Case No: A3/2015/3674

Neutral Citation Number: [2017] EWCA Civ 232

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)
Mr Justice Newey and Judge Charles Hellier
FTC/64/2014

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 06/04/2017

Before :

LORD JUSTICE LONGMORE
LORD JUSTICE PATTEN
and
LORD JUSTICE BRIGGS

- -

Between :

MR JULIAN BLACKWELL	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Respondent**

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- -

Mr Kevin Prosser QC and Mr Charles Bradley (instructed by **GRM Law**) for the **Appellant**
Mr Michael Jones (instructed by **HM Revenue & Customs Solicitors**) for the **Respondent**

Hearing dates : 28 March 2017

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Judgment

Lord Justice Briggs :

Introduction

1. The single question raised by this appeal is whether a taxpayer may, in computing the gain accruing to him on the disposal of shares, bring into account by way of deduction expenditure incurred by him in buying his release from a personal contractual obligation to a third party restrictive of his ability to vote or sell those shares.

2. The question arises on entirely uncontentious facts, and turns on the interpretation and application to those facts of s.38 of the Taxation of Capital Gains Act 1992, headed "Acquisition and Disposal Costs etc." which provides, so far as is relevant, as follows:

> "(1) Except as otherwise expressly provided, the sums allowable as a deduction from the consideration in the computation of the gain accruing to a person on the disposal of an asset shall be restricted to –
>
> (a) The amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset, together with the incidental costs to him of the acquisition or, if the asset was not acquired by him any expenditure wholly and exclusively incurred by him in providing the asset,
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> (b) The amount of any expenditure wholly and exclusively incurred on the asset by him or on his behalf for the purpose of enhancing the value of the asset, being expenditure reflected in the state or nature of the asset at the time of the disposal, and any expenditure wholly and exclusively incurred by him in establishing, preserving or defending his title to, or to a right over, the asset,
>
> (c) The incidental costs to him of making the disposal.
>
> (2) …"

3. In 2006 the Appellant Mr Julian Blackwell paid £17.5 million to be released from certain obligations he had undertaken in 2003 in relation to his shares in Blackwell Publishing (Holdings) Limited ("BP Holdings"). Shortly thereafter he disposed of those shares for a little over £100 million. He sought to deduct the £17.5 million under s.38(1)(b) in computing his capital gain on the disposal of the shares. HMRC refused to allow the deduction. Mr Blackwell appealed successfully to the First-tier Tribunal (Judge Richard Barlow and Mr Duncan McBride), but HMRC's appeal was allowed by the Upper Tribunal (Mr Justice Newey and Judge Charles Hellier) by a decision released on 13 August 2015 [2015] UKUT 0418 (TCC).

4. I can take the material facts from the concise recitation of them by the Upper Tribunal as follows:

> "4. Mr Blackwell held class A (and other) shares in BP Holdings such as would enable him to veto a special resolution, including one to approve or facilitate a takeover of the company. In 2003, following an unsuccessful takeover attempt by Taylor & Francis Group plc ("Taylor & Francis"), Mr Blackwell entered into an agreement ("the 2003 agreement") with Taylor & Francis to do and not to do certain things connected with his A shares in return for £1 million.
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> 5. In 2006 John Wiley & Sons Inc ("Wiley") made an offer for BP Holdings for a much higher sum than Taylor & Francis had offered in 2003.
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> 6. Mr Blackwell wished to accept Wiley's offer, but he was advised by his solicitors that the only way to avoid the risk of litigation was not to take any step in respect of the offer.
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> 7. Taylor & Francis offered to release Mr Blackwell from the 2003 agreement if he paid them £25 million.
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> 8. Mr Blackwell decided that it was necessary to make that payment in order to allow the Wiley deal to go through. He believed that the payment would enable the Wiley bid to be accepted.
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> 9. On 17 November 2006 Mr Blackwell entered into a new agreement ("the 2006 agreement") with Taylor & Francis whereby he was released from his undertakings under the 2003 agreement. In return he paid Taylor & Francis £25 million of which Wiley provided £7.5 million and he provided £17.5 million. The deduction was sought for the £17.5 million.
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> 10. The FTT found that Mr Blackwell held a rational and well founded belief that the 2003 agreement amounted to an impediment to his acting freely to vote his shares as he would have wished when the Wiley bid came to his attention: the threat of litigation, whether in the form of an attempt to obtain an injunction or otherwise, could well have had a detrimental effect on the prospect of a successful acceptance of the take over or at least have delayed it. The FTT considered that it was easy to see that the price of the shares could have been affected or even that the deal could have failed altogether."

5. Two things are worth noting about the 2003 agreement. The first is that it is common ground between the parties to this appeal that it conferred no proprietary rights or interest in the shares upon Taylor & Francis. Specific performance of Mr Blackwell's undertakings was largely (but not entirely) excluded. Those undertakings were therefore purely personal obligations owed by him to Taylor & Francis in contract.

6. The second point is that, nonetheless, the £1 million which Mr Blackwell received from Taylor & Francis pursuant to the 2003 agreement was treated by HMRC as

consideration received by him for a part-disposal of his shares, for the purposes of s.21 and s.22 of the Act. It may therefore add some poignancy to Mr Blackwell's sense of having been hard done by, and some substance to the submissions of Mr Prosser QC who appeared for Mr Blackwell on this appeal, that Mr Blackwell has been taxed in relation to a gain made upon making the 2003 agreement but is, thus far, unable to obtain a deduction for the much larger cost of un-making it, against the even larger gain made on his subsequent disposal of the shares under the scheme of arrangement which gave effect to the takeover by Wiley.

7. Looking more closely at s.38(1)(b), it is (now at least) common ground that Mr Blackwell paid the £17.5 million for the purpose of enhancing the value of the shares in his hands. But the Upper Tribunal held (and HMRC submit on this appeal) that the £17.5 million was not expenditure incurred "on" the shares, nor expenditure reflected in the "state or nature" of the shares at the time of the disposal pursuant to the takeover bid by Wiley. Nor was it expenditure incurred by Mr Blackwell in "establishing, preserving, or defending his title to, or to a right over", the shares.

8. The parties recognise that s.38(1)(b) really falls into two limbs, the first requiring both expenditure "on" the asset and expenditure which is reflected in the state or nature of the asset at the time of its disposal, and the second limb being a freestanding alternative, namely expenditure incurred in establishing, preserving or defending title to, or to a right over, the asset. The Upper Tribunal and the parties have treated those limbs separately in their determination and in counsels' submissions, and I shall do the same. But the fact that they constitute alternative means of establishing the condition for deduction imposed by s.38(1)(b) means that a reliable interpretation of s.38 requires both to be kept in mind together, rather than viewed in entirely self-contained compartments.

9. It needs also to be borne in mind that s.38 applies for the purpose of computing both gains and losses on the disposal of assets, and that "assets" are defined in the widest terms by s.21 as extending to all forms of property, including incorporeal property generally, but also chattels, such as works of art. It is of course common ground that shares are a form of incorporeal or intangible property, properly to be regarded as a bundle of rights, including rights to vote, rights to share in distributions by way of dividend or upon winding up and, because shares are a form of property, carrying with them rights to sell, lend or otherwise deal with them, subject to restrictions (if any) in the Articles of Association of the company concerned. The personal inhibitions which Mr Blackwell undertook in the 2003 agreement affected both his voting rights and his right to sell the shares.

Limb 1

10. Mr Prosser QC, assisted by Mr Charles Bradley, began his submissions by reminding us that, generally speaking, the capital gains tax legislation, and concepts, phrases and words used in it, are to be given a broad commercial interpretation, and that commercial common sense should prevail if a narrow juristic, mathematical or technical interpretation would conflict with it. This guidance is of course deeply enshrined with what has come to be known as the *Ramsay* principle, first propounded by Lord Wilberforce in *W T Ramsay Limited v Inland Revenue Commissioners* [1982] AC 300, page 326:

> “The capital gains tax was created to operate in the real world, not that of make-belief. As I said in *Aberdeen Construction Group Limited. v Inland Revenue Commissioners* [1978] A.C. 885, it is a tax on gains (or I might have added gains less losses), it is not a tax on arithmetical differences. To say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, there is not such a loss (or gain) as the legislation is dealing with, is in my opinion well and indeed essentially with the judicial function.”

11. As Lord Wilberforce acknowledges, this businesslike approach to capital gains tax had already been laid down by him three years earlier in *Aberdeen Construction Group Limited. v Commissioners of Inland Revenue* [1978] AC 885, a Scottish appeal which, in the Court of Session, had included an issue as to the construction of what is now s.38(1)(b), although the point was not pursued in the House of Lords.

12. For this general proposition about commercial interpretation, Mr Prosser referred us also to *MacNiven v Westmoreland Investments Limited* [2003] 1 AC 311 where, at paragraph 32, Lord Hoffmann emphasised the contrast being made by Lord Wilberforce (in the *Ramsay* case):

> “Between juristic or arithmetical realities on one hand and commercial realities on the other.”

13. Applying that general principle to the construction of s.38, Mr Prosser submitted that, wherever expenditure for the purpose of enhancing the value of an asset could be shown to be reflected in the “state or nature” of the asset at the time of the disposal, then it must have been expenditure “on” the asset. Although Mr Michael Jones for HMRC did not accept that, I am prepared to assume for present purposes that Mr Prosser is right, so that the real, single, issue arising under Limb 1 is whether Mr Blackwell’s payment of £17.5 million for the discharge of the 2003 agreement was “reflected in the state or nature of the asset at the time of the disposal”.

14. In addressing this question, Mr Prosser submitted that a commercial or businesslike approach required the court to identify the state or nature of the asset (here shares) as identified by all the rights, obligations and limitations affecting what Mr Blackwell could do with them, regardless whether those rights and inhibitions would benefit or affect a purchaser of the shares from him at the time of the disposition. Thus he submitted, prior to the discharge of the 2003 agreement, Mr Blackwell’s bundle of rights and obligations in relation to the shares included, or were confined by, the terms of the 2003 agreement, even though it was a separate contract between Mr Blackwell and Taylor & Francis, the terms of which would have had no effect upon any purchaser of the shares, either before or after the 2003 agreement was discharged. If that was the “state or nature” of the asset constituted by the shares, then his payment for the release of the 2003 agreement was plainly reflected in the state and nature of the asset at the time of the disposal to Wiley.

15. I accept the logic of Mr Prosser’s analysis, but only if he is correct in his submission that the “state or nature” of an intangible asset constituted by shares in a limited

company is properly to be identified by reference to a process which includes having regard to purely personal obligations about what the shareholder may do with the shares (or the rights attaching to them) undertaken in a contract with a third party which is neither the company, nor any other shareholder in the company, and on terms which are not to be found in the company's Articles of Association or any relevant shareholders agreement, and which do not confer any proprietary right or interest upon that third party in relation to the shares.

16. On that critical issue Mr Prosser took us to a number of authorities, all of which he submitted pointed away from an identification of the state or nature of an asset constituted by shares by reference only to the rights and obligations which, being attached to the shares, would affect anyone into whose hands those shares came. I did not find these authorities to offer binding or even persuasive support for Mr Prosser's central submission.

17. In *Schofield v Revenue and Customs Commissioners* [2012] STC 2019 [2012] EWCA Civ 927 the taxpayer sought to have dealt with separately for capital gains tax purposes four inter-related options and cross-options between himself and a bank which, because they were preordained and self-cancelling for all purposes other than tax, fell foul of the *Ramsay* principle, so that they created no separate gains or losses. Mr Prosser submitted that the Court of Appeal's analysis was, from start to finish, entirely focussed upon the overall effect of these various options in the taxpayer's hands. I am not persuaded that this was so. As far as I can ascertain, the transactions were equally preordained and self-cancelling if viewed from the perspective of the bank. In any event, the decision is a conventional application of the *Ramsay* principle, in which, once the transactions were viewed as a preordained series, rather than entirely separately, their self-cancelling nature displaced any attempt to treat them separately for tax purposes.

18. In *Inland Revenue Commissioners v John Lewis Properties PLC* [2002] 1WLR 35, the taxpayer assigned for five years its right to a rental stream from a number of properties to a bank in exchange for a lump sum. Lightman J held that the lump sum was a capital payment received on a part disposal of the properties within the meaning of s.21, because the right to the rental stream disposed of amounted to an interest in those properties in the hands of the bank: see paragraph 49. He added, obiter, that even if the assignment did not confer upon the bank an interest in the properties, the lump sum was nonetheless derived from a part disposal of them, because "the disposal reduced the value of the properties in the "hands of the [the taxpayer], looking at the business reality of the matter in the light of the *Aberdeen* case.

19. Again, this did not seem to me to support Mr Prosser's submission. Although of course the value of the shares in Mr Blackwell's hands was enhanced by the payment of £17.5 million for the discharge of the 2003 agreement, the question whether this affected the state or nature of the shares does not depend upon whether or not the expenditure affected their value. That might have been decisive in relation to the provisions about part disposal in s.21 and s.22, but a number of decisions, including the *Aberdeen* case itself in the Court of Session, show that it is not decisive for the purposes of s.38.

20. *O'Brien v Benson's Hosiery (Holdings) Limited* [1980] AC 562 was a case about the payment of £50,000 to a corporate taxpayer for the release of a service agreement

with one of its directors. The House of Lords held that, although entirely non-assignable, the service agreement was nonetheless an asset, capable of being disposed of for a chargeable gain, even if the company's rights under it could not be assigned. But that was not a case about the meaning of the phrase "state or nature of the asset" in s.38(1)(b), still less a case about the "state or nature" of an asset constituted by shares, which are a form of property generally capable of being assigned. Again therefore, I consider that it provides no significant support to Mr Prosser's submissions.

21. In my judgment Mr Prosser's central submission under Limb 1 is wrong. I consider that the "state or nature" of Mr Blackwell's shares is to be identified for the purposes of s.38(1)(b) by reference to the rights and obligations which those shares conferred or imposed upon a shareholder pursuant to the Articles of Association of BP Holdings, and that the state or nature of the asset was unaffected by the making, or subsequent discharge of the 2003 agreement, because it was a purely personal agreement between Mr Blackwell and a third party. It imposed inhibitions upon his exercise of his rights as a shareholder in BP Holdings, as a matter of bargain between him and Taylor & Francis, but the nature and state of the asset constituted by the shares remained the same throughout. My reasons follow.

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

23. The *Aberdeen* case, as analysed in the Court of Session, is a case in point. The taxpayer wished to sell its shareholding in its wholly owned subsidiary, which was indebted to it in the sum of £500,000. It agreed to sell the shares to a third party buyer for £250,000, on terms that it waived that debt. Corporation tax was assessed on the basis that the whole of the £250,000 had been received for the disposal of the shares. One of the ways in which the taxpayer sought to mitigate the severity of that analysis was by claiming that the waiver of the debt was expenditure "on" its shareholding in its subsidiary within the meaning of what is now s.38(1)(b), then paragraph 4(1)(b) of Schedule 6 to the Finance Act 1965. The submission made good business sense, because the waiver of the debt plainly increased the value of the shares being sold, and they might otherwise have been worthless.

24. In rejecting that submission, the Lord President (Emslie) said this, at (1978) 52 Tax Cases 281, 290:

> "To describe the making of the loans, or their waiver, as expenditure within the meaning of para 4(1)(b) of Sch6 is however, quite unacceptable. The making of the loan created rights and obligations and the waiver constituted an abandonment of the rights but in neither case was there the kind of expenditure with which para 4(1)(b) is concerned. In any event, by no reasonable stretch of the imagination is it possible

> to classify the making of the loans or their waiver as expenditure wholly and exclusively incurred "on" the shares and I find it impossible to say that either were reflected in the state or nature of the shares which were sold. The waiver of the loans may well have enhanced their value but what para 4(1)(b) is looking for is, as the result of the relevant expenditure, an identifiable change for the better in the state or nature of the asset, and this must be a change distinct from the enhancement of value."

25. Another example of a case in which what may be described as the juridical nuts and bolts of s.38 produced a result which a businessman might find surprising is *Garner v Pounds Shipowners and Shipbreakers Limited* [2000] 1 WLR 1107. The taxpayer company granted an option to purchase land for just under £400,000. Under the option the company agreed to use its best endeavours to secure releases from restrictive covenants and to obtain a lease dealing with other rights, and did so at a cost of £90,000. An attempt to claim the £90,000 as expenditure within the meaning of the predecessor to s.38(1)(b) (s.32(1)(b) of the Capital Gains Tax Act 1979) failed, because the disposal constituted by the grant of the option pre-dated that expenditure, so that it could not have been reflected in the state or nature of the asset at the time of the disposal: see per Lord Jauncey at page 1113 E to H. A businessman might well have expected expenditure undertaken pursuant to an obligation in the option itself to have been deductable, but it was not. That outcome is only slightly mitigated by the fact that, if the option had been exercised, the £90,000 might have been deductable against the much larger price then payable by the grantee, but it was never exercised.

26. Mr Jones drew our attention to *F D Fenston Will Trusts v HMRC* [2007] STC (SCD) 316, a case about the computation of losses incurred by taxpayer trustees upon the failure of a Delaware property development company in which they had acquired all the shares for a mere £661. Between their acquisition in 1983 and April 1987, the trustees had paid sums totalling £1.5 million odd as contributions to its paid-in surplus to be credited to the capital account of the estate, but no new shares were issued when those contributions were made although of course each contribution resulted in an increase in shareholder's equity shown in the accounts. The trustees sought to claim the £1.5 million as expenditure on the shares within the meaning of s.38(1)(b) so as to give rise to a loss which would have wiped out the whole of their chargeable gains for the relevant year of account. HMRC limited their loss to their original £661 acquisition cost, and disallowed the whole of the £1.5 million. A businessman would probably have thought that it would be irrational for the tax treatment of the £1.5 million to depend upon whether its contribution increased the value of the trustees' existing shares, or was made for the issue of further shares since, in either case, the trustees owned the whole of the company's share capital. The Special Commissioners, Sir Stephen Oliver QC and Nicholas Aleksander, nonetheless dismissed the trustees' appeal. At paragraph 23 they said:

> "It is clear from the provision (*s.38*) that Parliament did not intend that all expenditure incurred for the purpose of enhancing the value of an asset should be deductible in computing capital gains. Only such expenditure as would be reflected in the 'state and nature of the asset at the time of the

> disposal' was to be allowed. Further, 'state and nature' for these purposes must be something other than merely the value of the asset – otherwise this phrase would add nothing to the immediately preceding words. In this case the capital contributions did not result in any increase in the number of shares in issue, or result in any change in the rights or restrictions attaching to the shares. The only effect of the capital contributions was to increase the surplus of the company – which would increase the amount available for distribution to shareholders, and therefore presumably the value of the shares. We do not consider this sufficient for the expenditure on the capital contributions to be reflected in the state and nature of the shares, either at the time the expenditure was incurred or at any time subsequently."

27. Again, a businessman might well think it strange that the £1 million paid to Mr Blackwell for entering into the 2003 agreement constituted a part disposal of his shares, whereas the £17.5 million paid for his exit from the fetters imposed by that agreement could not be deducted upon his subsequent disposal of the shares in favour of Wiley. The lack of symmetry between the two may well be considered remarkable, but it derives from the very different language, on the one hand in s.21 and s.22 about part disposals and, on the other, in s.38 about allowable deductions. S.21 and s.22 are drafted in very wide all-embracing terms so as to capture a range of transactions which might not at first sight appear to amount to part disposals. By contrast s.38 is couched in cautiously restrictive terms, plainly designed to ensure that not all forms of expenditure which a businessman might think should be taken into account in identifying his chargeable gain are in fact permitted deductions.

28. Returning to the central issue under Limb 1, I do not regard it as at all un-commercial to apply a juristic analysis of the intangible asset constituted by shares in a company for the purpose of ascertaining its state or nature at any particular time. To draw a distinction between the rights and obligations conferred and imposed by the shares themselves, and personal undertakings by a shareholder to a third party which may restrict the exercise of those rights seems to me both businesslike and legally correct. No one would regard a personal contractual undertaking not, for example, to drive a classic car, or display a work of art in a public place, as affecting the state or nature of a chattel asset of that kind, even though a payment for the release of such restrictions might enhance the value of the asset in the hands of its owner.

29. For those reasons I would reject Mr Prosser's submissions under Limb 1.

Limb 2

30. Both Mr Prosser and Mr Jones dealt with this alternative with commendable brevity. Mr Prosser submitted that the payment of £17.5 million for the release of 2003 agreement re-established Mr Blackwell's title to a right over the shares, within the meaning of s.38(1)(b) because, for as long as the 2003 agreement subsisted, he had deprived himself of relevant rights both to vote those shares and to sell them.

31. Mr Jones submitted that the payment for the release of the 2003 agreement had nothing to do with Mr Blackwell's title to the shares, or his title to rights over the

shares. It was a payment to discharge personal obligations or, which is the same thing, to buy back rights which had been entered into or conferred upon Taylor & Francis under, the 2003 agreement. The rights in the 2003 agreement were personal rights of Taylor & Francis over Mr Blackwell, not rights of Mr Blackwell over the shares. Mr Jones also submitted that the Upper Tribunal had been correct to confine the concept of the "establishment" of title in s.38(1)(b) to making good or proving or clarifying the existence of a right, something entirely different from acquiring such a right.

32. In my judgment Mr Jones' analysis of the inapplicability of this limb of s.38(1)(b) to Mr Blackwell's payment for the discharge of the 2003 agreement is correct. It was simply not a payment which established or re-established Mr Blackwell's title to the shares or to any right over the shares, all of which persisted throughout, their existence (as opposed to the use which Mr Blackwell might be able to make of them) being unaffected by the 2003 agreement, or by its discharge.

33. For those reasons I would dismiss this appeal.

Patten LJ

34. I agree.

Longmore LJ

35. I also agree.