. On 13 January 2006 an enquiry was opened into the Appellant's 2003-04 tax return, in respect of an issue relating to a claim to relief for gifts of shares in various companies to charity. Following discussions between Deloitte, the Inspector, the Special Civil Investigations Office, and the Shares Valuation Office, the matter was

settled. The value of the gifts to charity was reduced by 12%, and the Inspector notified the Appellant on 14 July 2006 that he was closing the enquiry and amending the tax return. No enquiry was made into the transactions referred to in the white space.

61. HMRC obtained various pieces of additional information from sources other than the Appellant, as follows:

(1) "Binder A": Documents provided on different occasions (but particularly in September 2006 and 14 August 2008) by Deloitte relating to another taxpayer ("Mr A"). Those documents indicated that Mr A had also owned shares in Ever 1199 Ltd and had exchanged them for Loan Notes. The Loan Notes were of two types and were the same as the Loan Notes.

(2) "Binder B": Documents provided directly by Deloitte by Deloitte (via other advisers, mainly under cover of a letter dated 7 April 2006) in relation to Mr A and another taxpayer ("Mr B"). These included various scheme implementation documents, including some of those in Binder A, and correspondence relating to the planning between *inter alia* Deloitte and Mr A and Mr B. These documents indicated that both Mr A and Mr B had owned shares in Ever 1199 Ltd and exchanged them for Loan Notes.

(3) A letter dated 15 May 2003 from Michael H Bull of Deloitte in relation to the affairs of another taxpayer setting out the details and the desired effect of a tax planning scheme used by an unrelated taxpayer, which HMRC contended was the same or similar type of scheme as that implemented by the Appellant. This letter came to the attention of Mr Elliott, the HMRC officer responsible for investigating this particular scheme, on 16 May 2007.

62. On the basis of this information HMRC wrote to the Appellant on 30 September 2009 requesting copies of the Appellant's Loan Notes, the Deed of Variation and bank statements verifying redemption.

63. The documents requested were not initially provided. Therefore, on 11 December 2009 HMRC sent the Appellant an information notice, pursuant to paragraph 1 of Schedule 36 to the Finance Act 2008. This requested a number of documents relating to the arrangements, including those previously sought. The Appellant initially appealed against the information notice on 4 February 2010. There was correspondence between Deloitte and HMRC as to the reasons why the appeal was made late. However, the appeal fell away after the Deloitte confirmed that the documents in Binder B also applied to the Appellant, and also provided other information.

64. Mr Elliott took advice from expert colleagues within HMRC in July 2007 and February 2009. Both experts considered that the scheme could be successfully challenged by HMRC. Mr Elliott, however, considered that the advice from his colleagues did not lead to the discovery upon which he founded his section 29 TMA assessment. Instead, he considered that the discovery was based on the various

documents in his possession and the realisation that a number of individuals had used the same scheme.

65. In cross-examination, Mr Elliott was asked what new information led to the enquiry into the Appellant's 2003-2004 tax return in respect of the white space disclosure. Mr Elliott said that a number of factors were relevant:

(1) the Appellant had entered into a preordained tax avoidance scheme;

(2) the Deeds of Variation were uncommercial. The amendments to the Loan Notes were triggered by uncommercial foreign exchange rate movements and the reduction in value of the Loan Notes was uncommercial;

(3) there had been an attempt to "*Ramsay*-proof" the scheme (namely, the insertion of the contingency), which had not been disclosed.

66. On 15 December 2009 a discovery assessment was raised by Mr Elliott pursuant to section 29 TMA in the estimated amount of £176,515.82 for the tax year 2003-04. The assessment was raised on the basis that the Appellant had not realised an allowable loss on the redemption of his Loan Notes and that there was an insufficiency in his self-assessment return. The discovery was based on the documents referred to above and a review of the Appellant's 2003-2004 tax return (and the returns of other taxpayers who had used the same scheme).

67. On 29 December 2009 Deloitte, on behalf of the Appellant, appealed against the assessment and sought a postponement of the tax due (which was granted).

68. On 11 February 2010 Deloitte confirmed, in a telephone conversation with HMRC, that the documents in Binder B were equally applicable to the Appellant as to Mr B.

69. HMRC wrote to Deloitte on 16 February 2010, requiring written confirmation that the documents supplied in connection with Mr A and Mr B were applicable to the Appellant. In addition, it requested that the Appellant provide bank statements evidencing the sums received on redemption of the O2 Loan Notes.

70. Deloitte wrote to HMRC on 19 February 2010 confirming that the documents provided on 14 August 2008, in connection with enquiries relating to Mr A and Mr B, were equally applicable to the Appellant.

71. On 23 February 2010 HMRC wrote to Deloitte requesting a signed copy of the Deed of Variation, completed Loan Note certificates and bank statements. A copy of the Deed of Variation relating to the Appellant's A Loan Notes was provided on 26 February 2010. The accompanying letter stated that the Loan Note certificates were not available because they had been returned to the issuer on redemption, and that bank statements were not available because the originals had not been retained and the bank account in question had been closed.

72. On 16 March 2010 HMRC received a letter from Deloitte confirming the Appellant had received £265,960 and £62,900 on redemption of the A Loan Notes and B Loan Notes respectively, that redemption had occurred on 25 March 2004, and that the proceeds were received by way of cheque on 7 April 2004.

73. By a letter of 23 March 2010, HMRC confirmed that the information notice matter was now settled because the documents had been provided. In the same letter HMRC stated that its view remained that an allowable loss did not accrue to the Appellant.

74. In cross-examination, Mr Elliott accepted that the white space disclosure in the Appellant's 2003-2004 tax return was identical (except as regards the figures) to that of another taxpayer in respect of which an enquiry had been launched. Mr Elliott could not, however, confirm whether in the case of the other taxpayer the enquiry had been launched on the basis of the white space disclosure.

The substantive issue

Background

75. In HMRC's Statement of Case, the intended effects of the transactions entered into by the Appellant were summarised (the summary was not disputed) as follows:

> (1) The Loan Notes were originally NQCBs. This was the effect of the option for O2 to redeem the loan notes in a non-Sterling currency, and other than at the exchange rate prevailing at redemption (ss.117(1)(b), 117(2)(b) TCGA 1992).
>
> (2) The Loan Notes acquired by the [Appellant] in 1999 were treated as the same assets as his Ever 1199 Ltd shares such that any capital gain or loss attributable to the latter was effectively "rolled over", subject to the effect of the part disposal for cash (ss.127, 135 TCGA 1992).
>
> (3) It was considered that once the Relevant Event occurred the Loan Notes would be converted from NQCBs to QCBs. This was on the basis that the ability to redeem loan notes in a non-Sterling currency did not prevent them being QCBs if the exchange rate used is that applicable at redemption (s.117(2)(b) TCGA 1992).
>
> (4) When NQCBs are converted to QCBs a special tax regime applies under s.116(10) TCGA 1992, for the following reason. Section 132(3)(a)(ia) TCGA 1992 is satisfied such that ss.127-131 TCGA 1992 are *prima facie* applicable to the conversion by virtue of s.132(1) TCGA. However, the terms of s116(1) TCGA 1992 are also met, i.e. ss.127-130 TCGA 1992 would otherwise apply and the new holding consists of QCBs but the original holding did not. As a result ss.127-130 TCGA 1992 are prevented from applying by s.116(5) TCGA 1992, and instead s.116(10) TCGA 1992 applies. The effect of the latter subsection is as follows. A capital gain or loss is calculated on the basis of a hypothetical disposal of the old asset at the time of the conversion and at the market value of the old asset immediately before the conversion. The gain or loss is "frozen" and deemed to accrue on redemption of the QCBs. Any gain between the conversion and subsequent redemption is exempt from CGT (s.115 TCGA 1992). Therefore it was considered that any capital loss deemed to

accrue at the date of conversion would be “frozen”, and would be realised upon redemption irrespective of the redemption amount.

(5) It was further considered that the clauses enabling O2 to redeem at 3% of par value if the Loan Notes were held during the Second Relevant Period by a non-Relevant Loan Noteholder would artificially depress the market value of the O2 Loan Notes at the time of the hypothetical disposal such that a loss would arise and be “frozen” until redemption. Section 272 TCGA 1992 provides that market value is the amount which assets might reasonably be expected to fetch on a sale in the open market. It was thought that the market value of the Loan Notes would be 3% of their par value on the basis that:

(a) a hypothetical purchaser would not be a Relevant Note Holder because they were excluded from the pool of hypothetical purchasers by the effect of the charitable covenant, as this would require him to pay double the difference in value to the charity; and

(b) the hypothetical sale would be during the Second Relevant Period and O2 could give him notice to redeem at 3% of par value.

(6) Upon redemption of the O2 Loan Notes by the Appellant *prima facie* a capital gain would arise, since the Appellant would receive significantly more than the market value considered to prevail at the date of conversion. However, this would not be chargeable since gains on the disposal of QCBs are exempt (s.115 TCGA 1992).

76. We consider the above to be a reasonable summary of the way in which the scheme which the Appellant entered into was intended to work for tax purposes.

Did the Loan Notes continue to be NQCBs?

77. HMRC argued that the Loan Notes continued to be NQCBs after the Relevant Event occurred.

78. It will be recalled that the effect of the Deeds of Variation was, once the Relevant Event occurred, to alter the option to redeem in US Dollars from the rate of exchange applicable three days before redemption to the rate of exchange applicable at the time of redemption. Section 117(1)(b) TCGA provides that a QCB must be expressed in Sterling and "in respect of which no provision is made for conversion into, or redemption in, a currency other than sterling." Section 117(2)(b) TCGA provides that a provision for redemption in a currency other than Sterling but at the rate of exchange prevailing at redemption shall be disregarded and, therefore ,does not disqualify a Loan Note from being a QCB.

79. HMRC argued that the terms of the Loan Notes continued to include a provision for redemption in a currency other than Sterling. Mr Eicke argued that the terms of the Loan Notes continued to be governed by the original loan note agreement, but subject to the variations made by the Deeds of Variation. The Deeds did not excise the original option from the loan notes, but simply inserted additional clauses into them. Even after the Relevant Event occurred, it was necessary to read the original and new

clauses together to determine the way in which the US Dollar redemption option operated.

Harding and Klincke

80. In *Harding v HMRC Commissioners* 79 TC 885 the Court of Appeal considered section 117 (1) (b) TCGA. In that case the option for the loan notes to be redeemed in foreign currency had lapsed. The taxpayer contended that the lapse of the option converted the loan notes into QCBs. The Court of Appeal, dismissing the taxpayer's appeal, focused on the word "provision" in section 117 (1) (b) TCGA. The Court held that the word "provision" was a reference to the terms of the agreement, and not simply to subsisting rights. The loan notes therefore did not qualify as QCBs. Lawrence Collins LJ said:

> "[55] In my judgment the key to the interpretation of s 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 s 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."

81. The meaning of section 117(1)(b) TCGA was also considered by the Upper Tribunal in the subsequent case of *Klincke v HMRC Commissioners* [2010] STC 2032. The taxpayer held loan notes that were NQCBs because they contained a term which allowed the issuer to redeem the loan notes in a currency other than Sterling. At an extraordinary general meeting of the noteholders an extraordinary resolution was passed modifying the terms of the loan note instrument to cancel the issuer's foreign currency redemption right. This was followed by a deed of variation which varied the terms of the loan notes pursuant to the extraordinary resolution. Shortly afterwards, the taxpayer redeemed his notes.

82. The terms of the extraordinary resolution were as follows:

> "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."

83. Following the meeting, a deed of variation was executed by the issuer 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 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."

84. In the First-tier Tribunal ([2009] UKFTT 156), the judges were divided on the issue. Judge Aleksander considered that the deed of variation did not have the effect that the loan note instrument no longer included any provision for redemption in a currency other than sterling. This was because the deed of variation was a document expressed to be supplementary to the loan note instrument: it did not therefore supersede it. Following the deed of variation the loan note instrument had to be interpreted in the light of the deed of variation, and vice versa – the two documents were legally stapled together and had to be read together. Judge Sir Stephen Oliver QC, however, considered that once the deed of variation had been executed there was no longer any provision for redemption in a foreign currency. The relevant clauses had, in his view, ceased to exist by common consent of all the parties to the loan note instrument, albeit that the effect of the deed of variation could not be understood without reference to the original loan note instrument.

85. The Upper Tribunal (Newey J and Judge Gammie QC) held that the loan notes became QCBs after their amendment. The Tribunal said (at paragraph 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 s 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."

86. One difference between the facts in *Klincke* and the present case is that in *Klincke* the terms of the loan notes were altered for all loan noteholders. In the case of the Loan Notes in this appeal their terms were only altered for the Relevant Loan Note Holders. In our view, however, we do not consider this difference to be material. As we have noted, the effect of the Deeds of Variation was that the Loan Notes held by participating Loan Noteholders constituted different classes of Loan Notes from the Series A and B Loan Notes held by persons who did not participate in the variation. The significance of this point is that, in our view, a transferee from the participating Loan Noteholders, such as the Appellant, would have acquired a Loan Note which provided for redemption in a currency other than Sterling but at a rate of exchange prevailing on redemption.

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.

Application of the Ramsay Principle

88. HMRC also submit that the *Ramsay* principle (*WT Ramsay Ltd v IRC, Eilbeck (Inspector of Taxes) v Rawling* [1981] STC 174, [1982] AC 300), as explained in subsequent cases, has the effect that the Deeds of Variation failed to convert the Loan Notes from NQCBs to QCBs.

89. The *Ramsay* principle has been through many iterations in the higher courts. It was recently and conveniently summarised by the Upper Tribunal (Lewison J) in *Berry v HMRC Commissioners* [2011] STC 1057 as follows (at paragraph 1067) :

> "(i) The *Ramsay* principle is a general principle of statutory construction (*Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 at [35], 6 ITLR 454 at [35]; *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] STC 1 at [36], [2005] 1 AC 684 at [36]).

(ii) The principle is two-fold; and it applies to the interpretation of *any* statutory provision:

(a) To decide on a purposive construction exactly what transaction will answer to the statutory description; and

(b) To decide whether the transaction in question does so (*Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] STC 1 at [36], [2005] 1 AC 684 at [36])

(iii) It does not matter in which order these two steps are taken; and it may be that the whole process is an iterative process (*Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)*[2005] STC 1 at [32], [2005] 1 AC 684 at [32]; *Astall v Revenue and Customs Comrs* [2010] STC 137 at [44], 80 TC 22 at [44]).

(iv) Although the interpreter should assume that a statutory provision has some purpose, the purpose must be found in the words of the statute itself. The court must not infer a purpose without a proper foundation for doing so (*Astall v Revenue and Customs Comrs* [2010] STC 137 at [44], 80 TC 22 at [44]).

(v) In seeking the purpose of a statutory provision, the interpreter is not confined to a literal interpretation of the words, but must have regard to the context and scheme of the relevant Act as a whole (*WT Ramsay Ltd v IRC* [1981] STC 174 at 179, [1982] AC 300 at 323; *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] STC 1 at [29], [2005] 1 AC 684 at [29]).

(vi) However, the more comprehensively Parliament sets out the scope of a statutory provision or description, the less room there will be for an appeal to a purpose which is not the literal meaning of the words. (This, I think, is what Arden LJ meant in *Astall v Revenue and Customs Comrs* [2010] STC 137 at [34], 80 TC 22 at [34]. As Lord Hoffmann put it in an article on 'Tax Avoidance' ([2005] BTR 197): 'It is one thing to give the statute a purposive construction. It is another to rectify the terms of highly prescriptive legislation in order to include provisions which might have been included but are not actually there': see *Mayes v Revenue and Customs Comrs* [2009] EWHC 2443 (Ch) at [30], [2010] STC 1 at [30].)

(vii) In looking at particular words that Parliament uses what the interpreter is looking for is the relevant fiscal concept: *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2001] UKHL 6 at [48], [49], [2001] STC 237 at [48], [49], [2003] 1 AC 311.

(viii) Although one cannot classify all concepts a priori as 'commercial' or 'legal', it is not an unreasonable generalisation to say that if Parliament refers to some commercial concept such as a gain or loss it is likely to mean a real gain or a real loss rather than one that is illusory in the sense of not changing the overall economic position of the parties to a transaction: *WT Ramsay Ltd v IRC* [1981] STC 174 at 182, [1982] AC 300 at 326; *IRC v Burmah Oil Co Ltd* [1982] STC 30 at 38, 54 TC 200 at 221; *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1992] STC 226 at 238, 240–241, 246, [1992] 1 AC 655 at 673, 676, 683; *MacNiven (Inspector of Taxes) v*

Westmoreland Investments Ltd [2001] STC 237 at [5], [32], [2003] 1 AC 311 at [5], [32]; *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] STC 1 at [38], [2005] 1 AC 684 at [38].

(ix) A provision granting relief from tax is generally (though not universally) to be taken to refer to transactions undertaken for a commercial purpose and not solely for the purpose of complying with the statutory requirements of tax relief: see *Collector of Stamp Revenue v Arrowtown Assets Ltd* (2003) 6 ITLR 454 at [149]. However, even if a transaction is carried out in order to avoid tax it may still be one that answers the statutory description: *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] STC 1 at [37], [2005] 1 AC 684. In other words, tax avoidance schemes sometimes work.

(x) In approaching the factual question whether the transaction in question answers the statutory description the facts must be viewed realistically: *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] STC 1 at [36], [2005] 1 AC 684.

(xi) A realistic view of the facts includes looking at the overall effect of a composite transaction, rather than considering each step individually: (*WT Ramsay Ltd v IRC* [1981] STC 174 at 180, [1982] AC 300 at 324; *Stamp Comr v Carreras Group Ltd* [2004] UKPC 16 at [8], [2004] STC 1377 at [8]; *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] STC 1 at [35], [2005] 1 AC 684.

(xii) A series of transactions may be viewed as a composite transaction where the series of transactions is expected to be carried through as a whole, either because there is an obligation to do so, or because there is an expectation that they will be carried through as a whole and no likelihood in practice that they will not: *WT Ramsay Ltd v IRC* [1981] STC 174 at 180, [1982] AC 300 at 324.

(xiii) In considering the facts the fact-finding tribunal should not be distracted by any peripheral steps inserted by the actors that are in fact irrelevant to the way in which the scheme was intended to operate: (*Astall v Revenue and Customs Comrs* [2009] EWCA Civ 1010 at [34], [2010] STC 137 at [34], 80 TC 22).

(xiv) In considering whether there is no practical likelihood that the whole series of transactions will be carried out, it is legitimate to ignore commercially irrelevant contingencies and to consider it without regard to the possibility that, contrary to the intention and expectation of the parties it might not work as planned: *IRC v Scottish Provident Institution* [2005] STC 15 at [23], [2004] 1 WLR 3172 at [23]. Even if the contingency is a real commercial possibility it may be disregarded if the parties proceeded on the basis that it should be disregarded: *Astall v Revenue and Customs Comrs* [2010] STC 137 at [34], 80 TC 22 at [34]."

90. Mr Eicke submitted that a composite view must be taken of the facts in this appeal, ignoring any commercially irrelevant contingency (i.e. in this context the

Relevant Event), and, in turn, those facts must be assessed by reference to the legislation construed purposively. In the present case: (a) there was no commercial rationale for using an exchange rate applicable at the time of redemption as opposed to that prevailing three days earlier, (b) there was no real possibility that the loan notes would be redeemed in a non-Sterling currency at the former rather than the latter exchange rate, and (c) there was no commercial rationale for using a 1.5% exchange rate fluctuation as the basis for modifying the applicable exchange rate. In short, the Deeds of Variation were entered into solely in an attempt to create an artificial loss, and an artificial contingency was used in a misconceived attempt to prevent the *Ramsay* principle applying. Viewed as a composite whole these transactions did not fall within the purpose of the statutory provisions. Therefore the loan notes were not converted from NQCBs into QCBs.

91. Referring to the Upper Tribunal decision in *Berry v CCR* [2011] STC 1057 (where a 7% chance that an option would not be exercised was ignored as commercially irrelevant and the facts had to be viewed as a whole), Mr Eicke argued that, by analogy, in the present case there was no possibility of loss to the Appellant. If the Relevant Event occurred then the scheme would proceed, and if it did not occur the alleged conversion would not take place, but in either event there would be no economic loss to the Appellant (save for costs). Mr Eicke submitted that the contingency (i.e. the occurrence of the Relevant Event) was commercially irrelevant and should be ignored.

92. Mr Eicke also referred to the decision of the Upper Tribunal (Warren J and Judge Clark) in *Schofield v HMRC Commissioners* [2011] STC 1920. The Upper Tribunal decided that the four options in that case should not be viewed independently but rather as part of a composite transaction. In so doing the Tribunal held that a 10-15% chance of making an economic profit or loss of £50,000 could be ignored. In that case the Tribunal said (at paragraph 86):

> "We make clear that it is no part of our reasoning that steps are to be ignored for no other reason than that they are steps in a tax avoidance scheme. They are to be ignored in the present case, as we think that they were ignored in *Ramsay*, because the composite transaction in the present case is not one to which ss 2 and 16, TCGA 1992 apply so as to give rise to the loss claimed by Mr Schofield; and Mr Schofield fails to establish that the options code must be applied independently of the composite transaction."

93. On the basis of *Berry*, Mr Eicke submitted that in the present case the contingency (i.e. the Relevant Event) was even less commercial than that in *Berry*. There was no question of a profit or loss turning on the contingency. It simply governed whether the scheme would proceed or not. The Relevant Event should be ignored, and instead the facts should be viewed as a composite whole.

94. Mr Way submitted that the *Ramsay* principle had no application to the facts of the present appeal. In his view, the sole issue for the Tribunal was to identify:

(1) whether the Loan Notes were originally NQCBs;

(2) whether there was a conversion; and

(3) whether pursuant to that conversion the Loan Notes became QCBs.

95. Mr Way accepted that a question of valuation rose by reference to the time when the conversion took place. However, all of the three above matters were legal matters not susceptible to *Ramsay* and accordingly demonstrate the limits of *Ramsay* as was stated by Lord Hoffmann in *MacNiven v Westmoreland Investments Limited* [2001] STC 237 (at paragraph 58):

> "The limitations of the *Ramsay* principle therefore arise out of the paramount necessity of giving effect to the statutory language. One cannot elide the first and fundamental step in the process of construction, namely to identify the concept to which the statute refers. I readily accept that many expressions used in tax legislation (and not only in tax legislation) can be construed as referring to commercial concepts and that the courts are today readier to give them such a construction than they were before *Ramsay*. But that is not always the case. Taxing statutes often refer to purely legal concepts. They use expressions of which a commercial man, asked what they meant, would say 'You had better ask a lawyer'. For example, stamp duty is payable upon a 'conveyance or transfer on sale' (see para 1(1) of Sch 13 to the Finance Act 1999). Although slightly expanded by a definition in para 1(2), the statutory language defines the document subject to duty essentially by reference to external legal concepts such as 'conveyance' and 'sale'. If a transaction falls within the legal description, it makes no difference that it has no business purpose. Having a business purpose is not part of the relevant concept. If the 'disregarded' steps in *Furniss* (*Inspector of Taxes*) *v Dawson* had involved the use of documents of a legal description which attracted stamp duty, duty would have been payable."

96. In our view, the *Ramsay* principle is not irrelevant to this appeal.

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.

99. We do not accept, however, that the Loan Notes continued to be NQCBs and that the Deeds of Variation were ineffective to convert them into QCBs.

100. The relevant statutory provision is section 117 TCGA which defines a QCB. Section 117 provided:

> "(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 sub-paragraph (5) of paragraph 1 of Schedule 18 to the Taxes Act if for paragraph (a)(i) to (iii) of that sub-paragraph there were substituted the words "corporate bonds (within the meaning of section 117 of the 1992 Act)".
>
> (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."

101. In our view, the provisions of section 117(1)(b) and (2)(b) are prescriptive and leave little scope for purposive interpretation. They set out in a mechanical fashion the conditions to be satisfied if a debt security is to qualify as a QCB. Furthermore, we do not consider that the purpose of the Appellant is relevant to the correct interpretation of this provision. If a security contains a foreign currency conversion option at a rate of exchange prevailing at redemption then the effect of section 117(2)(b) is

mandatory: the security will (assuming the other conditions are satisfied) constitute a QCB. As Proudman J observed in *Mayes* in the High Court [2010] STC 1 at 33 (paragraph 47) (in a judgment affirmed by the Court of Appeal [2011] STC 1269) some legislation can adopt "a formulaic and prescriptive approach." We consider section 117(1)(b) and (2)(b) to be an illustration of that principle.

102. We also note that it was common ground that the foreign currency redemption option (which provided for a rate of exchange prevailing three days before redemption) was effective to ensure that the Loan Notes were NQCBs on issue. Indeed, it was HMRC's submission that the Loan Notes were NQCBs throughout. As already noted, the insertion of a foreign currency redemption option in these terms was a very common technique used to ensure that loan notes issued on a "reorganisation" constituted NQCBs for the reasons discussed. In almost all cases it is not envisaged that the option would ever be exercised. It is inserted solely to ensure that the tax status of the loan note was that of an NQCB. We have no doubt that many such loan notes issued in connection with takeovers received clearance from HMRC under section 138 TCGA. Although we do not base our conclusion on this point, in our view, the fact that a foreign currency redemption option (which the parties envisage will never be exercised and which is designed solely to attach certain tax attributes to the loan note) is treated as effective, strongly suggests that our conclusion is correct that the terms of section 117 (1) (b) and (2) (b) are prescriptive.

103. For these reasons, we conclude that the Deeds of Variation were effective to convert the Loan Notes from NQCBs to QCBs.

Was the value of the O2 Loan Notes on conversion £9,866?

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.

105. The Appellant contends that this was the effect of the Deeds of Variation, taken together with the Deeds of Covenant.

106. HMRC disputed this. Mr Eicke argued that the effect of the *Ramsay* principle was that the value of the Loan Notes for the purposes of sections 116(10) and 272 TCGA was not 3% of their par value. The purpose of section 116(10) was that any unrealised gain or loss genuinely existing at the date of conversion should be "frozen." Furthermore, the purpose of section 272 was to establish the genuine market value of assets, not artificially modified values which are divorced from reality. It was necessary to view the facts realistically. It was never intended that O2 should redeem the securities 3% of par value. Construing the provisions purposively, on this realistic view of the facts the market value of the Loan Notes immediately prior to conversion was not 7% of their par value.

107. Mr Way repeated his earlier submission that the *Ramsay* principle had no application in this case and, in particular, it had no application to questions of valuation – this was a strict matter of law.

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.

116. .We see no incongruity in holding that the definition of a QCB in section 117(1)(b) and (2)(b) TCGA is less susceptible to purposive interpretation than the requirement in section 116(10) that the frozen gain arising on conversion should be calculated at market value. Each statutory provision must be interpreted on its own merits, but in context. That is so even where the relevant provisions are found in neighbouring sections of the same Act. As the Court of Appeal observed in *Mayes* (at paragraph 78) not all statutory provisions readily lend themselves to a commercial construction.

117. Secondly, Mr Eicke initially argued that in valuing the Loan Notes the effect of the Deeds of Variation should be ignored because they were personal to the Appellant. The modifications contained in the Deeds would affect the Appellant but no one else. Further, they did not affect the Loan Notes in general. In argument before us Mr Eicke indicated that this argument was not being pursued.

118. Thirdly, Mr Eicke argued that the market value of the Loan Notes was greater than 3% of par value on the basis of the principle established in *AG for Ireland v Jameson* (1905) 2 IR 218.The argument was that the Loan Notes were worth what a purchaser would pay to stand in the Appellant's shoes – an amount considerably in excess of 3% of par value. The *Jameson* case involved the valuation of shares. The shares were subject to restrictions on transfer. It was held by the Court of Appeal that the price which the shares would fetch if sold on the open market should reflect the terms on which the purchaser would be entitled to be registered (i.e. subject to the restrictions). FitzGibbon LJ said (at page 230):

> "The price was to be that which a purchaser would pay for the right "to stand in Henry Jameson's shoes," with good title to get into them and remain in them, and receive all the profits, subject to all the liabilities, of the position. The price was what the shares were worth to Henry Jameson."

119. But the issue in that case was whether shares should be valued on a basis which either ignored or took account of the restrictions on transfer inherent in the shares. The Court of Appeal held that it was necessary to take account of the transfer restrictions when valuing the shares for estate duty purposes because these were the restrictions to which the testator was subject. It was this concept that FitzGibbon LJ was attempting to summarise in the passage quoted above. We do not think that this case (or the subsequent decision of the House of Lords in *IRC v Crossman* [1937] AC 26, which involved the same issue and which followed the *Jameson* decision) established a principle that ascertaining an open market value involved enquiring what the seller or transferor of property would themselves pay or what it was worth to them, but rather that account should be taken of the rights and liabilities affecting the property that was being transferred. Accordingly, we do not accept Mr Eicke's argument on this point.

120. Fourthly, Mr Eicke argued that because O2's ability to redeem the Loan Notes at 3% only applied during the Second Relevant Period, a hypothetical purchaser after that period would be prepared to pay more than 3% of par value. Insofar as we understood that submission, it seems incorrect. The issue is what was the market value of the Loan Notes at the time of conversion within the meaning of sections 116 (10) and 272 TCGA. We do not think it correct to say that the market value at the time of conversion can be ascertained by reference to what a purchaser would have been willing to pay at a later date. We accept that the hypothetical purchaser might be prepared to take a risk, particularly close to the end of the Second Relevant Period, that O2 would not manage to redeem the Loan Notes for 3% of their par value. However, this would require some estimate of risk and the factors which a hypothetical purchaser would use to assess that risk. No such evidence or submissions were made. For other reasons, we have concluded that the Deeds of Variation did not

have the effect of reducing the market value of the Loan Notes and, therefore, it is unnecessary to consider this point further.

Drafting error in the Deeds of Variation – effect on valuation: submissions

121. Mr Eicke argued that the Deeds of Variation were drafted in such a way that O2 could never (except on the occurrence of certain events of default – see further below) have paid a non-Relevant Loan Noteholder 3% of par value (the device on which the depression in value of the Loan Notes depended).

122. Mr Eicke pointed out that any early redemption by a holder of Loan Notes had to occur on a "Quarter Day" (Condition 3.3 of the A Loan Notes and Paragraph 1, Schedule III of the B Loan Notes). The first Quarter Day after the conversion of the loan notes (the market value of the Loan Notes had to be ascertained immediately before conversion) was on 25 March 2004. However, the ability to redeem at 3% of par only applied during the Second Relevant Period, which expired on 21 March 2004. This was clear from the introductory words to Clause 9.8 (the amendment to the B Loan Notes effected by the Deed of Variation permitting redemption at 3% of par value and set out in full at paragraph 38 above) stated:

> "9.8 The provisions of this clause 9.8 *shall apply during the Second Relevant Period and not otherwise.*" (Emphasis added)

123. In relation to the A Loan Notes the relevant Clause – Clause 4.8 – was drafted in identical terms. For simplicity, the following discussion refers only to the Clauses in respect of the B Loan Notes but is equally applicable to the identical drafting of the B Loan Notes.

124. Although the point was touched on relatively briefly at the hearing it was not argued at any length and, indeed, was not dealt with at all in the Appellant’s skeleton argument. In view of its potential importance, we invited the parties to make further written submissions on the point (Directions dated 24 April 2012 and 12 June 2012). The Appellant's written submissions were filed on 19 June 2012, the Respondents filed their written submissions on 3 July. The Appellant's Reply was filed on 16 July 2012.

125. Mr Way accepted, at the hearing, that the Clause contained an unintentional drafting error, saying “read literally it is accepted that this clause does not work”. The introductory words to Clause 9.8 should have excluded Clause 9.8.3. However, in his view the Tribunal should construe Clause 9.8 to facilitate the wishes of the parties and to exclude Clause 9.8.3 from the introductory words. O2 and the Relevant Loan Noteholders intended the Clause should be workable.

126. In his written submissions Mr Way argued that this was a case where (as Lord Hoffmann said in *Investors Compensation Scheme Limited v West Bromwich Building Society* [1998] 1 WLR896 at 913) "the parties must, for whatever reason, have used the wrong words or syntax." Alternatively, Mr Way submitted that in Clause 9.8 the word "apply" should be construed as meaning "be activated". Mr Way submitted that there was no distinction to be drawn between participating and non-participating Loan Noteholders because the task of interpretation had to be approached objectively. In

this context, the relevant background knowledge to be ascribed to the parties was that of the parties to the contract, who were the participating Loan Noteholders and O2.

127. In his written submissions Mr Eicke argued that the words in Clause 9.8 were not "defective", although in argument at the hearing (according to our notes) he had, in fact, referred to the drafting as "defective" and as containing a " drafting error". He submitted that the question was one of giving the clauses an objective interpretation. At most, a clause might be viewed as "defective" if, on the plain and natural reading, the clause was entirely unworkable. That was not the case, he submitted, with Clause 9.8. Following the decision of the Supreme Court in *Rainy Sky* (*see below* per Lord Clarke at [23]) the plain and unambiguous construction had to be upheld. Before a court could depart from the plain and unambiguous meaning of words used there had to be an "arbitrary" or "irrational" outcome. In this case there was no such outcome because in some situations the Loan Notes can be redeemed early, other than on a Quarter Day. For example, the Loan Notes provided that in the event of a winding up petition being served on O2, or if O2 ceased to carry on business (otherwise than as part of the solvent reconstruction or amalgamation), or if O2 was unable to pay its debts within the meaning of section 123 (1) Insolvency Act 1986, a Loan Noteholder would have been entitled to call for immediate (i.e. accelerated) repayment and this could have occurred during the Second Relevant Period.

128. Finally, Mr Eicke submitted that, as regards the consent of the non-participating Loan Noteholders, their subjective intentions were irrelevant, as were those of the Appellant. It was clear, as a matter of fact, that the consent of the Loan Noteholders related to the Deeds of Variation as actually drafted.

Drafting error in the Deeds of Variation – effect on valuation: authorities

129. In *Investors Compensation Scheme Ltd v West Bromwich Building Society and others* [1998] 1 All ER 98 Lord Hoffmann summarised (at pages 114-115) the relevant principles to be applied in interpreting defectively drafted contractual provisions:

> “ (1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.
>
> (2) The background was famously referred to by Lord Wilberforce as the 'matrix of fact', but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.
>
> (3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only,

legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.

(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax (see *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] 3 All ER 352, [1997] 2 WLR 945.

(5) The 'rule' that words should be given their 'natural and ordinary meaning' reflects the commonsense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Cia Naviera SA v Salen Rederierna AB, The Antaios* [1984] 3 All ER 229 at 233, [1985] AC 191 at 201:

> '… if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense.'"

130. In *Pink Floyd Music Ltd v EMI Records Ltd* [2010] EWCA Civ 1429 at [17], Lord Neuberger set out the correct approach to construction, saying that:

"[16] Each of the declarations granted below raises a question of interpretation of a provision in a commercial contract. The answer to such a question does not simply depend upon the words used in that provision: it is also dependent on the other provisions of the contract, on commercial common sense, and on the surrounding circumstances (or the matrix of facts) at the time the contract was made. Accordingly, when construing a provision in a commercial document, one should not carry out "a detailed semantic and syntactical analysis of the words used" - per Lord Diplock in *The Antaios II* [1985] AC 185, 201.

[17] The ultimate aim of interpreting such a provision is to determine what the parties to the contract meant by it. And that involves ascertaining what a reasonable person would have understood the parties to the contract to have meant. In that connection, we were referred, in particular, to passages in the speeches of Lord Hoffmann in *Mannai Investments Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749, [1997] 3 All ER 352, [1997] 2 WLR 945; passim, Investors *Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 All ER 98, [1998] 1 BCLC 493, [1998] 1 WLR 896, 912F-913G and in

Chartbrook Ltd v Persimmon Homes Ltd [2009] UKHL 38, [2009] AC 1101, paras 21 - 26, [2009] 4 All ER 677.

[18] Those well known and important passages demonstrate that while one may proceed on the prima facie assumption that the words at issue mean what they naturally say, they cannot be interpreted in a vacuum. The words must be interpreted by reference to what a reasonable person (who is informed with business common sense, the knowledge of the parties, including of course of the other provisions of the contract, and the experience and expertise enjoyed by the parties, at the time of the contract) would have understood by the provision. So construed, the words of a provision may have a meaning which is not that which they may appear to have if read out of context, or the meaning which they may appear to have had at first sight. Indeed, it is clear that there will be circumstances where the words in question are attributed a meaning which they simply cannot have as a matter of ordinary linguistic analysis, because the notional reasonable person would be satisfied that something had gone wrong in the drafting.

[19] In both *Investors Compensation* [1998] 1 BCLC 493 and *Chartbrook* [2009] 1 AC 1101, Lord Hoffmann made it clear that there is a fundamental difference between interpretation and rectification: the difference arises from the fact that in a claim for rectification, the court can take into account, and in an appropriate case can give effect to, the negotiations between the parties, whereas it cannot do so on an issue of interpretation...

[20] Further, as Lord Hoffmann also made clear in *Investors Compensation* [1998] 1 WLR 896, there is a difference between cases of ambiguity, which may result in giving the words a meaning they can naturally bear, even if it is not their prima facie most natural meaning, and cases of mistake, which may result from concluding that the parties made a mistake and used the wrong words or syntax. However, he emphasised the court does "not readily accept that people have made mistakes in formal documents" - *Chartbrook* [2009] 1 AC 1101, para 23. He also pointed out in paragraph 20, that, as the court, and therefore the notional reasonable person, cannot take into account the antecedent negotiations, the fact that the natural meaning of the words appears to produce "a bad bargain" for one of the parties or an "unduly favourable" result for another, is not enough to justify the conclusion that something has gone wrong. One is normally looking for an outcome which is "arbitrary" or "irrational", before a mistake argument will run.

[21] Accordingly, before the court can be satisfied that something has gone wrong, the court has to be satisfied both that there has been "a clear mistake" and that it is clear "what correction ought to be made" (per Lord Hoffmann in *Chartbrook* [2009] 1 AC 1101, paras 22-24, approving the analysis of Brightman LJ *in East v Pantiles (Plant Hire) Ltd* (1981) 263 EG 61, as refined by Carnwath LJ in *KPMG LLP v Network Rail Infrastructure Ltd* [2007] Bus LR 1336).

[22] To the same effect, Chadwick LJ said in *City Alliance Ltd v Oxford Forecasting Services Ltd* [2001] 1 All ER Comm 233, para 13

> (in a passage cited with approval in *Lediaev v Vallen* [2009] EWCA Civ 156, para 68) that the court cannot "introduce words that the parties have not used" into a contract unless "satisfied (i) that the words actually used produce a result which is so commercially nonsensical that the parties could not have intended it, and (ii) that they did intend some other commercial purpose which can be identified with confidence."

131. The issue of contractual interpretation was considered recently by the Supreme Court in *Rainy Sky SA and others v Kookmin Bank* [2011] UKSC 50 and, in our view Lord Clarke's judgment – which was the judgment of the whole Court – shows a subtle change in emphasis from *Investors Compensation Fund* and *Pink Floyd* in relation to unambiguous contractual wording. Lord Clarke said at [14] and [23]:

> " 14. For the most part, the correct approach to construction of the bonds, as in the case of any contract, was not in dispute. The principles have been discussed in many cases, notably of course, as Lord Neuberger MR said in *Pink Floyd Music Ltd v EMI Records Ltd* [2010] EWCA Civ 1429 at [17], [2011] 1 WLR 770n, by Lord Hoffmann in *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] 3 All ER 352, [1997] AC 749, passim, in *Investors Compensation Scheme Ltd v West Bromwich Building Society, Investors Compensation Scheme Ltd v Hopkin & Sons (a firm), Alford v West Bromwich Building Society, Armitage v West Bromwich Building Society* [1998] 1 All ER 98 at 114–115, [1998] 1 WLR 896 at 912–913 and in *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38 at [21]–[26], [2010] 1 All ER (Comm) 365 at [21]–[26], [2009] AC 1101. I agree with Lord Neuberger (also at [17]) that those cases show that the ultimate aim of interpreting a provision in a contract, especially a commercial contract, is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant. As Lord Hoffmann made clear in the first of the principles he summarised in the *Investors Compensation Scheme case* [1998] 1 All ER 98 at 114–115, [1998] 1 WLR 896 at 912–913, the relevant reasonable person is one who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.
>
> 23. Where the parties have used unambiguous language, the court must apply it. This can be seen from the decision of the Court of Appeal in *Co-operative Wholesale Society Ltd v National Westminster Bank plc* [1995] 1 EGLR 97. The court was considering the true construction of rent review clauses in a number of different cases. The underlying result which the landlords sought in each case was the same. The court regarded it as a most improbable commercial result. Where the result, though improbable, flowed from the unambiguous language of the clause, the landlords succeeded, whereas where it did not, they failed. The court held that ordinary principles of construction applied to rent review clauses and applied the principles in *Antaios Cia Naviera SA v Salen Rederierna AB, The Antaios* [1984] 3 All ER 229, [1985] AC

> 191. After quoting the passage from the speech of Lord Diplock cited above, Hoffmann LJ said at 99):
>
> 'This robust declaration does not, however, mean that one can rewrite the language which the parties have used in order to make the contract conform to business common sense. But language is a very flexible instrument and, if it is capable of more than one construction, one chooses that which seems most likely to give effect to the commercial purpose of the agreement.'"

Drafting error in the Deeds of Variation – effect on valuation: discussion

132. There is, in our view, a divergence in approach revealed by these authorities where the language of the contractual provision is unambiguous and results in an improbable or odd commercial result. Lord Hoffmann in the *Investors Compensation Scheme* case considers that if "something has gone wrong with the language" a court need not construe contractual language in a way which attributes to the parties an intention they could not have had. On the other hand, in *Rainy Sky* Lord Clarke considers that unambiguous language must be applied even if it leads to a most improbable commercial result.

133. In our view, where contractual language is unambiguous, even though it leads to a strange or improbable result, that language can only be changed in an action for rectification. If it were otherwise it would effectively mean that that there was little or no scope for rectification. This would go beyond the authorities: see Lord Hoffman in *Investors Compensation Scheme* (para 128 above, point 3) and Lord Neuberger in *Rainy Sky* (para 129 above at [19]). In our judgment, to construe unambiguous language in a way which cannot be supported by the meaning of the words goes beyond the construction of a contract and involves re-writing its provisions.

134. In this case, we consider the introductory wording of Clause 9.8 to be clear and unambiguous. It states that the provisions of that clause 9.8 were only to apply during the Second Relevant Period "and not otherwise". In order to exclude Clause 9.8.3 it would be necessary, for example, to read into the introductory wording that it applied only to Clauses 9.8.1 and 9.8.2 or, alternatively, Clause 9.8.3 that was excluded. The references in clauses 9.8.1, 9.8.2 and 9.8.3 to Clause 9.8 would, in consequence, have to be amended to refer to Clause 9.8.3. This may well be what the Relevant Loan Note holders and O2 subjectively intended. The introduction of Clause 9.8, when read with the other terms and conditions of the Loan Notes, may well be pointless (or in Mr Eicke's submission, of limited effect). But giving effect to this subjective intention is precluded by the plain words of Clause 9.8. If we were to accept Mr Way's proposed construction of Clause 9.8, we would be mistaking the meaning of what the parties said in Clause 9.8 with what, in his view, they intended to say but palpably did not. In our view, any defect can only be remedied, if at all, by an action for rectification.

135. For this reason, we have concluded that Clause 9.8 in respect of the B Loan Notes (and Clause 4.8 in respect of the A Loan Notes) cannot be construed in the manner contended for by the Appellant.

136. We should add, although it is not necessary for our decision, that in many of the authorities on contractual interpretation, including those cited above, reference is made to favouring an interpretation which makes "business" or "commercial common sense" or giving effect to the "business purpose of the contract". None of these authorities involved tax avoidance schemes.

137. Mr Way submitted that the meaning of the words in Clause 9.8 could not be ignored in construing their intended meaning simply because there were part of a tax avoidance arrangement. He submitted that the context was akin to that described in *MacNiven v Westmoreland Investments* [2001] STC 237 where Lord Hoffmann said at [59](albeit in the context of statutory construction):

> "Even if a statutory expression refers to a business or economic concept, one cannot disregard a transaction which comes within the statutory language, construed in the correct commercial sense, simply on the ground that it was entered into solely for tax reasons."

138. In this case, as we have seen, the Appellant attempted temporarily to reduce the value of his Loan Notes in an artificial manner. It was never intended that circumstances would arise under which O2 would redeem the notes for 3% of par value. At most, it was intended that should be a mere possibility in circumstances which were, in our view, highly unlikely to occur, that the Loan Notes could be redeemed for 3% of par value. The only purpose which lay behind these amendments contained in Clause 9.8 (and the corresponding Clause 4.8) of the Deeds of Variation (with the possible exception of the Four Dead Men clause) was not a commercial purpose in the commonly understood meaning of that term but rather one of tax avoidance: to ensure that the market value of the Loan Notes at the date of conversion was artificially depressed.

139. It is, therefore, somewhat strained to speak about commercial common sense or business purposes in the context of such artificial tax-driven arrangements. Had the words used by the Appellant and O2 been ambiguous we would nonetheless have sought to interpret the Deeds of Variation in accordance with the intention of the parties, determined objectively. We would, however, be wary, particularly in a case where unambiguous language is used, of re-writing a contract under the supposed guise of contractual construction to give effect to an un-commercial and artificial tax-driven purpose. Had it been necessary for our decision, we would have refused to do so.

140. Moreover, what was amended here was the terms and conditions of the Loan Notes. To constitute a valid amendment, a written resolution had to be signed by all the Noteholders of both series of Loan Notes – see paragraphs 41 to 45 above. The difficulty is that the Loan Noteholders consented to the terms of the Deeds of Variation in the terms on which they were drafted. The non-participating Loan Noteholders specifically consented "to the proposed variation, *as set out in the Deed of Variation*, of the terms of the Series [A/B] Loan Stock" (emphasis added).

141. Lord Clarke in *Rainy Sky* at [14] noted that:

> "I agree with Lord Neuberger (also at [17]) that those cases show that the ultimate aim of interpreting a provision in a contract, especially a commercial contract, is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant. As Lord Hoffmann made clear in the first of the principles he summarised in the *Investors Compensation Scheme* case [1998] 1 All ER 98 at 114–115, [1998] 1 WLR 896 at 912–913, the relevant reasonable person is one who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract."

142. Lord Clarke's comments need to be adapted to the circumstances of this case. The contracting parties were the participating Loan Noteholders and O2. Their agreement (the Deeds of Variation) to amend the terms of the participating Loan Noteholders' Loan Notes would not, however, be effective, without the consent of *all* the Loan Noteholders, including the non-participating Loan Noteholders.

143. In our view it is necessary to establish objectively to what amendments the non-participating Loan Noteholders' consent was given. In order to construe their consent it is necessary to ascertain the background knowledge which was reasonably available to those Loan Noteholders. In our Directions dated 24 April 2012 we asked the parties to supply any further evidence relevant to the background knowledge of the non-participating Loan Noteholders, but none was forthcoming.

144. There is no evidence that non-participating Loan Noteholders received anything other than a letter from O2 dated 9 February 2004 which is quoted earlier. The background knowledge which was reasonably available to the non-participating Loan Noteholders was contained in that letter. Their background knowledge was, therefore, considerably less than that of participating Loan Noteholders who were participating in the scheme.

145. In their written submissions on this point, both Mr Way and Mr Eicke said that the subjective intentions of the non-participating Loan Noteholders were just as irrelevant as the subjective intentions of the Appellant. We agree, but this misses the point. The question is: what was the background knowledge of the non-participating Loan Noteholders in order to construe the consent which they gave? In deciding objectively what the non-participating Loan Noteholders consented to, the background knowledge which they could be reasonably expected to possess was, on the evidence, minimal. There is no reason to suppose that they consented to anything other than the Deeds of Variation on the terms in which they were actually drafted, and these terms did not effectively carry out what the Appellant says was the actual intention of the Appellant and O2.

146. Thus, even if we are wrong in our view that the amendments to Clause 9.8 cannot be interpreted in the way for which the Appellants contend, we consider that it is not possible to apply the principles of interpretation set out by Lord Hoffmann in *Investors Compensation Scheme*, Lord Neuberger in *Pink Floyd* and Lord Clarke in

Rainy Sky so as to "interpret" or “construe” the approval given by the non-participating Loan Noteholders to extend that approval to the way in which the Appellant contends Deeds of Variation should be construed.

147. In our view, therefore, the construction of Clause 9.8 favoured by the Appellant was not approved by all the Loan Noteholders in accordance with the terms of those Loan Notes. Accordingly, the drafting of clause 9.8 (and its counterpart in respect of the A Loan Notes) and as a result the terms and conditions of the Loan Notes were not amended in an effective manner. Thus the attempt (in Clauses 9.8 and 4.8) to provide that O2 could redeem the Loan Notes at 3% and thereby reduce the value of the Loan Notes, was ineffective.

Summary of conclusions on the substantive issue

148. For the reasons given above we consider that the market values of the Loan Notes for the purposes of sections 116 (10) and 272 TCGA were not reduced by the Deeds of Variation. We have also concluded that the Deeds of Variation were effective to convert the Loan Notes from NQCBs into QCBs but that the "frozen" gain that arose on this conversion must be calculated without reference to the artificial depression in value attempted by the Deeds of Variation. In any event, we have also decided that the drafting of the Deeds of Variation was such that, when considered with the terms and conditions of the Loan Notes, they did not entitle the Issuer to redeem the Loan Notes for 3% of their par value (except in certain very limited circumstances, such insolvency or a winding up).

The "discovery" issue

149. Having decided the substantive point against the Appellant we now turn to consider the "discovery" issue. Even though we have held that the scheme entered into by the Appellant was ineffective as regards market value, the Appellant will succeed in this appeal if HMRC were not entitled to issue a discovery assessment under section 29(1)TMA.

150. Two main issues arose under this heading. First, Mr Way argued that HMRC's assessment of 15 December 2009 did not satisfy the requirements of section 29(1) TMA because HMRC had not made a valid "discovery." Secondly, if there was a valid "discovery", HMRC had not discharged the burden of showing that the self-assessment return did not alert HMRC to the insufficiency of tax in accordance with section 29(5) TMA.

Introduction

151. The discovery issue involves an understanding of the self-assessment for individuals introduced by the Finance Act 1994 which operated with effect from the income tax year 1996-1997.

152. Prior to self-assessment, a taxpayer would make a personal tax return under section 8 TMA and the assessment to tax was made by HMRC on the basis of the information contained in the return. Very frequently, HMRC would make an estimated assessment and the taxpayer would, as a matter of routine, appeal that assessment. Detailed discussions would then take place between the taxpayer (and his

advisers) and HMRC. Once agreement had been reached, the appeal would be settled by agreement under section 54 TMA. On a number of occasions there were disagreements as to what the agreement covered: see *Scorer (HMIT) v Olin Energy Systems Limited* [1985] AC 645.

153. This all changed with the introduction of self-assessment. Under section 9 TMA a taxpayer must, in his tax return, include a self-assessment of the amounts in which, "on the basis of the information contained in the return", he is chargeable to income tax and capital gains tax for the year of assessment. The taxpayer must usually deliver the tax return by 31 January of the year following the year of assessment. Every tax return must (section 8(2) TMA) include a declaration by the taxpayer to the effect that the return "is to the best of his knowledge correct and complete."

154. Once the tax return has been delivered, HMRC have a 12 month "window" in which to enquire into the return. The 12 month period runs from the date on which the return was filed. (Section 9A TMA).

155. If HMRC does not make an enquiry (or the taxpayer does not amend the return), within the 12 month enquiry period, the self-assessment is final unless HMRC can make a discovery assessment under section 29 TMA.

Was there a "discovery"?

156. Mr Way argues that the change from the old system of assessment by HMRC to the new system of self-assessment by the taxpayer has affected the circumstances in which HMRC can use its powers under section 29(1) to make a discovery assessment. Under the self-assessment regime it is the taxpayer, Mr Way argues, who makes the final determination of his tax liability and if that disclosure is honest and straightforward that should an end to the matter; therefore, the old rules and old case law relating to discovery assessments have little relevance.

157. Mr Way contended that the Appellant's tax return contained all the necessary information for HMRC to make an assessment. He argued that under the new self-assessment regime a discovery assessment cannot be made simply on the grounds of a mere change of mind by HMRC. There had to be something “new”. In support of his argument he referred to a paper produced by HMRC on 31 May 1996 in anticipation of the introduction of the self-assessment system which stated:

> "A change of opinion on information that has previously been made available to the Revenue will not be grounds for discovery assessment."

158. We have considered Mr Way’s arguments. It is clear that the powers of HMRC to make an assessment if it is discovered that profits gains have not been adequately assessed dates back many years – long before the introduction of self-assessment. In *Cenlon Finance Co Limited v Ellwood* (HMIT) [1962] AC 782 Viscount Simonds said (at page 204):

> "I can see no reason for saying that a discovery of undercharge can only arise where a new fact has been discovered. The words are apt to

> include any case in which for any reason it newly appears that the taxpayer has been undercharged, and the context supports rather than detracts from this interpretation."

159. Section 29(1) TMA allows HMRC to raise an assessment "if an officer of the Board or the Board discover" that an assessment is or has become insufficient. It would be surprising, given the well-known interpretation of the word "discover" under the pre-self-assessment rules, if Parliament had intended that the same word should have a different meaning for the purposes of self-assessment. It would be expected that Parliament would have made such a change clear, but it did not do so. If it "newly appears" to an officer then that is sufficient for there to be a discovery assessment even though no new fact has arisen or come to HMRC's attention. For this reason alone, we would reject Mr Way's argument.

160. We are not, however, the first Tribunal or court to reach this conclusion. As regards this Tribunal the same conclusion has been reached in *Charlton et al v HMRC* [2011] UKFTT 467 (TC), *Sanderson v HMRC* [2012] UKFTT 207 (TC) and *While v HMRC* [2012] UKFTT 58 (TC). Moreover, in *Langham v Veltema* [2004] STC 544 at 546 Auld LJ seems to have reached the same conclusion when he said:

> "The discovery procedure in section 29 has its origin in earlier tax statutes and may apply where, after the normal finality of an assessment, some new fact comes to light or incorrect application of the law (subject to section 29 (2)) or where, for any reason, it newly appears that the taxpayer has been undercharged; see *Cenlon Finance Co Limited v Ellwood (HMIT)* [1962] AC 782 at 794, per Viscount Simonds. Section 29 enables the Revenue, where it discovers an insufficient assessment, subject to one or two other conditions, to make an assessment in the amount of further amount necessary to make good the loss of tax (section 29(1) and (3) of [TMA])."

161. In addition, the point was recently considered by the Court of Appeal in *Hankinson v HMRC* [2011] EWCA Civ 1566 where Lewison LJ said, at [15-16]:

> "[15] I begin with section 29(1) [TMA]. This sub-section comes into operation if an officer of the Board 'discovers' an undercharge. The word 'discovers' in this context has a long history. Although the conditions under which a discovery assessment can be made have been tightened in recent years following the introduction of the self-assessment regime, the meaning of the word 'discovers' in this context has not changed. In *R v Commissioners for the General Purposes of the Income Tax for Kensington* [1913] 3 KB 870 Bray J said that it meant 'comes to the conclusion from the examination he makes and from any information he may choose to receive'; and Lush J said that it was equivalent to 'finds' or 'satisfies himself'. In *Cenlon Finance Co Ltd v Ellwood* [1962] AC 782 the House of Lords considered the meaning of the word 'discovers'. They rejected the argument that a discovery entailed the ascertainment of a new fact. Viscount Simonds said:
>
> 'I can see no reason for saying that a discovery of undercharge can only arise where a new fact has been discovered. The words are apt to

include any case in which for any reason it newly appears that the taxpayer has been undercharged and the context supports rather than detracts from this interpretation.'

[16] Lord Denning said:

'Mr Shelbourne said that "discovery" means finding out something new about the facts. It does not mean a change of mind about the law. He said that everyone is presumed to know the law, even an inspector of taxes. I am afraid I cannot agree with Mr Shelbourne about this. It is a mistake to say that everyone is presumed to know the law. The true proposition is that no one is to be excused from doing his duty by pleading that he did not know the law. Every lawyer who, in his researches in the books, finds out that he was mistaken about the law, makes a discovery. So also does an inspector of taxes.'"

162. We suggest, unless and until a higher court takes a different view, this point is no longer open as regards this Tribunal. In our view, HMRC can raise a discovery assessment under section 29(1) TMA, subject to the conditions referred to below, if it newly discovers – which includes a change of mind – any of the circumstances set out in subsection (1)(a)-(b) apply i.e. in summary, that insufficient tax has been assessed or excessive relief has been given.

Should an officer of HMRC be reasonably expected to be aware of an insufficiency in the Appellant's tax return?

163. There are, however, conditions placed upon HMRC's ability to raise a discovery assessment under section 29(1) TMA. Section 29(3) provides that a discovery assessment shall not be raised unless one of two conditions is satisfied. The first condition permits the discovery assessment to be made if there is fraud or negligence on the part of the taxpayer (section 29(4)) it was common ground that this condition did not apply in this appeal.

164. The second condition, relevant to this appeal, contained in section 29(5) TMA, 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."

165. Section 29(6) describes the "information made available" to the Inspector:

(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) …

(c) … 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.

166. We consider, following the views of Henderson J in *HMRC v Household Estate Agents* [2008] STC 2045, where he considers the equivalent corporation tax discovery provisions contained in paragraphs 43 and 44 of schedule 18 of the Finance Act 1998, that the burden of proof of establishing that the condition contained in section 29(5) is satisfied lies on HMRC.

167. Section 29(5) TMA was considered by the Court of Appeal in *Langham v Veltema*. The following main principles can be derived from that decision:

> (1) "Awareness" refers to the officer's awareness of an insufficiency in the self-assessment return, rather than an awareness that he should do something to check whether there is an insufficiency. It is not enough that the officer should realise that he should make further enquiries;
>
> (2) There cannot be attributed to the officer factual information which he might have acquired if he made further enquiries;
>
> (3) The test is concerned, not with what an officer could reasonably have been expected to do, but with that which he could have been reasonably expected to be aware;
>
> (4) The test as to whether an officer could reasonably have been expected to be aware of an insufficiency is an objective test;
>
> (5) The sources of information referred to in section 29(6) [as amplified by section 29(7)] 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. Section 29(5) refers to the officer's awareness being formed "*on the basis* of the information made available to him before that time" (emphasis added);
>
> (6) Section 29(5) allows for constructive awareness of insufficiency, that is, for something less than an awareness of insufficiency, in the form of an inference of insufficiency; and
>
> (7) The information in question must clearly alert the officer to the insufficiency of the assessment.

168. In *HMRC Commissioners v Lansdowne Partners Ltd Partnership* [2012] STC 544, the Court of Appeal again considered provisions equivalent to section 29(5)

TMA. In that case L, a UK limited partnership, was the investment manager of a Cayman Island registered investment company. In 2004-05 it received over £92 million in management and performance fees. L rebated fees totalling over £4.6 million to third parties, of which over £2 million went to L's limited partners, their families and trusts. That sum was not accounted for as taxable income or profit in L's return for the year. HMRC did not open an enquiry during the relevant "window" period and sought to raise a discovery assessment. The provisions in question were those of section 30B(4) TMA – the equivalent of section 29(5) in relation to partnerships.

169. The Chancellor considered that the officer (a hypothetical officer) would have been aware of an actual insufficiency in the declared profit from the information provided by the taxpayer. HMRC's appeal was dismissed.

170. The Chancellor said (at paragraph 56):

> "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."

171. Moses LJ (at paragraphs 69 and 70):

> "69. But even if the information had been obtained shortly before the time for enquiry expired, I would have taken the view that an officer could have reasonably been expected to be aware that the profits stated were insufficient. The legal points were not complex or difficult. As the Chancellor points out (at [56]), awareness of an insufficiency does not require resolution of any potential dispute. After all, once an amendment is made, it may turn out after complex debate in a succession of appeals as to the facts or law, that the profits stated were not insufficient. I have dwelt on this point because I wish to leave open the possibility that, even where the taxpayer has disclosed enough factual information, there may be circumstances in which an officer could not reasonably be expected to be aware of an insufficiency by reason of the complexity of the relevant law.
>
> 70. I also wish to express polite disapproval of any judicial paraphrase of the wording of the condition at s 30B(6) or s 29(5). I think there is a danger in substituting wording appropriate to standards of proof for the statutory condition. The statutory condition turns on the situation of which the officer could reasonably have been expected to be aware. Awareness is a matter of perception and of understanding, not of conclusion. I wish, therefore, to express doubt as to the approach of the Special Commissioner in *Corbally-Stourton v Revenue and Customs Comrs* [2008] STC (SCD) 907 and of the Outer House in *R (on the application of Pattullo) v Revenue and Customs Comrs* [2009] CSOH 137, [2010] STC 107, namely that to be aware of a situation is the same as concluding that it is more probable than not. The statutory context of the condition is the grant of a power to raise an assessment.

> In that context, the question is whether the taxpayer has provided sufficient information to an officer, with such understanding as he might reasonably be expected to have, to justify the exercise of the power to raise the assessment to make good the insufficiency. "

172. Both the Chancellor and Moses LJ emphasise that section 29(5) does not require that the Inspector should be able to resolve points of law when applying the "awareness" test. Moses LJ, however, left open the possibility that in some cases, where the law was complex, mere disclosure of the facts might not be enough to satisfy the "awareness" test.

173. In our view, section 29(5) requires that a taxpayer should make sufficient disclosure in order to enable an officer to make an informed decision whether an insufficiency existed sufficient to justify, in the words of Moses LJ, the exercise of the power to raise a discovery assessment under section 29(1). We respectfully agree with Moses LJ that the possibility should remain open that mere factual disclosure may not, in some cases involving complex issues of law, be sufficient.

174. The purpose of section 29(5) is to strike a balance between the protection of the revenue, on the one hand, and the taxpayer on the other. The taxpayer is protected against a discovery assessment provided adequate disclosure is made. The disclosure must be from the sources referred to in section 29(6) (as amplified by section 29(7)). HMRC are protected because they can raise a discovery assessment if adequate disclosure has not been made.

175. It seems to us that section 29(5) hinges on the adequacy of the disclosure by the taxpayer. In argument before us there was some debate about what level of knowledge of tax law should be assumed to be possessed by the hypothetical officer. Was he assumed to have read his statutes, should he be assumed to have read the relevant parts of HMRC's Manuals and should he be taken to have consulted specialists within HMRC? In our view, this approaches the section in the wrong way.

176. What constitutes adequate disclosure for the purposes of section 29(5) will vary from case to case. It depends on the nature of the arrangements concerned and not on the assumed knowledge (or lack of knowledge) of the hypothetical officer. In a relatively simple case, where the legal principles are clear, it would be sufficient for a taxpayer simply to give a full disclosure of the factual position. The return must also make clear in outline what position the taxpayer is adopting in relation to the factual position (e.g. whether a receipt was not taxable or whether a claim for relief was being made). This was the basis of the decision of the Court of Appeal in *Lansdowne*. The facts in *Olin Energy Systems* (see above) – a case on section 54 TMA – and *Veltema* itself would be other examples of simple cases of fact and law.

177. But there may be other cases where the law and the facts (and/or the relationship between the law and the facts) are so complex that adequate disclosure may require more than pure factual disclosure: namely some brief explanation of the main tax law issues and the position taken in respect of those issues. An officer is not required to play "spot the [fiscal] ball" in complex cases.

178. Plainly, the greater the level of disclosure, the greater the officer's awareness can reasonably be expected to be. If a disclosure on a tax return includes all material facts and, in complex cases, an adequate explanation (which can be brief) of the technical issues raised by those facts and the position taken in relation to those issues, it would be reasonable to expect an officer to be aware of an insufficiency. What constitutes reasonable awareness is linked to the fullness and adequacy of the disclosure, not to whether he has ploughed through his textbooks, whether he has taken advice from specialist colleagues or whether he is a junior, middle-ranking or senior officer.

179. In argument before us Mr Eicke came close to suggesting, as we understood it, that a hypothetical officer could not be expected to understand complex or specialist areas of tax law. We disagree. If the disclosure (factual and technical) is adequate in the circumstances of the case, a hypothetical officer can reasonably be expected to be aware of an insufficiency even in a complex case or one involving specialist technical knowledge. If the disclosure is inadequate then it is fair that a hypothetical officer could not reasonably be expected to be aware of insufficiency in such a case. That is the balance that section 29(5) strikes.

180. We note that in *Charlton & Others v HMRC Commissioners* [2011] UKFTT 467 (TC) the Tribunal reached a similar conclusion. In the case, the Tribunal stated (at paragraphs 122-124) that:

> "[122] And if it is glaringly obvious either that the relevant officer should consider the law, and possibly referred to published material or, where and SRN number [a reference number in respect of tax avoidance schemes disclosed under the provisions of the Finance Act 2004, generally known as the 'DOTAS' rules], simply send an e-mail or make a phone call to colleagues and asked for guidance, this is precisely how we should treat the notional officer is proceeding.
>
> 123. This approach does not fall into the error of attributing to the 'notional average officer' the views and knowledge of specialists as such. It only has this effect in those cases where any officer would inevitably seek guidance, and indeed know precisely where to seek that guidance. It simply deems the notional average officer to approach matters realistically, as HMRC would inevitably expect him to operate, and it avoids the absurdity of consigning the officer to his dark room, without legislation, books or other information, and with no opportunity to seek guidance from colleagues.
>
> 124. The above approach would have no bearing on the simple case where we would postulate the notional average officer taking his own decision on whether to assess. It simply suggests that one just considers what the notional officer should and would have done in the relevant circumstances. It thus deals perfectly sensibly with the very simple cases, the distinct type of situation referred to in paragraph 115 above, and the manifestly obvious tax avoidance scheme that has already been disclosed to, and reviewed by, HMRC in this case. It deals with each in the appropriate way, and it avoids the consequence of HMRC's contention and acceptance that the test is crafted

> essentially for the simple scheme, and thus regrettably fails to work sensibly in a case such as the present case."

181. In our view, section 29(5) requires the test of what can be reasonably expected of the notional officer to be determined by reference to the quality and nature of the information provided pursuant to section 29(6). Section 29(5) makes no reference to the competence or otherwise of the officer and it makes no reference to what the officer should be assumed to have done once he received the section 29(6) information. Although, in practice, our test is very similar to that used in *Charlton*, we prefer our formulation of the test as set out above.

182. The test, as we have explained it, does not require an investigation of what would or would not be done by an officer or of the level of technical expertise of the hypothetical officer. Moreover, it does not require this Tribunal to estimate or describe the competence of an average officer – a task for which this Tribunal (even with its specialist expertise) has no logical evidential basis and which would require a considerable amount of uninformed guesswork.

183. A taxpayer can only prevent a discovery assessment by providing information which satisfies the "reasonably expect" test in section 29(5). Providing adequate disclosure is all that a taxpayer can do. It is, therefore, the quality and nature of this information in the light of the circumstances of each individual case which should determine whether the officer could be reasonably expected to be aware of the insufficiency. It should not be determined, in our view, by uninformed speculation by us about the level of competence of a hypothetical officer – a matter as regards which the statute is entirely silent.

184. For completeness, we do not consider that the above approach is inconsistent with the judgment of Auld LJ in *Veltema*. In fact, Auld LJ did not hold that the hypothetical Inspector should be assumed not to have taken specialist advice. Auld LJ's concern was that factual knowledge should not be imputed to the Inspector from sources other than those set out in section 29(6). In any event, we do not base our decision on the degree of technical knowledge possessed by the hypothetical Inspector. We agree with the Tribunal's analysis in *Charlton* (in paragraphs 108 and 122) of the Court of Appeal's decision in *Veltema* which was as follows:

> "[108]Whilst there are a number of references in Lord Justice Auld's judgment to the requirement that the return must disclose that there was an actual insufficiency disclosed by the Return, it was abundantly clear that all these references referred to the fact that it was inadequate information that occasion the doubt as to whether there was in fact an under-assessment...
>
> [122]We consider that the ban on raising further enquiries about the facts, implicit in the Court of Appeal's decision in *Veltema*, and indeed in sub-section 29(6), has no bearing on how we should expect the notional officer to approach is proper task of them considering the information in deciding whether or not he should raise assessments."

185. We should also add, at this point, that section 29(5) does not require a taxpayer to state or imply that his or her return is or may be doubtful or incorrect. As we have

noted section 8(2) TMA requires that a return must include a declaration by the taxpayer to the effect that the return "is to the best of his knowledge correct and complete." We note that this Tribunal in *Charlton* reached the same conclusion (at paragraph 111).

186. Mr Way argued that because materially identical white space disclosures made by two other taxpayers prompted other officers to launch enquiries within the one-year "window" this should be taken as an indication that the Appellant's white space disclosure was sufficient for the condition in section 29(5) to prevent a discovery assessment. We disagree. *Veltema* is clear authority that it is not enough that the disclosure should have alerted an Inspector to the need to make further enquiries. The disclosure must alert the hypothetical Inspector to an objective awareness of an actual insufficiency.

187. Mr Way referred to HMRC's Statement of Practice 1/06 dealing with HMRC's discovery powers. Relevant paragraphs are as follows:

> "9. A taxpayer can further restrict the opportunity for discovery by providing enough information for an HMRC officer to realise within the enquiry period that the self-assessment is insufficient. **However taxpayers are encouraged to submit the minimum necessary to make disclosure of an insufficiency. The *Veltema* judgement does not require the provision of enough information to quantify the effect on the assessment. Information will not be treated as being made available where the total amount supplied is so extensive that an officer "could not have been reasonably expected to be aware" of the significance of particular information and the officer's attention has not been drawn to it by the taxpayer or taxpayers representative.**
>
> 10. HMRC recognises that a taxpayer, unless acting fraudulently or negligently, will consider his return to be correct and complete with no insufficiency. Most figures entered on a return will be absolute, however some will be open to interpretation or uncertain. In these circumstances, the taxpayer will have made a judgement as to the correct figure to enter. HMRC may regard this figure as insufficient. Where the taxpayer has fully alerted HMRC to the full circumstances of such an entry on the return, then the conditions set by the Court of Appeal in *Langham v Veltema* have been met and the assessment will not be open to discovery on that point." [Emphasis added by Mr Way]

188. Mr Way argued that the Statement of Practice showed that very little documentation or description needed to be shown to HMRC.

189. Mr Eicke argued that the Statement of Practice did not state in the abstract that a limited amount of information should be disclosed. The Statement of Practice highlighted the need to make the minimum disclosure "necessary" to disclose an insufficiency and it alerts taxpayers to the risk that even an overwhelming factual disclosure might not be such as would alert an officer to an insufficiency. Mr Eicke drew attention to the passages which stated that a taxpayer should "provide enough information for an HMRC officer to realise within the enquiry period that the self-

assessment is insufficient" and where it stated that a discovery assessment would not be possible if a taxpayer has "fully alerted HMRC to the full circumstances."

190. In our view, the Statement of Practice is not inconsistent with the case law. We agree that, in context, the Statement of Practice insists on sufficient disclosure necessary to disclose an insufficiency but is also warning taxpayers not to "bury" relevant information in a mass of disclosures. This seems to us a perfectly reasonable point to make and we agree that the officer is not required to find a needle in a factual haystack.

191. Mr Way also submitted that the white space disclosure was "entirely candid", with the result that the condition contained in section 29(5) TMA was not satisfied. Mr Way noted that the white space disclosure referred to a redemption of Loan Notes of £328,860 on 25 March 2004. The Loan Notes were likely to have that value. The issuer of the Loan Notes was a well-known company and it was unlikely that the value had crashed because of market conditions to £9,866. Admittedly, the value of the Loan Notes could vary depending on interest rates but not by that amount. It was therefore reasonable to infer that something had been done to reduce the value of the Loan Notes. Mr Way argued that the reference in the white space disclosure to a value of £9,866 made it obvious (taken together with the references to the amount of the Loan Notes) that the value of the Loan Notes had been reduced.

192. Mr Way also drew attention to the fact that in the last paragraph of the white space disclosure it was noted that the Loan Notes were originally NQCBs and that a Deed of Variation was entered into by the parties "which in certain circumstances would vary its terms and the price at which it could be redeemed." The white space disclosure then noted that the Loan Notes were converted to QCBs at a time when their open market value was £9,866. £9,866 was 3% of £328,860 i.e. the par value of the Loan Notes as stated in the white space disclosure. Mr Way submitted that the Inspector should have inferred that the changes (i.e. the change from NQCBs to QCBs and the dramatic reduction in value) took place as a result of the Deed of Variation.

193. Mr Way further noted that the white space disclosure indicated that the issuer had the ability to repay the Loan Notes at £9,866 on any transfer in the open market. The disclosure also stated that no independent valuation had been obtained – the failure to disclose the lack of an independent valuation was a concern that had been raised in *Veltema* but was a concern that was fully addressed in this case. The disclosure concluded by indicating that the chargeable loss had been calculated at the time of conversion but fell to be taxed at the date of redemption. The disclosure noted the relevant statutory provision, viz section 116(1) TCGA.

194. On this basis, Mr Way submitted that the Appellant had given a full disclosure of the material facts and that the condition in section 29(5) TMA was not satisfied. Therefore, the discovery assessment raised under section 29(1) TMA was invalid.

195. Mr Eicke challenged the adequacy of the white space disclosure on a number of grounds.

(1) There was no indication that the Appellant had engaged in a pre-ordained series of transactions which were tax driven.

(2) There was no indication that the conversion of the Loan Notes from NQCBs to QCBs was a result of an uncommercial contingency i.e. a movement of 1.5% or more in the Sterling-US Dollar exchange rate.

(3) There was no indication that external factors (which we took to be a reference to the Relevant Event) had been introduced into the transactions in an attempt to prevent a *Ramsay*-based argument succeeding.

(4) There was no indication that an attempt had been made temporarily and artificially to depress the market value of the Loan Notes. There was no reason to assume that the estimated market value of £9,866 was artificially low, since issue price and open market value are unconnected.

(5) The white space disclosure stated that "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 white space proceeded to state "[t]he loan notes were converted into Qualifying Corporate Bonds on 27 February 2004, at a time when the open market value was estimated to be £9,866." Mr Eicke submitted that the disclosure did not state (a) what the "circumstances" were, (b) that those "circumstances" had occurred, (c) that it was the occurrence of those "circumstances" which was considered to have caused the alleged conversion of the Loan Notes into QCBs, or (d) that it was by virtue of those "circumstances" that the Loan Notes were considered to have a market value of £9,866 (i.e. it was not made clear that the alleged market value was not a genuine market value but instead a result of the deed of variation).

196. We have considered all the above arguments. In relation to the first four of Mr Eicke’s arguments, while we accept that these factors were not disclosed, in our view, the real questions were:

(1) whether sufficient information had been provided so that the officer could reasonably have been expected to be aware of the insufficiency arising from any failing in the arrangement, namely from the conversion of the Loan Notes from NQCBs into QCBs; and

(2) whether the Deeds of Variation were effective (together with the Deeds of Covenant) to reduce the value of the Loan Notes before the conversion.

197. The first three submissions do not, in our view, bear directly on these points, and the fourth submission is, in our view, closely related to the fifth and they are best dealt with together. We find, however, that the criticisms set out by Mr Eicke in his fifth (and to some extent his fourth) submission have considerable force.

198. It is true that, as Mr Way pointed out, the white space disclosure estimated the open market value to be £9,866, 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.

200. We also considered Mr Way’s submission that the hypothetical officer should be expected to be aware that O2 was a well-known company and it was unlikely that the value had crashed because of market conditions, interest rates or discounts, from the value on redemption to a mere £9,866; he should thus have realised that the Deed of Variation did something to the value which triggered this fall in value. Since the actual proceeds on redemption were not included on the face of the Appellant’s return, the hypothetical officer would also have to assume that O2 did redeem the loan notes at par value. Both these facts were, as we understand Mr Way’s submission, facts which could “reasonably be expected to be inferred by an officer of the Board” from information provided within the white space.

201. In our view, this sort of inference goes beyond what is expected of the hypothetical officer. The difference between the issue price and the market value on conversion might have alerted the officer to make enquiries as to whether there was any factor, such as a stock market warning, or the threat of an impending administration, which would have cut the value so significantly. But this is not “constructive awareness of the insufficiency” (see the summary of *Veltema* at paragraph 167 above), although it might reasonably have been the trigger for further enquiries. That, however, is not enough to protect the Appellant from a discovery assessment.

202. In our view, it would not have been possible reasonably to expect a hypothetical officer to be aware of an insufficiency on the basis of the information concerning the Deeds of Variation contained in the white space disclosure. He could not come to an informed decision on whether he would be justified in exercising his power to raise a section 29(1) discovery assessment.

203. Mr Eicke also referred to the decision of the Outer House of the Court of Session in *Neil Pattullo* [2009] CSOH 137. In this case, Lord Bannatyne held (paragraph 113–114, *inter alia*, that the failure by the taxpayer to disclose in his tax return that he was a participant in a particular variety of tax avoidance scheme had the

result that the taxpayer's white space disclosure was such that the hypothetical officer could not reasonably have been expected to be aware of the insufficiency.

204. In our view, this is not a relevant factor. The characterisation of transactions and arrangements effected by a taxpayer as "tax avoidance" does not affect the fundamental legal analysis of the factual position. What constitutes "tax avoidance" is a notoriously slippery concept. It is well-known that certain routine forms of tax planning of which HMRC were aware and appeared to condone (e.g. "mixer" companies in relation to foreign tax credits) suddenly became stigmatised as tax avoidance. It may well be that the arrangements put in place by the Appellant in this case can be regarded as tax avoidance, as that expression is commonly used, but we do not think that attaching labels with an imprecise meaning can be of critical importance in determining whether adequate disclosure has been made for the purposes of section 29(5) TMA. The *Pattullo* case, as a Scottish case, is of persuasive authority for a Tribunal sitting in England and Wales. It is not binding upon us and, as regards Lord Bannatyne's views on this point, we respectfully decline to follow them.

205. In any event, this point may be of less significance since the advent of the DOTAS rules referred to above. As in *Charlton*, the inclusion of an SRN (a reference number to a tax avoidance scheme disclosure under the DOTAS rules) would clearly alert and officer to the existence of a tax avoidance scheme. The events in this appeal pre-dated the DOTAS rules.

206. 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 decision

207. For the reasons given above, we have decided that the Deeds of Variation and Deeds of Covenant were not effective to reduce the value of the Loan Notes immediately prior to their conversion into QCBs. Secondly, we have decided that section 29(5) TMA did not preclude HMRC from issuing a discovery assessment under section 29(1) TMA.

208. We therefore dismiss this appeal. We leave it to the parties to establish the effect of this decision on the computations in Mr Blumenthal's tax return.

209. 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: 8 August 2012

APPENDIX

RELEVANT STATUTORY PROVISIONS

The substantive issue

Provisions Relevant In 1998-99

1. Section 117 TCGA 1992, so far as relevant and as applicable in 1998-99, 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 sub-paragraph (5) of paragraph 1 of Schedule 18 to the Taxes Act if for paragraph (a)(i) to (iii) of that sub-paragraph there were substituted the words "corporate bonds (within the meaning of section 117 of the 1992 Act)".
>
> (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.
>
> ..."

2. Section 127 TCGA 1992, as applicable in1998-99, provides:

> "Subject to sections 128 to 130, a reorganisation shall not be treated as involving any disposal of the original shares or any acquisition of the new holding or any part of it, but the original shares (taken as a single asset) and the new holding (taken as a single asset) shall be treated as the same asset acquired as the original shares were acquired."

3. Section 135 TCGA 1992, as applicable in 1998-99, provides:

> "(1) Subsection (3) below has effect where a company ("company A") issues shares or debentures to a person in exchange for shares in or debentures of another company ("company B") and—
>
> (a)company A holds, or in consequence of the exchange will hold, more than one-quarter of the ordinary share capital (as defined in section 832(1) of the Taxes Act) of company B, or
>
> (b) company A issues the shares or debentures in exchange for shares as the result of a general offer—
>
> (i)which is made to members of company B or any class of them (with or without exceptions for persons connected with company A), and
>
> (ii)which is made in the first instance on a condition such that if it were satisfied company A would have control of company B,
>
> or
>
> (c) company A holds, or in consequence of the exchange will hold, the greater part of the voting power in company B.
>
> (2)Subsection (3) below also has effect where under section 136 persons are to be treated as exchanging shares or debentures held by them in consequence of the arrangement there mentioned.
>
> (3)Subject to sections 137 and 138, sections 127 to 131 shall apply with any necessary adaptations as if the 2 companies mentioned in subsection (1) above or, as the case may be, in section 136 were the same company and the exchange were a reorganisation of its share capital."

Provisions Relevant in 2003-04

4. Section 115 TCGA 1992, as applicable in 2003-04, provides:

> "(1) A gain which accrues on the disposal by any person of—
>
> (a) gilt-edged securities or qualifying corporate bonds, or
>
> (b) any option or contract to acquire or dispose of gilt-edged securities or qualifying corporate bonds,

shall not be a chargeable gain.

(2) In subsection (1) above the reference to the disposal of a contract to acquire or dispose of gilt-edged securities or qualifying corporate bonds is a reference to the disposal of the outstanding obligations under such a contract.

(3) Without prejudice to section 143(5), where a person who has entered into any such contract as is referred to in subsection (1)(b) above closes out that contract by entering into another contract with obligations which are reciprocal to those of the first-mentioned contract, that transaction shall for the purposes of this section constitute the disposal of an asset, namely, his outstanding obligations under the first-mentioned contract."

5. Section 116 TCGA 1992, so far as relevant and as applicable in 2003-04, 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.

…

(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.…"

6. Sections 117 and 127 TCGA 1992 were in the same form as above.

7. Section 132 TCGA 1992, as applicable in 2003-04, provides:

"(1) Sections 127 to 131 shall apply with any necessary adaptations in relation to the conversion of securities as they apply in relation to a reorganisation (that is to say, a reorganisation or reduction of a company's share capital).

(2) This section has effect subject to sections 133 and 134.

(3) For the purposes of this section and section 133—

(a) "conversion of securities" includes any of the following, whether effected by a transaction or occurring in consequence of the operation of the terms of any security or of any debenture which is not a security, that is to say—

(i) a conversion of securities of a company into shares in the company, and (ia) a conversion of a security which is not a qualifying corporate bond into a security of the same company which is such a bond, and

(ib) a conversion of a qualifying corporate bond into a security which is a security of the same company but is not such a bond, and

(ii) a conversion at the option of the holder of the securities converted as an alternative to the redemption of those securities for cash, and

(iii) any exchange of securities effected in pursuance of any enactment (including an enactment passed after this Act) which provides for the compulsory acquisition of any shares or securities and the issue of securities or other securities instead,

(b) "security" includes any loan stock or similar security whether of the Government of the United Kingdom or of any other government, or of any public or local authority in the United Kingdom or elsewhere, or of any company, and whether secured or unsecured.

(4) In subsection (3)(a)(ia) above the reference to the conversion of a security of a company into a qualifying corporate bond includes a reference to—

(a) any such conversion of a debenture of that company that is deemed to be a security for the purposes of section 251 as produces a security of that company which is a qualifying corporate bond; and

(b) any such conversion of a security of that company, or of a debenture that is deemed to be a security for those purposes, as produces a debenture of that company which, when deemed to be a security for those purposes, is such a bond.

(5) In subsection (3)(a)(ib) above the reference to the conversion of a qualifying corporate bond into a security of the same company which is not such a bond includes a reference to any conversion of a qualifying corporate bond which produces a debenture which—

(a) is not a security; and

(b) when deemed to be a security for the purposes of section 251, is not such a bond."

8. Section 272 TCGA 1992, so far as relevant and as applicable in 2003-04, 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.

…"

9. Section 273 TCGA 1992, as applicable in 2003-04, provides:

"(1)The provisions of subsection (3) below shall have effect in any case where, in relation to an asset to which this section applies, there falls to be determined by virtue of section 272(1) the price which the asset might reasonably be expected to fetch on a sale in the open market.

(2)The assets to which this section applies are shares and securities which are not quoted on a recognised stock exchange at the time as at which their market value for the purposes of tax on chargeable gains falls to be determined.

(3)For the purposes of a determination falling within subsection (1) above, it shall be assumed that, in the open market which is postulated for the purposes of that determination, there is available to any prospective purchaser of the asset in question all the information which a prudent prospective purchaser of the asset might reasonably require if he were proposing to purchase it from a willing vendor by private treaty and at arm's length"

The discovery issue

10. Section 29 TMA 1970, so far as relevant and as applicable in 2008-09, 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.