[2014] UKFTT 967 (TC)

TC04079

Appeal number: TC/2014/02575

CAPITAL GAINS TAX – whether a bond a QCB – bond had provision for conversion to euro if UK joined monetary union – bond a QCB

FIRST-TIER TRIBUNAL
TAX CHAMBER

NICHOLAS M F TRIGG **Appellant**

- and -

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

TRIBUNAL: JUDGE BARBARA MOSEDALE

Sitting in public at Bedford Square, London on 22-23 September 2014

M Gammie QC instructed by Herbert Smith Freehills LLP for the Appellant

Mr A Nawbatt, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. The appellant filed his tax return for 2009/10 on or before the filling date and noted in the white space that he had disposed of certain bonds and that he had treated his gain on them as exempt from capital gains tax on the grounds that he considered them to be qualifying corporate bonds ("QCBs"). For the reasons he stated in the white space, he knew that that view might be contrary to the view held by HMRC.

2. HMRC opened an enquiry on 23 November 2011 into his return and into the returns of other taxpayers who were members of the same investment partnership and who had made identical disposals.

3. HMRC and Mr Trigg agreed to a joint reference to this Tribunal during the course of the enquiry under s 28ZA of the Taxes Management Act 1970. That joint reference was:

> Does the inclusion in the Bonds (at the time of their issue) of a clause in the form set out in Schedule A or B to this Joint Reference prevent the Bonds from being qualifying corporate bonds by virtue of section 117(1)(b) of the Taxation of Chargeable Gains Act 1992?

This reference is now the lead appeal under Rule 18 of the Tribunal Procedure (First tier Tribunal) (Tax Chamber) Rules for a number of references lodged in this Tribunal by other partners in the same partnership.

The facts

4. There was no dispute on the facts. The partnership of Tonnant LLP was established in around 2006 with a view to exploiting what it saw as an undervaluation by the market of certain bonds. With a view to profiting off this perceived undervaluation, the partnership bought a number of bonds on the secondary market at what it considered to be an undervalue, with a view to holding the bonds until they matured or could be sold at a profit.

5. Six bonds were later realised in whole or in part. All of these six bonds were issued, denominated and redeemable in sterling. Interest was payable in sterling.

6. The terms of all of the bonds identified risk factors associated with their purchase. Many risk factors were identified; one risk factor identified by most of the bonds was that the UK might adopt the euro before the redemption date of the bonds. The identified risk was that the bond would be redenominated in euros and in general that the bond market might be de-stabilised by the change of currency

7. Each of the six bonds contained one or other of two clauses (but not both) which HMRC was of the opinion meant that the bonds were not entitled to exemption as QCBs. They were referred to as 'Schedule A' and 'Schedule B' and I have reproduced them in full in an appendix at the end of this decision notice.

Schedule A

8. In summary, Schedule A made no specific reference to the euro (other than in its heading). It became operative:

> "If at any time there is a change in the currency of the United Kingdom such that the Bank of England recognises a different currency or currency unit or more than one currency or currency unit as the lawful currency of the United Kingdom…."

9. When it became operative, its effect was:

> "…references in, and obligations arising under, the Notes ….will be converted into, and/or any amount becoming payable under the Notes ….will be paid in, the currency or currency unit of the United Kingdom…."

10. It provided a rate at which conversion which occur:

> "Any such conversion will be made at the official rate of exchange recognised for that purpose by the Bank of England."

11. Further provisions permitted the terms of the Bonds to be amended by the issuer to put all parties in the same position as if no change in currency had occurred and such changes could be retrospective.

Schedule B

12. This clause was in different terms. It came into effect 'after the date (if any) on which the United Kingdom becomes a Participating Member State'. A participating member state was defined as any member state of the European Union which has adopted the euro as its lawful currency in accordance with the Treaty establishing the European Union.

13. Once the UK had adopted the euro as its lawful currency, this enabled the issuer of the bond (on 30 days notice) to designate a 'Redenomination Date' as long as that date fell on a Note payment date. The effect of the issuer giving such notice was that on the specified Redenomination Date, the notes would be deemed to be redenominated in euros at the conversion rate established by the Council of the European Union, and coupons and interest would be re-issued or paid in euros.

The law

14. While the hearing was scheduled to take three days and actually only took two, it turned on the construction of only a few words of the Taxation of Chargeable Gains Act 1992 ("TCGA"), as there was no dispute on the relevant facts and HMRC accepted that, if the clause referred to in the reference (§3 above) did not prevent the bonds qualifying as QCBs, then the bonds were QCBs.

15. Section 115 TCGA provides exemption for gains on QCBs. Section 117 defines QCBs:

117 Meaning of 'qualifying corporate bond'

(A1) ….for purposes other than those of corporation tax references to a qualifying corporate bond shall be construed in accordance with the following provisions of this section.

(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) <u>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</u>,

and in paragraph (a) above 'normal commercial loan' has the meaning which would be given by section 162 of CTA 2010 if for paragraphs (a) to (c) of subsection (2) of that section there were substituted the words 'corporate bonds (within the meaning of section 117 of TCGA 1992)'

(2) For the purposes of subsection (1)(b) above -

> (a) a security shall not be regarded as expressed in sterling if the amount of sterling falls to be determined by reference to the value at any time of any other currency or asset; and
>
> (b) <u>a provision for redemption in a currency other than sterling but at the rate of exchange prevailing at redemption shall be disregarded</u>. (my emphasis)

The law on adoption of the euro as currency

16. While the UK has not enacted any legislation (at least none was drawn was drawn to my attention) governing the adoption by it of a new currency, the EU does of course have legislation which governs how Member States join the currency union.

17. These measures do not apply to the UK as it has a derogation (Protocol 15 of the Treaty on the Functioning of the European Union) from the adoption of the euro; these rules would apply to the UK if the UK both chose to give up its derogation and actually met the criteria for adoption of the euro, unless, of course, the European Council chose to amend the rules in the meantime.

18. Council Regulation 1103/97 provides, amongst other things, that the Council would define the conversion rates of the euro in terms of each of the national currency of participating Member States, and that those conversion rates will be used for any conversion between the euro and national currency (subject to rules on rounding).

19. Article 3 provides that subject to the parties agreeing otherwise "The introduction of the euro shall not have the effect of altering any term of the legal instrument or of discharging or excusing performance of any legal instrument, nor give a party the right unilaterally to alter or terminate such an instrument"

20. Council Regulation 974/98 provided for staged introduction of the euro by participating member states. The euro became the national currency on the first day (1 January 1999) ('euro adoption date'), but the old currencies remained in circulation for a transitional period until euro currency was introduced (on 1 January 2002) ('cash changeover date') and for a short period afterwards.

21. It also provided (Articles 5-8) that during the transitional period, contracts would not be redenominated in euros (other than where the parties provided for this) but could be paid in euros.

22. Council Regulation 2169/2005 is the last regulation dealing with adoption of the euro and it amended the earlier regulations. It applies where a new member State joins the euro and would be the Regulation which applied if the UK adopted the euro. It merely amended the earlier regulations. New participating states can chose to have a transitional period of any time up to three years spanning the date from adoption of the euro to the date of 'cash changeover' or they could opt to have no transitional period. But as with the original regulation, the exchange rate for national currency to euro is irrevocably fixed on the euro adoption date.

The dispute

23. In brief, HMRC considered that the inclusion in the terms of the bonds of Schedule A or Schedule B meant that the bonds had a provision 'for conversion into, or redemption in, a currency other than sterling' and that therefore the bonds failed the test for QCBs. The appellant's case is that the six bonds in issue contained no provisions 'for conversion into, or redemption in, a currency other than sterling'.

24. The appellant argued the case in a number of ways. Principally, its position was that in the situation where either Schedule A and B became operative, the euro was not a 'currency other than sterling' if that provision was given a purposive construction.

25. The alternative case was that Schedules A and B did not provide for conversion into, or redemption in euros.

The meaning of 'sterling'

26. The appellant said that 'sterling' must be given the meaning of 'the lawful currency of the UK from time to time' rather than 'the lawful currency of the UK at the date of the Act'. Its case was that because the conversion of the bonds into euros could only occur on or after the euro was adopted by the UK as its currency, while euros are not currently sterling, they would be the lawful currency of the UK at the date of conversion under either Schedule A or B.

27. There is no definition of the very familiar term 'sterling'. Indeed, reading Lord Denning's comments in *Treseder-Griffen* [1956] QBD 127 at page 147 it seems no one can be completely sure where the expression originated and why the currency of Britain has historically been referred to as 'sterling'.

28. Decimalisation did not result in the adoption by the UK of a new currency, merely a re-denomination of the units of currency (shillings and pence to 'p'). The currency remained pounds sterling.

29. The origins of the pound sterling may be lost in the mists of time, but in recent times adoption of a new currency has been contemplated. But did Parliament, when enacting the forerunner of what is now s 117 TCGA, or when re-enacting it as the TCGA, intend 'sterling' to mean the then currency of the UK called sterling, or to mean the 'lawful currency of the UK from time to time' even though the new currency would not be called sterling?

30. The appellant's case was that the latter interpretation, albeit one that does some violence to the words used by Parliament, was more logical.

Cases on the meaning of sterling

31. The appellant referred me to some cases where the meaning of 'sterling' has been considered. In *Bonython v Commonwealth of Australia* [1951] AC 201 the Privy Council ruled that a debenture issued by the self-governing colony of Queensland in 1895 in 'pounds sterling' referred to the currency of Queensland which, in 1895, was known as pounds sterling, although it was a distinct currency from British pounds sterling. The effect was that when the debentures were redeemable, in 1945, they were to be paid in Australian pounds, as Queensland by then had become a part of Australia.

32. It is difficult to see that this case offers any assistance. While the currency did change in Queensland between the date on which the debenture was issued and the date on which it was redeemed, the case was not about that change: the case was about whether originally the parties to the debenture were referring to British pounds sterling or Queensland pounds sterling. As the Privy Council determined that the contract was to be read as referring to Queensland pounds sterling, it followed from an application of Australian law, which was not in dispute, that the debentures fell to be redeemed in Australian pounds.

33. The later case of *De Bueger v J Ballantyne and Co Ltd* [1938] AC 452 demonstrates that by 1938 the meaning of 'sterling' had become restricted to the British pound. In this case, the Privy Council ruled that the use of the word 'sterling' in a contract meant that the parties intended the price to be paid in British pounds rather than New Zealand pounds, even though the work was carried out in New Zealand.

34. To the extent either of these cases is relevant, they indicate that Parliament, by using the word 'sterling' in s 117, intended to refer to British pounds sterling. Neither case supports the suggestion that Parliament intended sterling to mean the British currency for the time being.

Status of sterling for capital gains tax

35. The appellant also relies on what it sees as the particular status sterling has in the TCGA. Sterling is not an asset for the purposes of TCGA. It is the unit of measure by which gains and losses are calculated. For instance, a person who owned £500,000 in cash in say 1980 and still owns it today cannot claim a loss even though the half million pounds has (in real terms) significantly diminished in value. This has been the case since the inception of capital gains tax in 1965:

> **Finance Act 1965 s 22(1)(b)**
>
> 'all forms of property shall be assets for the purpose of this Part of this Act…including….(b) any currency other than sterling'

36. The appellant's point is that euros would have to take over the special position held by sterling in the TCGA if the UK adopted the euro as the lawful currency of the UK. Gains and losses for CGT purposes would in future have to be measured in euros. For assets held before and after adoption of a new currency the gain/loss would have to be computed by reference to the fixed exchange rate sterling to euros that would have to be established at the time of adoption of euros as the currency.

37. The appellant referred me to the case of *Capcount Trading v Evans* [1993] STC 11. In that case the appellant purchased Canadian shares with Canadian dollars, and sold them for Canadian dollars some years later at a loss. The dispute was over how the loss should be measured for the purpose of corporation tax on capital gains. The taxpayer maintained that the dollar sale price should be deducted from the dollar purchase price and the difference converted into sterling to be the loss brought into account for corporation tax on capital gains.

38. HMRC maintained that the dollar sale price and dollar purchase price should both be converted into sterling at the respective dates of sale and purchase, and the difference between the two sterling values be brought into account as a loss.

39. The difference to the taxpayer between the two different methods was substantial as the pound had fallen dramatically against the dollar in the intervening years. The Court of Appeal dismissed the appellant's case:

> "...the capital gains tax which forms the basis of corporation tax on chargeable gains is a tax measured on differences computed in pounds sterling and in no other way." [page 24a-b]

40. The decisions in *Bentley v Pike* [1981] STC 360 and *Goodbrand v Loffland Bros North Sea Inc* [1998] STC 930 were to similar effect. In the latter case, Millett LJ said:

> "For the purposes of capital gains tax, foreign currency is not 'money' but 'money's worth'……" [page 932h]

41. If I understand the appellant's case correctly, it is that CGT has to have a unit of measure. It has to have a unit of measure in order to calculate the amount of any loss or gain. That unit of measure is sterling. If sterling were to cease to exist as British currency, the currency which replaces it would become the unit of measure. So that

when in the TCGA Parliament referred to 'sterling' it must have meant the currency which was the unit of measure for CGT for the time being.

42. I do not agree. There is no reason to suppose Parliament had in mind the possibility of sterling bring replaced by the euro. Although the legislation was consolidated in 1992, at a time when Parliament must have been contemplating the possibility of joining the euro, Parliament still chose to use the phrase 'sterling'.

Principle of updating construction

43. As Mr Gammie says, Parliament must be presumed to have intended the courts to apply a construction that continually updates the wording of an Act to allow for changes. In *McCartan Turkington Breen v Times Newspapers Ltd* [2001] 2 Ac 277 Lord Steyn at 296A said:

> "Unless they reveal a contrary intention, all statutes are to be interpreted as 'always speaking statutes'….There are at least two strands covered by this principle. The first is that courts must interpret and apply a statute to the world as it exists today… Equally important is the second strand, namely that the statute must be interpreted in light of the legal system as it exists today. In the classic work of Sir Rupert Cross, Statutory Interpretation, 3rd ed (1995) pp51-52, the position is explained as follows: '…the ordinary legal interpreter of today…expects to apply ordinary current meaning to legal texts, rather than to embark on research into linguistic, cultural and political history, unless he is specifically put on notice that the latter approach is required."

44. While I do not doubt that this is a correct and binding statement of how to interpret statutes, it does not follow that 'sterling' should be read in 2014 as meaning 'the currency of the UK from time to time' as sterling is still, and has been for over a thousand years, the lawful currency of the UK and that does not appear likely to change in the short term. The interpretation of 'sterling' might be different if and when the UK actually adopts the euro.

45. I consider a purposive construction of s 117(1)(b) in more detail below.

Purposive interpretation

46. The appellant's case is that Parliament's intention in introducing the exemption for QCBs was to promote competitiveness of such bonds with gilts. He relies on *Weston v Garnett* [2005] EWCA Civ 742 at [41] and *Harding v HMRC* [2008] EWHC 99 at [16]. Based on this purpose, the appellant's case is that the conditions attaching to QCBs must be interpreted consistently with this purpose. So a clause which merely allows for conversion into the new British currency should not prevent the bond being a QCB when the purpose of s 117(1)(b) was to limit the exemption to bonds which were in competition with gilts, with which the bonds in issue would remain in competition after conversion to euro as gilts would also be converted to euros on any adoption by the UK of euros as currency.

47. Further, gains and losses on non-sterling denominated bonds which can rise and fall in value through currency fluctuations against sterling are not exempt from capital gains tax, as such bonds do not fall within the QCB exemption. There is no point in excluding a bond from QCB status if it cannot rise or fall in value through currency fluctuations. The bonds in this case cannot rise or fall in value through currency fluctuations as they are denominated solely in sterling and could only become denominated in euros if the UK adopted the euro as its currency, and it is inevitable that if and when it does so, the euro will be immutably fixed in value as against sterling pending the complete abolition of sterling.

48. This is why, for instance, there is the qualification in s 117(2)(b) which disregards a currency conversion clause which effects an exchange at the date of redemption at the rate prevailing at that date: the currency conversion could not affect the gain or loss on the bond.

49. From s 117(2)(b) it was clearly Parliament's expectation that a 'currency other than sterling' was a currency which was capable in varying in value as against sterling. This would not be true of euros if and when adopted by the UK as its national currency as at that date the exchange rate euro to sterling would be immutably fixed and sterling, immediately or at some point later, abolished.

50. On the other hand, HMRC considers that 'sterling' should be given its literal meaning, which is 'British pounds'. It considers that the purposive construction urged by the appellant does such violence to the language of the statute, it moves beyond being a purposive construction to becoming a reconstruction. Sterling, says HMRC, means sterling.

The cases on construction of s 117

51. I was referred to the cases in which the courts have considered the construction of s 117 TCGA, although in none of these cases whre a currency conversion clause was in issue was it a conversion which could only happen if a new currency replaced sterling.

52. *Weston v Garnett* involved a tax avoidance scheme to roll-over a gain on shares into a QCB, albeit that the bond could later be converted back into shares. The case turned on whether a particular loan note was a QCB and that depended on whether it secured a 'normal commercial loan' as required by s 117(1)(a). It was held it was not a QCB as it did not secure a 'normal commercial loan' because the security could be converted into shares. Chadwick LJ said that an ordinary reading of s 117(1)(a) was that a normal commercial loan was not one which carried the right to convert the loan into a proprietary interest in the company. The taxpayers lost their case.

53. The later cases of *Harding, Klincke* and *Blumenthal* also involved tax avoidance schemes to exploit a combination of the QCB exemption and roll-over relief on conversion of securities under s 127. Parliament did not intend roll-over relief to be used when shares were converted into QCBs because the inevitable result of that would would exemption from CGT for not only the gain on the QCB but the

gain on the security exchanged for the QCB. For this reason, Parliament excluded QCBs from roll-over relief by s 116(5) TCGA; instead the gain on the original asset is simply deferred to fall into charge only on disposal of the QCB.

54. The schemes in these three cases were to exchange shares for bonds which were not QCBs (“NQCBs”). This exchange would fall within s 127 and the accrued gain on the share would be rolled over into the bonds. The scheme was then to convert the NQCBs into QCBs before they were realised, so that the sale of the bonds was exempt from CGT and the rolled up gain would never fall into tax.

55. In *Harding,* the bond contained a clause for conversion into another currency. Thus it failed the QCB test and was at the moment of issue an ‘NQCB’ and entitled to roll-over relief in s 127. However, the conversion clause was designed to lapse after a stated period. The taxpayer claimed that once the conversion clause had lapsed, the bond no longer failed the s 117(1)(b) test and became a QCB. He was unsuccessful. The unanimous conclusion of the Court of Appeal [2008] EWCA Civ 1164 at [55-56], upholding the High Court decision, was that the word ‘provision’ applied to any provision in the bond, irrespective of whether it was currently exercisable and whether or not it had lapsed. The bond did not become a QCB when the conversion provision lapsed.

56. In *Klincke* [2010] STC 2032, however, the Upper Tribunal held that an *amendment* to a bond to *remove* the provision for currency conversion was effective to convert an NQCB into a QCB. (The scheme nevertheless failed to prevent the gain on the shares falling into charge because the Upper Tribunal ruled that a purposive construction of s 116 meant that rolled over gain was frozen at the point the NQCB became a QCB, and was then deferred, to be charged when the QCB was realised.) The decision in *Blumenthal* [2012] UKFTT 497 (TC), where the bond was altered by a Deed of Variation to remove a currency conversion clause, was to much the same effect.

57. These three cases are not directly relevant to the point at issue in this case. HMRC rely on them to show that a literal rather than purposive construction of s 117(1)(b) ought to be adopted. In *Blumenthal,* the tax tribunal said:

> “[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 quality as a QCB….

58. The Tribunal went on to say that subsections s 117(1)(b) and (2)(b) were an illustration of a ‘formulaic and prescriptive approach’ by Parliament to legislation as identified by Arden LJ in *Mayes* [2011] STC 1269. However, I note that in *Harding,* Lawrence Collins LJ said:

> ‘Consequently, there is no contrast here between a literal construction and the purpose of the legislation, nor any need for a special construction to avoid anomalies. There is no anomaly….”

59. This suggests Lawrence Collins LJ did not consider a purposive construction was ruled out. I agree with Mr Gammie that, while the scheme of s 117 is a tick-box approach and does depend on whether the conditions have been met, that does not answer the question of how each condition ought to be interpreted. Such an interpretation ought to be purposive. It so happened in *Harding* that a literal and purposive interpretation of s 117(1)(a) gave the same result: that does not mean that s 117(1)(b) cannot be given a purposive interpretation rather than a literal one, if the two would not give rise to the same result.

What if the bonds did not contain this conversion clause?

60. The appellant's case is that Parliament must have intended 'sterling' to mean 'the UK currency from time to time'. They say this is demonstrated because HMRC accept that any bonds which are identical to these bonds, but which do not contain either of the clauses set out at Schedule A or B, are QCBs. The appellant considers this view highlights illogicality in HMRC's position because such bonds would necessarily be converted to euros at the time the UK adopts (if it ever does) the euro as the national currency. While there are no British legislative provisions which state what the legal effects of such adoption would be, as a matter of common sense it must follow that all assets denominated in pounds would have to be re-denominated in euros on the date of adoption of the euro and in any event there is existing EU legislation which would apply to the adoption of the euro by the UK and that does provide for re-denomination in euros.

61. So the appellant's position is that HMRC's case relies on illogicality. Since bonds which do contain either Schedule A and B and bonds which contain neither will all be re-denominated in euros at the exchange rate determined by the Council of the EU at the date of any adoption by the UK of the euro, why should Parliament have intended their tax treatment be different?

62. HMRC's position is that s 117 has a tick-box approach and the question is not whether conversion to currency other than sterling would occur as a matter of law in any event if the UK adopted euros, but whether the bond contained a provision for conversion into another currency. Parliament, on HMRC's view, was concerned with whether there was provision for conversion, and not whether conversion could or would take place.

63. In the same way, as I mention at §25, it was part of the appellant's case that the bonds did not actually contain a provision for conversion to another currency because such conversion would happen through the operation of the law irrespective of the provision in the bond providing for such conversion. In fact, this is not quite right. My understanding of both the terms of Schedule A and Schedule B and the euro adoption legislation referred to at §§16-22 above is that the effect of Regulation 974/98 is that adoption of the euro would not necessarily lead to immediate redenomination of the bond (depending on whether a new participating member state opted for a transitional period or not) whereas Schedule A and Schedule B could lead to such immediate redenomination. In other words, Schedule A and Schedule B

might potentially lead to redenomination earlier than the any identical bond not containing such a provision would be redenominated by operation of law.

64. But this does not matter. As I have said, the binding effect of *Harding* is that it is enough that there is a provision in the terms of the bonds at issue that falls foul of s 117(1)(b): it is irrelevant whether the provision could ever be operative. Although in practice, as I have said, it is possible that Schedule A or B could have become operative had the UK adopted the euro during the bonds' lifetime.

65. The illogicality of HMRC's case is especially exposed, says the appellant, if the definition of 'sterling' in the bonds itself is considered. The bonds all defined sterling as the lawful currency for the time being of the UK. The appellant's contention was that this clause by itself, and irrespective of whether the Bond contained a conversion clause of a type like either Schedule A or B, meant that if and when the UK adopted the euro, the bond would automatically be re-denominated in sterling because every reference to sterling in the Bond would at that moment become a reference to euros. Yet HMRC did not suggest that this definition clause by itself fell foul of s 117(1)(b).

66. HMRC's answer to this is that they did not consider a definitions clause to be a currency conversion clause caught by s 117(1)(b). I do not need to decide as it is clear in this case that each bond had an express currency conversion clause which would operate if the UK adopted euros as its national currency.

67. My conclusion is that, while I accept that *Harding* requires the Tribunal to look at whether there is a provision for conversion, irrespective of whether other bonds would by operation of the law be affected in the same manner by adoption of the euro, that potential illogicality should be considered when considering what Parliament intended, as Parliament is unlikely to have intended to make a distinction without practical difference. I return to this point at §103 below.

The relevance of parties' intentions to a purposive interpretation?

68. It is clear (for example see points (xi)-(xiv) in *Berry* at [2011] STC 1057 [page 1067]) that the parties' intention could be relevant in a purposive construction of legislation. In this case HMRC appear to be concerned that the appellants (or persons in a similar position) might be able to have their cake and eat it. It is HMRC's published position that clauses such as Schedule A and B prevent bonds being QCBs. Such clauses may have been adopted (if not in this case, in others) with a view to ensuring that the bonds were NQCBs. While CGT exemptions might ordinarily be desirable, that is not always the case where shares (with as yet unrealised gains) are being exchanged for bonds. If the bonds are QCBs, the gain is deferred so that there is no relief for the taxpayer if the bonds decrease in value. The alternative treatment of *rolling over* the gains on the shares until the bonds are disposed of might well be preferable to a taxpayer, as the ultimate tax liability will take into account changes in value of the bonds. Bonds issued on a company purchase might therefore be designed to fall foul of s 117 by including a currency conversion clause specifically to prevent the bonds being QCBs. HMRC's concerns are therefore that the bonds in this appeal, or ones containing similar provisions, may have been designed to be NQCBs.

69. In this case, there was no evidence of why the bonds' drafters included either Schedule A or B. The partnership to which the appellant belonged purchased the bonds on the secondary market as investments some years after they were issued and could have had no impact on how the bonds were structured.

70. In any event, both parties were (rightly) agreed that the intentions of the original issuer (or indeed the expectations of the appellant when it purchased the bonds some time later) were irrelevant to the question in front of the Tribunal. It was similarly irrelevant that some of the prospectuses issued by the issuers of some of the bonds indicated that it was their view that the bonds were NQCBs.

71. This is not a case where there is a series of transactions to which the parties' intentions are relevant such as identified in *Berry.* On the contrary, it is clear that Parliament intended s 117 to be a list of conditions for qualification as a QCB and that qualification as a QCB would not depend on the parties' intentions but on the terms of the bond. That the intentions of the issuer are irrelevant has been stated before. Chadwick LJ in *Weston v Garnett* made the point that the participants' intentions to avoid CGT was irrelevant to the question of construction ([13]):

> "[13] The short question …is whether the loan notes….are securities which satisfy the requirements under section 117(1) TCGA 1992….In addressing that question it is immaterial that the arrangements were carried through in implementation of a scheme devised to avoid a charge to capital gains tax."

72. Much the same was said in *Blumenthal* at [101]:

> "…Furthermore, we do not consider that the purpose of the Appellant is relevant to the correct interpretation of this provision…."

73. The bonds either were or were not QCBs. If I find they were QCBs then they would have been QCBs from the moment of issue. If I find they were not QCBs then they would never have been QCBs at any point. But while the parties' intentions are irrelevant to whether the bonds were QCBs or not, Parliament's intentions are relevant to a purposive interpretation of the conditions within s 117.

Parliament's intentions

74. My attention was drawn to various judicial pronouncements on what Parliament intended by s 117 TCGA. Buxton LJ in *Weston v Garnett* [2005] EWCA Civ 742 said:

> "The notes to the *Current Law Statutes* edition of the Finance Act 1984, the predecessor legislation to sections 115 and following of the (consolidating) 1992 Act, report that the exemption from capital gains tax of 'corporate bonds' was introduced in order to stimulate the British bond market. That accounts for the requirement in section 117(1) of the 1992 Act, otherwise difficult to explain (or justify) that to gain exemption bonds must be denominated in sterling and not be convertible into any other currency."

75. A few years later, the tale was taken up by Briggs J in *Harding* (2008) Tax Cases Vol 79 part 6 885:

> "[15] By 1995 the requirement that, to qualify as a QCB, a security had to be listed, or issued by a company with other listed shares or securities, had been removed. It follows that the original purpose, identified by Buxton LJ, of stimulating the British bond market, and limiting the special treatment by way of exception to bonds genuinely traded in that market has been outgrown. Nonetheless, the purpose of excluding loans that give the loan creditor an actual or potential interest in the debtor company or its performance remains, as does the exclusion of participation in anything other than sterling bonds, both denominated and redeemable as such. This follows from the preservation without significant amendment of what is now s 117(a) and (b) from 1984 through to 1995 and beyond.
>
> [16] [Counsel for the taxpayer] submitted that the obvious purpose of the exclusion of securities with provision for conversion into, or redemption in, a currency other than sterling was because Parliament consciously wished to ensure that forex gains and losses should remain liable to tax, whereas gains and losses merely incident to the marking of normal commercial loans should not. To the extent that it matters, I am not inclined to accept this analysis. If the original purpose of what is now s 117(b) was to only exclude from tax investments ordinarily obtainable *in the British market* so as to promote tax-efficient competition with gilts, then I see no reason why the extension of the same treatment to off-market bonds, should without any corresponding amendment to that sub-subsection serve any different purpose. Nonetheless, I accept that the practical effect of that sub-subsection was to exclude securities incorporating forex risks and advantages from immunity from capital gains tax as QCBs."

76. This analysis was effectively approved in the Court of Appeal where Lawrence Collins LJ said:

> [19] As the Judge pointed out, by 1995 the requirement that, to qualify as a QCB, a security had to be listed, or issued by a company with other listed shares or securities, had been removed. It follows that the original purpose, identified by Buxton LJ, of stimulating the British bond market, and limiting the special treatment by way of exception to bonds genuinely traded in that market had been outgrown."

77. A rather different explanation was given by the Tribunal in *Blumenthal* at [9] but I agree with Mr Gammie that the above explanations are the authoritative ones.

Conclusions on construction of s 117(1)(b)

78. When Parliament required a QCB to be a bond 'in respect of which no provision is made for conversion into, or redemption in, a currency other than sterling' did it mean, by use of the word '*sterling'*, British pounds sterling or British currency from time to time?

79. The original purpose of the QCB exemption was to give marketable bonds the same CGT exemption as gilts (§74 above – *Weston v Garnett)*: they were therefore required to be like gilts and denominated in sterling. They had to be British securities. As recognised in *Harding,* (§75 above), Parliament chose to retain the qualification that the bonds be sterling bonds even when extending the exemption to off market bonds, not because of the desire to deny forex gains/losses exemption (although that was the effect) but because Parliament still intended only to exempt 'investments ordinarily obtainable *in the British market'* ([16] of *Harding* at §75 above).

80. The appellant's point is that this purpose is not in any way frustrated by reading 'sterling' as 'British currency for the time being' and allowing bonds which contain provisions for conversion to euros if and when the euro is adopted to benefit from QCB exemption. After all, they will still be bonds which were obtained on the British market.

81. On the other hand, this seems to me to a case which falls into 're-contruction' rather than construction, as Lewison J in *Berry* reports Lord Hoffman saying in an article '*Tax Avoidance'* in 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."

82. Moreover, it is not obvious to me that if Parliament had contemplated the possibility of British currency becoming euros, that it would necessarily have wanted 'sterling' to be read in s 117 as referring to euros after the date of adoption of the new currency. It might have preferred to re-consider the entire QCB exemption. The point is that s 117(1)(b) would read, in the appellant's interpretation as follows:

> "[a bond] which is expressed in ~~sterling~~ British currency for the time being and in respect of which no provision is made for conversion into, or redemption in, a currency other than ~~sterling~~ British currency for the time being."

Yet if the UK adopts the euro, it is adopting a currency already used by most other Western European countries. That would bring within the QCB exemption bonds issued in other Western European countries in euros as well as bonds issued in sterling. That would enormously expand the number of bonds entitled to the QCB exemption and it would take the exemption beyond the purpose identified in *Harding* of being limited to 'British' bonds. There is no reason to suppose that this was intended by Parliament.

83. Therefore, I agree with Mr Nawbatt that 'sterling' must be read as British pounds sterling. Euros, even after an adoption of them as British currency, are not British pounds sterling. Parliament intended sterling to be read as sterling. There is no evidence when enacting s 117 that Parliament contemplated the possibility that sterling might one day cease to be British currency nor is it obvious that, if Parliament had thought about it, they would have intended the reference to 'sterling' in s 117 to

be read as a reference to the new currency, particularly in circumstances when that currency was the lawful currency of many other countries too.

The meaning of 'currency other than sterling'

84. That is not the end of the case. The appellant's next position was that, if I rejected (as I have) the analysis that sterling meant 'lawful currency of the UK from time to time' then for the same reasons as explained at §§45-50 & §§60-61 above, 'currency other than sterling' needed to be read as meaning that sterling had to exist as the UK's lawful currency at the time of conversion/redemption in another currency. 'Other than sterling', said the appellant, implied sterling would co-exist with the other currency. Yet sterling would not exist if it was replaced with the euro.

85. Mr Gammie's position is that even if there was a period of overlap of sterling and euros, as there might well be (see §22 above), this does not alter the analysis as during that period euros would not be a currency 'other than sterling' as sterling would be defined by the euro.

86. Such an interpretation would not have the same effect as reading 'sterling' as 'the lawful currency of the UK from time to time'. On this interpretation, s 117(1)(b) would read as:

> "[a bond] which is expressed in sterling and in respect of which (if sterling still exists) no provision is made for conversion into, or redemption in, a currency other than sterling"

87. So, unlike the reading of 'sterling' proposed by the appellant and rejected by me at §83, such a reading could not be criticised on the basis that it would take the exemption beyond the purpose identified in *Harding* of being limited to 'British' bonds. The bonds would have to have been issued in sterling and only convertible into euros in the event sterling ceased to exist as a currency separately from euros.

88. But is such an interpretation going beyond a construction to a re-construction? Is it not simply the case that Parliament never contemplated the possibility of a British currency other than sterling?

89. The TCGA was a consolidating Act but nevertheless Parliament made no changes to these provisions even though in 1992 the adoption of a European-wide currency must have at least been a recognised even if remote possibility. So would Parliament have regarded the euro, on its adoption in place of sterling, as a 'currency other than sterling'? To answer this, I consider the kind of currency conversion clause which Parliament does allow a QCB to contain.

The exemption in s 117(2)(b) applies to these bonds?

90. There are two qualifications to s 117(1)(b) contained in s 117(2) as set out above:

> (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.

91. It was not suggested that clause s 117(2)(a) was relevant and I agree. As it is obviously apt to and intended to exclude from exemption a bond ostensibly denominated in sterling but actually where its value in sterling was determined by another currency. In any event, it is not apt to apply to either Schedule A or Schedule B because those schedules only apply when a different currency becomes British currency; the bonds will then cease to be denominated in sterling. Their value in sterling will not fall to be determined by reference to euros, as they would no longer have a value in sterling.

92. Clause s 117(2)(b) was the subject of dispute. The appellant's case was that Schedule A and Schedule B should be disregarded as they were provisions for redemption in a currency other than sterling at the rate of exchange prevailing at redemption.

93. HMRC did not agree. Mr Nawbutt's point was that the effect of either Schedule A or Schedule B was that the bonds would be redenominated in euros at the date (or soon after) that the UK adopted the euros as its currency; that would be before the actual date of redemption. Schedule A and Schedule B provided for *conversion* into euros, not merely redemption in euros.

94. However, as I have already said, a purposive interpretation of the 'tick boxes' should be applied. The purpose of s 117(1)(b) was to allow within the QCB exemption sterling bonds which did have foreign currency conversion clauses but where in effect there were no forex gains or losses because all that happened was that the sterling value of the bond at date of redemption was paid in another currency. Such bonds were effectively sterling bonds, but their sterling value was simply paid in a different currency.

95. Schedule A and Schedule B do, in effect, provide for redemption in a non-sterling currency by re-denominating the bonds in euros at the point euros are adopted as British currency. It follows the bonds would be redeemed in euros if the clause became operative. Moreover, they would be redeemed at the 'rate of exchange prevailing at redemption' because it must be the case that when a new currency is adopted there is only one rate of conversion of the old currency to the new currency. This is expressly provided for in the European legislation to which I was referred (see §§18 & 22 above) but logically it has to be so. In other words the rate of exchange at the moment of conversion is necessarily the same rate of exchange at the moment of redemption.

96. HMRC's point is that it is not enough to show that Schedule A and B do provide for 'redemption in a currency other than sterling but at the rate of exchange prevailing at redemption' because, even if that aspect of Schedule A and B is

disregarded, the effect of those schedules is to provide for conversion before the date of redemption, and s 117(2)(b) does not disregard conversion clauses.

97. The question is therefore whether a purposive construction would 'read' s 117(2)(b) as including a clause which converts bonds in such a way that the effect of the clause is that the bonds will be redeemed in a currency other than sterling but at the rate of exchange prevailing at redemption. I have already said that the purpose of s 117(1)(b) was to allow within the QCB exemption sterling bonds which did have foreign currency conversion clauses but where in effect there were no forex gains or losses because all that happened was that the sterling value of the bond at date of redemption was paid in another currency. Such bonds were effectively sterling bonds, but their sterling value was paid in a different currency.

98. The position is subtly different to the position with s 117(1)(b). As I have said I am not satisfied that Parliament intended 'sterling' to be read as anything other than 'sterling'. Such a reading preserves the 'Britishness' of bonds in that they must be issued denominated in sterling. The bonds in this appeal were issued denominated in sterling. As long as a bond's value cannot vary by reference to another currency, however, s 117(2)(b) provides that it will still get the QCB exemption even if redeemed in another currency. It is the case that the redemption value of the bonds in this appeal cannot vary by reference to another currency because the euro redemption value is fixed at the moment of conversion.

99. The effect of the re-denomination in euros would be no more than to permit the bonds to be redeemed in euros but at the rate of exchange which prevails at the date of redemption (which must be the same rate as prevails at the date of conversion). HMRC point out that conversion before the redemption date means that the interest will be payable in euros. That must be right but I do not see that it matters as no where in s 117 does Parliament impose any restrictions on the currency in which the interest is paid.

100. In other words, a purposive interpretation of s 177(2)(b) is that that subclause includes a provision for *conversion* of the bond into another currency if the rate of exchange on conversion is identical to the rate of exchange prevailing at redemption, because there is no logic in making a distinction between the two positions, and Parliament cannot have intended absurdity.

101. Such a purposive interpretation of s 117(1)(b) appears to accord with the purpose identified in *Harding.* 'British' bonds, in the sense of bonds issued denominated in sterling and no other currency, with their value fixed in sterling, obtain QCB exemption even if they are actually redeemed in a different currency. How can it matter whether they are converted before rather than at the moment of redemption as long as their sterling value is unchanged? Parliament cannot have intended to draw such a pointless distinction and s 117(2)(b) must be read accordingly.

102. So while I accept Parliament meant British pounds sterling when it referred to sterling in s 117, nevertheless the QCB exemption was intended to extend to bonds

issued in sterling even if there was provision to convert them to another currency, as long as such conversion did not mean that on redemption any change in value of that other currency was reflected in the value of the bond.

103. The same can be said of the appellant's case on the meaning of 'currency other than sterling' at §§84-89. Allowing Parliament's purpose in enacting s 117(2)(b) to influence the interpretation of these words in s 117(1)(b), I agree also with the appellant's case that 'currency other than sterling' necessarily imported the requirement that sterling continued to exist as a separate currency to the currency to which the bonds were converted. And reverting to the illogicality identified by the appellant at §§60-67 above, such interpretations remove the discrepancy and again that suggests my construction is right as Parliament should not be assumed to have intended absurdity.

104. Such an interpretation means that the inclusion of neither Schedule A nor Schedule B was the inclusion of a provision which fell outside s 117(1)(b) as there was no provision for conversion or redemption in a currency 'other than' sterling and, in any event, the exception in s 117(2)(b) applied as while the provision was in effect a provision for redemption in another currency, it was at the rate of exchange prevailing at redemption.

105. I do not know whether Schedule A or B were incorporated into these bonds with the intention of deliberately removing the bonds from QCB status but, as I have said, the purpose was irrelevant to the question of construction. HMRC's position is that irrespective of the reason why the issuers of these bonds incorporated either Schedule A or Schedule B, such provisions are typical of the sorts of provisions which are included to ensure a bond is a NQCB rather than a QCB. HMRC hint that a ruling that bonds containing euro conversion clauses are nevertheless QCBs is contrary to the general understanding and might affect existing bonds, giving them quite different, and undesired, tax treatment. HMRC may or may not be right about people's general understanding, but there is no rule of construction that legislation should be interpreted to be consistent with how HMRC and/or tax advisers and/or the general public have interpreted the law after it was enacted. Taxpayers will no doubt be protected if they have relied on HMRC's published position. And it is clear from cases such as *Harding, Klincke* and *Blumenthal* that it is possible to structure an NQCB by including a currency conversion clause which operated at the rate of exchange a day or so before the date of redemption.

106. 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.

BARBARA MOSEDALE
TRIBUNAL JUDGE

RELEASE DATE: 20 October 2014

APPENDIX

SCHEDULE A

Redenomination in Euro

(i) If at any time there is a change in the currency of the United Kingdom such that the Bank of England recognises a different currency or currency unit or more than one currency or currency unit as the lawful currency of the United Kingdom, then references in, and obligations arising under, the Notes outstanding at the time of any such change and which are expressed in sterling will be converted into, and/or any amount becoming payable under the Notes thereafter as specified in these Conditions will be paid in, the currency or currency unit of the United Kingdom, and in the manner designated by the Principal Paying Agent.

Any such conversion will be made at the official rate of exchange recognised for that purpose by the Bank of England.

(ii) Where such a change in currency occurs, the Global Notes in respect of the Notes then outstanding and these Conditions in respect of the Notes will be amended in the manner agreed by the Issuer and the Note Trustee so as to reflect that change and, so far as practicable, to place the Issuer, the Note Trustee and the Noteholders in the same position each would have been in had no change in currency occurred (such amendments to include, without limitation, changes required to reflect any modification to business day or other conventions arising in connection with such change in currency). All amendments made pursuant to this Condition 6(g) will be binding upon holders of such Notes.

(iii) Notification of the amendments made to the Notes pursuant to this Condition 6(g) will be made to the Noteholders in accordance with Condition 14 which will state, among other things, the date on which such amendments are to take or took effect, as the case may be.

SCHEDULE B

“Euro Commencement Date” means the date (if any) on which the United Kingdom becomes a Participating Member State.

“Participating Member State” means at any time any member state of the European Union that has adopted the euro as its lawful currency in accordance with the Treaty

“Redenomination Date” means the Note Payment Date falling on or after the Euro Commencement Date on which the Issuer intends to redenominate the currency of any of the Notes into euro (if any)

“Treaty” means the Treaty establishing the European Union, as amended by the Treaty on European Union and the Treaty of Amsterdam”

…

Redenomination

(a) Notice of Redenomination

The Issuer may, after the date (if any) on which the United Kingdom becomes a Participating Member State, without the consent of the Noteholders, the Couponholders and the Receiptholders on giving at least thirty (30) days prior notice to the Noteholders and the Paying Agents, designate a Note Payment Date as the Redenomination Date.

(b) Redenomination

With effect from the Redenomination Date:

(i) the Notes in each class shall be deemed to be redenominated in to euro with the Principal Amount Outstanding of each Note in each class being equal to the Principal Amount Outstanding of that Bond in such class in Sterling, converted into euro at the rate for conversion of Sterling into euro established by the Council of the European Union under the Treaty (including compliance with rules relating to rounding in accordance with European Union regulations); and

(ii) notwithstanding Condition 18(b)(i) (Redenomination), if the Issuer determines, with the agreement of the Trustee, that the then market practice in respect of the redenomination into euro of internationally offered securities is different from that specified above, such provision shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Noteholders, and the Couponholders, the Receiptholders, the Stock Exchange, the Paying Agent of the Agent Bank of such deemed amendments in accordance with Condition 17 (Notices to Noteholders).

(c) Notice of Redenomination Date

The Issuer will notify the Noteholders, Couponholders and Receiptholders of the intended Redenomination Date in accordance with Condition 17 (Notice to Noteholders).

(d) Effect of Redenomination

With effect from the Redenomination Date:

(i) all unmatured Coupons and Receipts denominated in Sterling (whether or not attached to the Notes) will become void and no payments will be made in respect of such Coupons and Receipts;

(ii) the payment obligations contained in all Notes denominated in Sterling will become void but all other obligations of the Issue thereunder (including the obligation to exchange such Notes in accordance with this Condition 18 (Redenomination)) shall remain in full force and effect;

(iii) new Notes, Coupons and Receipts denominated in euro will be issued in exchange for Notes, Coupons and Receipts denominated in Sterling in such manner as the Principal Paying Agent may specify and as shall be notified to the Noteholders in accordance with Condition 17 (Notice to Noteholders); and

(iv) all payments in respect of the Notes (other than, unless the Redenomination Date is on or after such date as Sterling ceases to be a sub-division of the euro, payments of interest in respect of periods commencing before the Redenomination Date) will be made solely in euro by cheque drawn on, or by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) maintained by the payee with a bank in the principal financial centre of any Participating Member State.