Case No: A3/2013/0395

Neutral Citation Number: [2014] EWCA Civ 31

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
The Hon. Mr Justice Roth and Judge Julian Ghosh QC
FTC/22/2011

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: Thursday 30th January 2014

Before:

LORD JUSTICE MCFARLANE
LORD JUSTICE VOS
and
SIR TIMOTHY LLOYD

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Between:

Nicholas Barnes	**Appellant**
- and -	
The Commissioners for Her Majesty's Revenue and Customs	**Respondent**

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(Transcript of the Handed Down Judgment of
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Mr David Ewart QC and Ms Barbara Belgrano (instructed by Bird & Bird LLP) for the Appellant

Mr Malcolm Gammie QC and Mr David Yates (instructed by the HM Revenue and Customs Solicitors Office) for the Respondent

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Judgment

Lord Justice Vos:

Introduction

1. The Appellant, Mr Nicholas Barnes ("Mr Barnes"), was one of some 230 taxpayers who participated in 2005 in what was known as the "Corbiere Scheme" (the "Scheme"). The Scheme was specifically designed to avoid tax. In Mr Barnes's case, it is said that his participation in the Scheme entitled him to a net income tax deduction of some £1.2 million against his other income for the tax year 2004-2005. Both the First Tier Tribunal (Judge Kempster and Mr Agboola) (the "FTT") and the Upper Tribunal (Roth J and Judge Julian Ghosh QC) (the "UT") held that the Scheme was ineffective. This is a second appeal, for which Briggs LJ gave permission at an oral hearing on 11th June 2013.

2. The Scheme exploits the fact that tax legislation offers two separate reliefs in some circumstances where securities are transferred. The first relief is an "accrued interest" relief, and the second is a "manufactured interest" relief. They deal with somewhat different situations, but the originators of the Scheme sought to design a transaction that would make them both applicable, so as to allow the taxpayer to have one obligation to pay £x but two reliefs (of £x each) against that obligation. The Scheme fails unless both of the two reliefs are allowable. It was common ground that if the accrued interest relief was not available (because the transaction was treated as a stock-lending arrangement), then the manufactured interest relief was available. The FTT held that accrued interest relief was available, but manufactured interest relief was not. The UT agreed as to the latter but also held that accrued interest relief was not available.

3. In the briefest of outline, the Scheme provided for a British Virgin Islands company to transfer certain gilts to Mr Barnes the day before the record date for the interest coupon, and therefore with the right to payment of the interest, and for Mr Barnes to re-transfer those gilts or near equivalent gilts to the BVI company the next day on the coupon date. It also provided for a small additional number of the same or near equivalent gilts to be provided by Mr Barnes to the BVI company on the re-transfer, and for the amount of the coupon on the re-transferred gilts to be paid by Mr Barnes to the BVI company once it was received by Mr Barnes.

4. Accrued interest relief deals with the situation where securities are transferred with accrued interest before the record date for interest for a period including the time during which the transferor held the security. Without sections 713 and 714 of the Income and Corporation Taxes Act 1988 ("ICTA"), the transferee would pay tax on the whole of the interest he received, even though he may be obliged to account to the transferor for the part of it that represented the period during which the transferor held the securities. The accrued interest provisions are disapplied by section 727(2) of ICTA where a disposal and acquisition are made in pursuance of a stock lending arrangement and are thereby to be disregarded for capital gains tax purposes. Section 263B of the Taxation of Chargeable Gains Act 1992 (the "TCGA") defines a "*stock lending arrangement*", which is to have this effect.

5. The manufactured interest relief applies where, under a contract or other arrangements for the transfer of UK securities, one of the parties is required to pay the other "*an amount ... which is representative of a periodical payment of interest on the*

securities" (paragraph 3(1) of schedule 23A to ICTA). Such an arrangement is common in stock lending transactions, since, otherwise, the borrower would be entitled to keep the entire dividend declared or interest becoming payable during the period of a loan, even if that dividend or interest related to a period during which the lender held the securities.

6. It is important to understand that accrued interest relief and manufactured interest relief apply to different payments. Accrued interest relief is granted to the transferee where securities are transferred and the dividend or interest is payable to the transferee. It applies to the interest receipt in the hands of the transferee. Manufactured interest relief applies to the payment that a transferee makes when the whole or part of a dividend received by the transferee is paid over to the transferor. It applies to the manufactured interest payment made by the transferee to the transferor, but is a relief available to the transferee who makes the payment, presumably on the basis that he would not otherwise be able to set the payment against the taxation of his income.

7. The two reliefs are, however, triggered by the same events, namely the payment of interest to the transferee in respect of a period during which the transferor held the securities, in circumstances in which the transferee, in effect, passes or has passed part of that interest back to the transferor. In a normal situation where, say, the transferor held the securities for 9 months out of a 12-month period, and the interest became due at the end of the 12th month, 3 months after the transfer, the transferee would then transfer the interest attributable to the 9-month period during which the securities were held by the transferor to him. The transferee would expect to be taxed only on the interest attributable to the 3-month period during which he had held the securities. One would hardly expect both reliefs to be available to the transferee. The question in this case is whether the Scheme achieves a different result.

8. The UT's reasoning, in the briefest of outline, was that manufactured interest relief was not available to Mr Barnes because paragraph 3(2A) of schedule 23A to ICTA 1988, which required him to be "*chargeable to income tax on the periodical payment*" was not satisfied. The UT held that section 714(5) of ICTA operated "*expressly to reduce the quantum of the interest received for the purposes of the Tax Acts*". In other words, on this analysis, the accrued interest relief had already automatically reduced Mr Barnes's taxable receipt of interest to zero (or close to zero), so that the manufactured interest relief could not apply.

9. The UT also held that accrued interest relief was anyway not available to Mr Barnes, because the relevant part of the transaction fell within the definition of a "*stock lending arrangement*". That part of the transaction was the transfer and re-transfer of the borrowed securities, which was within what was contemplated by the words "*so much of any arrangements between two persons*" in section 263B of the TCGA. In refusing permission to appeal, the UT also rejected the argument that there was no "*requirement*" imposed on the borrower to transfer "*those [same] securities*" back to the lender within sections 263B(1)(b), 263B(5) and (6), because the contract between the parties only required "*near equivalent*" securities to be re-delivered. The UT relied on the FTT's finding that the common understanding of the parties at the time of the contract was that the very same securities would be transferred back and that there was no other realistic possibility.

10. It was common ground that, if accrued interest relief were not available, because it was a stock lending arrangement, then manufactured interest relief was available, but the Scheme obviously failed in those circumstances because only one relief was available.

The issues

11. Against this conceptually simple but statutorily complicated background, three issues were before this court:-

    i) Issue 1: Whether the UT was right to hold that the transaction was a "*stock lending arrangement*" within section 263B of the TCGA, so that sections 713-4 of ICTA were disapplied under section 727(2) of ICTA, and Mr Barnes was not entitled to accrued interest relief?

    ii) Issue 2: If Mr Barnes was entitled to accrued interest relief, was he also entitled to manufactured interest relief under paragraphs 3(2)(c) and 3(2A) of schedule 23A to ICTA? The main question here is whether, if Mr Barnes was entitled to accrued interest relief, the effect of section 714(5) was to reduce the interest payment to nil, so that Mr Barnes was no longer "*chargeable to income tax*" on it, and he was not therefore entitled to manufactured interest relief because of the effect of paragraph 3(2A) of schedule 23 to ICTA.

    iii) Issue 3: Whether the reality and substantive legal effect of the Scheme was such as to mean that Mr Barnes had no entitlement to the borrowed securities or to the interest coupon payable on them?

12. The 3rd issue was raised before both the FTT and the UT by HMRC, but neither tribunal dealt with it. Having heard argument on the first 2 issues, this court decided that we too did not need to hear argument on the 3rd issue. Our reasons for that approach will shortly become apparent.

13. Before dealing with the substance of the appeal, I should pay tribute to the clarity and concision of the decisions by both the FTT and the UT. The quality of their decisions has much assisted me in the preparation of this judgment.

The transaction

14. I gratefully adopt the UT's exposition of the transaction and factual findings of the FTT as follows, taken from paragraphs 3-5 of the UT's decision:-

    "*[3] In essence, the [Scheme] sought to enable the participant to obtain a tax deduction equivalent to the amount of a coupon payment on borrowed gilts. In Mr Barnes' case, the gilts involved were United Kingdom Treasury Gilts 8.75% 2017 ('Gilts') which went ex-dividend on 16 February 2005. The relevant transactions were as follows:*

    (1) On 16 February, 2005 –

    (a) pursuant to a Stock Loan Agreement, Mr Barnes borrowed from Clement View Ltd ('CVL'), a British Virgin Islands company, £27,428,571.41 (nominal value) Gilts ('the Borrowed Gilts'), being part of a much larger parcel of such

Gilts which had been acquired by CVL on that date from BGC International under a Purchase and Re-sale Agreement;

(b) the Borrowed Gilts were credited to Mr Barnes' custody account with SG Hambros Bank & Trust (Jersey) Ltd ('Hambros');

(c) pursuant to the Stock Loan Agreement, Mr Barnes posted with CVL cash collateral of £38,586,239, Mr Barnes having been put in funds for that purpose by Société Générale Bank and Trust ('SocGen');

(d) Mr Barnes purchased further Gilts of £2,742.86 (nominal value) ('the Margin Gilts'), which were credited to his custody account with Hambros; the cost of the purchase was debited to Mr Barnes' account with SG Hambros Bank (Channel Islands) Ltd ('the Bank');

(e) the Borrowed Gilts and the Margin Gilts in Mr Barnes' custody account were charged to secure his obligations to SocGen; and

(f) a further (subordinated) charge over those Borrowed Gilts and the Margin Gilts was created in favour of CVL.

(2) On 17 February, 2005 –

(a) pursuant to the Stock Loan Agreement, Mr Barnes transferred back to CVL £27,431,314.27 Gilts, comprising both the Borrowed Gilts and the Margin Gilts;

(b) CVL repaid to Mr Barnes (with interest) the collateral which he had posted under the Stock Loan Agreement; and

(c) Mr Barnes repaid to SocGen (with interest) the moneys which he had borrowed to fund that collateral.

(3) On 25 February, 2005 –

(a) Mr Barnes received into his account with Hambros the sum of £1,200,120, being the interest payable (record date 17 February 2005) on his holdings of both the Borrowed Gilts and the Margin Gilts;

(b) Mr Barnes borrowed from SocGen a further sum of £1,200,000, which was paid into a separate account set up by Mr Barnes with the Bank;

(c) out of the newly set up account, Mr Barnes paid to CVL the sum of £1,200,000 as required under the terms of the Stock Loan Agreement; and

(d) out of the interest which had been paid into his original account with the Bank, Mr Barnes repaid the loan of £1,200,000 which had been made to him by SocGen.

[4] The FTT found that all of the transaction documents were executed as stated on the face of those documents and were implemented in accordance with their terms: Decision, para [29].

[5] The FTT made additional findings of fact as follows: Decision, para [102]:

'(1) The scheme was a designed and marketed tax avoidance scheme.

(2) The scheme had no commercial purpose, other than the intended obtaining of a fiscal benefit.

(3) The parties intended that each of the steps and transactions comprising the scheme would be carried out and executed exactly as envisaged from the outset. There was a standard set of documentation which had been used on several occasions by many taxpayers. In the February 2005 round there were some 39 participants, each undertaking near identical transactions all with Hambros and SocGen as the counterparties. This all took place over two consecutive days, and any departure from the agreed plan would not have been feasible without derailing the scheme.

(4) Once Mr Barnes had decided to participate in the scheme his only real involvement was to sign in escrow a set of the documentation and to pay the agreed fee. In particular ... there was no realistic possibility that the gilt loan could be unwound other than by redelivery of the exact securities borrowed and then held by Hambros as custodian (plus the Margin Gilts, which only featured for the tax technical reasons already explored above). It is all but inconceivable that on the morning of 17 February Mr Barnes could have decided to unwind the gilts loan by arranging a delivery of £39m worth of alternative "near equivalent securities". There was no practical possibility that Mr Barnes could do anything with the borrowed gilts other than return them the following day - and that was the definite intention of all the parties from beginning to end.'"

Issue 1: Was the UT right to hold that the transaction was a "*stock lending arrangement*" within section 263B of the TCGA, so that sections 713-4 of ICTA were disapplied under section 727(2) of ICTA and Mr Barnes was not entitled to accrued interest relief?

15. Mr David Ewart QC, who appeared with Ms Barbara Belgrano (neither of them having appeared below), for Mr Barnes, argues that the UT was wrong to hold that accrued interest relief was unavailable to Mr Barnes on the ground that the transaction was a "*stock lending arrangement*" within section 263B of the TCGA. Section 263B(1) defines a "*stock lending arrangement*" as "*so much of any arrangements between two persons ('the borrower' and 'the lender') as are arrangements under which - (a) the lender transfers securities to the borrower otherwise than by way of sale; and (b) a requirement is imposed on the borrower to transfer those securities back to the lender otherwise than by way of sale*".

16. The UT held, as I have explained, that section 263B(1) applied to "*so much*" of the arrangements in this case as provided for the Borrowed Gilts to be transferred by CVL to Mr Barnes and retransferred by Mr Barnes to CVL. It rejected the suggestion that there was no "*requirement*" imposed on Mr Barnes to "*transfer those securities back to [CVL]*" within section 263B(1) of the TCGA. Though it did not deal in detail with the argument that sections 263B(5) and (6) necessitated an express contractual requirement that the very same securities should be retransferred, it held, as I have said, that in reality that was the position here. It also held that it did not matter for

this purpose that the Margin Gilts were also transferred to CVL at the same time as the Borrowed Gilts were retransferred.

17. Sections 263B(5) and (6) of TCGA provide that:-

> "*(5) References in this section, in relation to a person to whom securities are transferred, to the transfer of those securities back to another person shall be construed as if the cases where those securities are taken to be transferred back to that other person included any case where securities of the same description as those securities are transferred to that other person either —*
>
> *(a) in accordance with a requirement to transfer securities of the same description; or*
>
> *(b) in exercise of a power to substitute securities of the same description for the securities that are required to be transferred back.*
>
> *(6) For the purposes of this section securities shall not be taken to be of the same description as other securities unless they are in the same quantities, give the same rights against the same persons and are of the same type and nominal value as the other securities*".

18. Mr Ewart relies in this appeal on clause 8.1 of the Stock Lending Agreement between Mr Barnes and CVL, which provided that Mr Barnes should "*procure the redelivery of Near Equivalent Securities to [CVL] ... on termination of the Loan*", Near Equivalent Securities being defined in clause 2 as those (i) issued by the same issuer, (ii) having at least 100.01% of the nominal value of the Loaned Securities (the Borrowed Gilts), and (iii) having at least the same Redelivery Market Value on the redelivery date as the Loaned Securities.

19. These provisions, Mr Ewart contends, mean that Mr Barnes was permitted to transfer back to CVL securities in different quantities and with a different nominal value from the securities which he borrowed from CVL. There was, therefore, no requirement to transfer back "*those securities*" within the meaning of section 263B(1)(b) and (5).

20. Mr Ewart rejected the UT's reasoning as to the significance of the words "*so much*" in section 263B(1) as simply focusing on the part of the overall arrangements which deal with the lending and transfer back of securities, relying on sections 263B(5) and (6) as making it clear that the securities redelivered had to be required by the contract governing the transaction to be of the same quantities and the same nominal value. That, he said, was not the case here.

21. Section 263B(1) seems to me to be the key provision. It explains what is meant by a "*stock lending arrangement*" of the kind that is to be disregarded for the purposes of capital gains tax under section 263B(2). Such a stock lending arrangement is defined as "*so much of any arrangements between two persons ("the borrower" and "the lender") as are arrangements under which – (a) the lender transfers securities to the borrower otherwise than by way of a sale; and (b) a requirement is imposed on the borrower to transfer those securities back to the lender otherwise than by way of sale*". The section clearly contemplates that the defined "*stock lending arrangement*"

will or may form part of a larger set of arrangements between the lender and the borrower.

22. It is true that some assistance is given by section 263B(5) and (6) to the proper understanding of section 263B(1). But the primary sub-section 263B(5) defines only what is meant by the "*transfer of those [loaned] securities back to another person*", and says that they may be "*securities of the same description*" transferred back either in accordance with a requirement to do so, or in exercise of a power of substitution. Such securities are then said in section 263B(6) only to be "*of the same description*" if they are (i) in the same quantities, (ii) give the same rights against the same persons, and (iii) are of the same type and nominal value, as the loaned securities.

23. It seems to me, however, that sections 263B(5) and (6) are merely extending the rather narrow definition in section 263B(1) by allowing the transaction to be disregarded for capital gains tax purposes even if what is retransferred is of the same description as the loaned securities, rather than the identical securities themselves. This would obviously include a host of stock lending transactions where the lender is given the right to utilise the loaned securities, so that it needs to buy back similar securities to repay the loan. Every stock lending transaction includes some method of payment for the loan, and it would be slightly odd if section 263B excluded all those transactions where the payment was to be made by the retransfer of an additional amount of the same securities. I do not think it does so. To fall within section 263B(1), the arrangements between the lender and the borrower must include a requirement imposed on the borrower to transfer the loaned securities or securities of the same description back to the lender. It cannot matter that more are to be returned, whether the additional amount is large - or small, as in this case. The defined "*stock lending arrangement*" refers only to so much of the arrangement as relates to the transfer of the loaned securities and retransfer of the loaned securities or securities of the same description.

24. The next question is whether the arrangements in this case did actually include a requirement imposed on Mr Barnes to retransfer "*those securities*", as explained by sections 263B(5) and (6), to CVL. It is this aspect that has caused me the most concern. But, as it seems to me, the provisions of section 263B must be construed purposively. The word "*requirement*" need not refer only to the black letter wording of the Stock Lending Agreement. It must be intended to refer to a requirement being imposed on the borrower (Mr Barnes) taking all the circumstances of the transactional arrangements into account.

25. When pressed, Mr Malcolm Gammie QC who appeared with Mr David Yates for HMRC, submitted that here the findings made by the FTT amounted to a collateral contract whereby Mr Barnes was required in practice to retransfer the very same securities that he had received the day before from CVL. Alternatively, he said that where the contract required Mr Barnes to transfer one of several things, only one of which he could in reality transfer, the requirement of the arrangements was properly to be regarded as one obliging him to transfer the only thing that it was possible for him to do.

26. I bear in mind that the ultimate question in the process of statutory construction was helpfully described by Ribeiro PJ in Collector of Stamp Revenue v. Arrowtown Assets Ltd. [2003] HKFCA 46 at paragraph 35 as "*whether the relevant statutory*

provisions, construed purposively, were intended to apply to the transaction, viewed realistically" (approved by the House of Lords in Barclays Mercantile Business Finance Ltd. v. Mawson [2005] 1 A.C. 684 at paragraph 36 per Lord Nicholls giving the opinion of the Committee).

27. Put in that way, it seems to me that there is only one possible answer. The provisions of section 263B were obviously intended to apply to this transaction if one views it realistically. As the FTT found, there was "*no realistic possibility that the gilt loan could be unwound other than by the redelivery of the exact securities borrowed*", and "*there was no practical possibility that Mr Barnes could do anything with the borrowed gilts other than return them the following day*", and "*that was the definite intention of all the parties from beginning to end*". In real terms, therefore, Mr Barnes was required to return the very same securities that he had borrowed. The part of the arrangements that constituted the transfer and retransfer of the Borrowed Gilts was, therefore, a "*stock lending arrangement*" within section 263B of TCGA.

28. I prefer not to analyse the matter in a strictly contractual manner, since this was not how it was viewed or argued before the FTT. The FTT was looking at the practical and realistic requirements of the arrangements that the parties had made in reaching the findings of fact that I have just mentioned. That is the view of the arrangements to which, in my judgment, section 263B of TCGA is directed.

29. This conclusion means that Mr Barnes was not entitled to claim accrued interest relief in respect of the coupon received from the Borrowed Gilts under sections 713-4 of ICTA. Those sections were disapplied by section 727(2) of ICTA by reason of the application of the capital gains tax exemption in section 263B(2) of TCGA.

30. Once this is established, it is common ground that Mr Barnes was entitled to manufactured interest relief on the payment he made to CVL, and that the Scheme fails. I shall nonetheless consider the second issue in the case on the (now false) premise that Mr Barnes was indeed entitled to accrued interest relief in respect of the coupon received from the Borrowed Gilts.

Issue 2: If Mr Barnes was entitled to accrued interest relief, was he also entitled to manufactured interest relief under paragraphs 3(2)(c) and 3(2A) of schedule 23A to ICTA?

31. The main question here, according to the UT and the parties, was whether, on the basis that Mr Barnes was entitled to accrued interest relief, the effect of section 714(5) was to reduce the interest payment to nil (or almost to nil), so that Mr Barnes was no longer "*chargeable to income tax*" on the entirety of that payment. If the FTT and the UT were right on this point, Mr Barnes would not have been entitled to manufactured interest relief, in addition to accrued interest relief, because of the effect of paragraph 3(2A) of schedule 23 to ICTA.

32. Paragraph 3 of schedule 23 to ICTA provides for manufactured interest relief as follows:-

> "*(1) This paragraph applies ... in any case where, under a contract or other arrangements for the transfer of United Kingdom securities, one of the parties (an "interest manufacturer") is required to pay to the other ("the*

recipient") an amount ("the manufactured interest") which is representative of a periodical payment of interest on the securities.

(2) For the relevant purposes of the Tax Acts, in their application in relation to the interest manufacturer—

(a) the manufactured interest shall be treated, except in determining whether it is deductible, as if it—

(i) were an annual payment to the recipient, but

(ii) were neither yearly interest nor an amount payable wholly out of profits or gains brought into charge for income tax;

(b) the gross amount of that deemed annual payment shall be taken—

(i) to be equal to the gross amount of the interest of which the manufactured interest is representative; and

(ii) to constitute income of the recipient falling within section 1A;

and

(c) an amount equal to so much of the gross amount of the manufactured interest as is not otherwise deductible shall be allowable as a deduction against the total income or, as the case may be, total profits of the interest manufacturer, but only to the extent that –

(i) it would be so allowable if it were interest, or

(ii) so far as not falling within sub-paragraph (i) above, it falls within sub-paragraph (2A) below.

(2A) An amount of manufactured interest falls within this subparagraph if and to the extent that the interest manufacturer –

(a) receives the periodical payment of interest on the securities which is represented by the manufactured interest, or receives a payment which is representative of that periodical payment of interest, and is chargeable to income tax on the periodical payment or representative payment so received;

(b) is treated under section 713(2)(a) or (3)(b) (accrued interest scheme) as entitled to a sum in respect of a transfer of the securities and is chargeable to income tax on that sum; or ..."

33. The UT held that Mr Barnes was not "*chargeable to income tax*" on the interest payment within the meaning of paragraph 3(2A)(a), insofar as he was already entitled to the accrued interest allowance under section 714(4) of ICTA. It reasoned as follows:-

i) Mr Barnes was treated as entitled to relief in the sum of the accrued amount under section 713(2)(b) of ICTA;

ii) That relief entitled Mr Barnes to an allowance of the whole amount of the interest he received under section 714(4) and (5) of ICTA;

iii) Section 714(5) provided that the interest payment received by Mr Barnes which is taken into account in computing tax charged should be treated as reduced by the amount of the allowance under section 714(4), which was (anyway almost) the full amount of the payment, so reducing the interest on which tax is charged to Mr Barnes to nil.

34. The first point to note is that it is common ground that Mr Barnes, as opposed to CVL, was the "*transferee*" within the meaning of the provisions in sections 710-728 of ICTA. At first sight, this might seem counter-intuitive, since it was Mr Barnes that re-transferred the Borrowed Gilts back to CVL as part of the transaction in which the interest coupon was later also paid over to CVL. But the parties were right to regard Mr Barnes as the transferee for the purposes of these provisions because of the terms of sections 710(5) and (6). The latter sub-section provides that "*[w]here an agreement for the transfer of securities is made, they are transferred, and the person to whom they are agreed to be transferred becomes entitled to them, when the agreement is made and not on a later transfer made pursuant to the agreement; and "entitled", "transfer" and cognate expressions shall be construed accordingly*". In the circumstances, the original loan of securities by CVL to Mr Barnes is the dominant transaction for the identification of the "*transferor*" and "*transferee*" in sections 713 and 714 of ICTA (see, in particular section 713(2)(b), which entitled Mr Barnes to his relief). Thus for the purposes of those provisions, Mr Barnes is to be regarded as the transferee, even though he was in fact the transferor under the retransfer that immediately preceded the interest payment to CVL. Moreover, in the terms of section 713(2), it was only on the transfer from CVL to Mr Barnes that securities were transferred "*with accrued interest*".

35. Mr Ewart submits that the UT's conclusion was wrong because similar words to those used in section 714(6) of ICTA, including "*treated as reduced by the amount of [the loss]*", are also used in sections 385, 393(1) and 393A(1) of ICTA where relief is given for losses, and income or profits are treated as reduced by the amount of that loss. In the case of profits, it is said to be clear that they are "*chargeable to tax*", and the losses set against them merely constitute a relief; they do not obliterate their original chargeability to tax. In other words, Mr Ewart submits that section 714(5) is simply a computation provision, which does not have the effect of negating the chargeability to tax of the original coupon payment to Mr Barnes. Mr Ewart also focused on the words in section 714(5)(b) of ICTA defining the amount of the interest payment as being that "*taken into account in computing tax charged for the chargeable period in which the interest period ends*", arguing that this demonstrated that the whole of the interest payment was indeed chargeable to tax, even if a relief were granted.

36. Mr Gammie drew attention to the distinction between the item taxed and the person to be taxed. Sections 1 and 18 of ICTA lay down the items that are to be charged to tax, whilst section 59 determines the person that is to be chargeable on those items. Section 18 of ICTA provides that interest (like the coupon in this case) is taxable

under Case III of Schedule D, although it is noteworthy that the part of the interest attributed to the transferor (CVL in this case) is chargeable to tax under Case VI of Schedule D by reason of section 714(2) of ICTA.

37. Mr Gammie said that section 714(5) was dealing with the item to be taxed, and that was the interest payment Mr Barnes received reduced by the amount of the accrued interest allowance. By contrast, paragraph 3(2A) of schedule 23A to ICTA was focusing on the person chargeable, namely the interest manufacturer, Mr Barnes, and providing that he obtained manufactured interest relief as long as he was chargeable to tax on the interest payment he received.

38. As it seems to me, the FTT and the UT were right on this point. In one sense, section 714(5) is, of course, a computational provision, but that does not provide an answer to the problem. The true question is as to the meaning of the words "*chargeable to income tax*" in paragraph 3(2A)(5)(a) of schedule 23A to ICTA. I take into account that Kensington Commissioners v. Aramayo [1916] A.C. 215 at 234 and 239 suggested that words similar to "*chargeable to tax*" have no fixed meaning and that their meaning in a particular section needs to be determined from their immediate context (see paragraph 34 of the Special Commissioners' decision in Prudential Assurance Co. Ltd. v. Bibby (Inspector of Taxes) [1999] STC (SCD) 153).

39. The words "*chargeable to income tax*" in paragraph 3(2A)(i) must be intended to identify whether Mr Barnes would actually be taxed on the interest payment that he has received, absent the manufactured interest relief. The paragraph is, as Mr Gammie says, focusing on Mr Barnes's tax position. Section 714(5) then provides for the amount of the interest payment on which he is chargeable to tax, which in this case is the amount of the interest payment reduced by the amount of the accrued income allowance (i.e. almost nothing).

40. I do not think that section 714(5)(b) provides any support to Mr Ewart's argument, because that section is simply concerned with the interest period. Nor do I think that the analogy with the relief provisions in sections 385, 393(1) and 393A(1) of ICTA is helpful. Case III of Schedule D in section 18 of ICTA taxes interest without any calculation or reduction being made. Cases I and II tax profits which need to be calculated under the relevant provisions. Sections 713-714 concern a relief against tax on interest where, in effect, the interest may be handed over to a transferor. Even though the words used may, in part, be the same, there is no real analogy with losses that may, by different provisions in a different context, be set against profits in computing the final amount of tax payable by a given taxpayer. I would reiterate the point made in Prudential Assurance Co. Ltd. v. Bibby supra to the effect that, even though the words may be the same, they must be read in their immediate context.

41. In my judgment, therefore, the FTT and the UT were right to think that the effect of section 714(5) is, for tax purposes, to reduce the interest payment received by Mr Barnes by the amount of the accrued interest allowance (i.e. in this case almost to nil). In those circumstances, when one comes to apply paragraph 3(2A) of schedule 23A to ICTA, Mr Barnes is not "*chargeable to income tax*" on the "*periodical payment of interest on the securities which is represented by the manufactured interest*" which he received. Accordingly, he is not entitled to manufactured interest relief within the proper meaning of paragraph 3 of schedule 23A to ICTA.

42. Accordingly, the Scheme fails on this ground too.

Issue 3: Was the reality and substantive legal effect of the Scheme such as to mean that Mr Barnes had no entitlement to the borrowed securities or to the interest coupon payable on them?

43. Since Mr Barnes's appeal and the Scheme fails whatever the result of this issue, I do not think that the Court should comment on the complicated arguments that have been adduced on both sides under this head. They can await a case in which they are material to the outcome.

Disposal

44. For the reasons I have tried shortly to give, I would dismiss this appeal on issue 1, holding that Mr Barnes was not entitled to accrued interest relief under sections 713 and 714 of ICTA, and I would dismiss Mr Barnes's appeal on issue 2, holding that, if he had been entitled to accrued interest relief, he would not have been entitled to manufactured interest relief under paragraph 3 of schedule 23A to ICTA.

45. The effect of these conclusions is that I would hold that the Scheme fails on the points decided by the UT, and that Mr Barnes's appeal against the terms of the closure notice issued by HMRC is unsuccessful.

Sir Timothy Lloyd

46. I agree with Vos LJ that the Scheme fails because the transaction undertaken fell within the definition of a stock-lending arrangement in section 263B of TCGA 1992, to the extent of the gilts originally transferred by CVL to Mr Barnes and transferred back by him the next day (the Borrowed Gilts). The fact that he also had to transfer a small number of additional gilts to CVL (the Margin Gilts) did not mean that the arrangements, so far as they provided for the loan and the return of the Borrowed Gilts, were outside the scope of section 263B. In my judgment, an arrangement under which A transfers, say, 1000 of some particular securities to B (not by way of sale) and B is obliged then to transfer 1001 of the same securities back to A is within the section to the extent of the 1000, though not as regards the additional one.

47. It is worth recalling that the point of section 263B, in itself, is to exempt stock-lending transactions from capital gains tax so that neither the original transfer nor the re-transfer should constitute a disposal for capital gains tax purposes. That being so, it seems to me natural that the provision should apply to the transfer and re-transfer of 1000 of the same stock, but not to any part of the relevant arrangements which involve either the transfer or the re-transfer of additional securities not matched on the other side of the transaction.

48. I agree with Vos LJ that section 263B(5) and (6) are of relevance only in extending, modestly, the scope of the words "those securities" in section 263B(1)(b).

49. There was some debate before us as to whether the "requirement" referred to in section 263B(1)(b) has to be contractual or whether it could be of some other kind. It seems to me that it is likely to be a contractual obligation, in that stock-lending arrangements are in their nature likely to be the subject of contracts, for the protection

of both sides to the transaction. At all events, it seems to me that the requirement must be pursuant to an obligation legally binding on the borrower.

50. In the present case, as Vos LJ says, the major argument on this aspect of the case before us was as to whether Mr Barnes was under a binding obligation to transfer "those securities" to CVL. The definition of "Near Equivalent Securities" in the agreement between him and CVL allows for the possibility of the return of different securities, so long as they satisfy conditions which are plainly not the same as those provided for by section 263B(6). Consistently with this, the transactional documentation referred to Mr Barnes as having the opportunity to satisfy the obligation by returning different securities, and to him reserving the right to decide to use other securities, and in turn to him, "after careful consideration, of the financial consequences", having decided to use the original Borrowed Gilts to repay the loan. However, as the FTT recognised, and as was indeed common ground, the circumstances were such that there never was any practical possibility of his doing anything else. First of all, the whole process was set up in advance by documents (including those from which I have just quoted) being executed all together in advance in escrow, so that Mr Barnes was left with nothing to do himself on 16 or 17 February 2005. Moreover, the Borrowed Gilts were held by Hambros, and while in his ownership they were charged to SocGen as security for its loan to him of £38 million, which he required in order to provide CVL with cash collateral for his obligation to return the gilts to CVL. Taking into account, in particular, the fact that the re-transfer obligation had to be performed on the very day after the transfer by CVL to him, it is plain that the only thing he could ever have done, on 17 February, was to re-transfer to CVL the very same gilts which CVL had transferred to him on 16 February.

51. Mr Ewart relied on the FTT's holding (paragraph 29) that all the transaction documents were executed as stated on their face and were implemented in accordance with their terms. There was no suggestion that any part of any of the documents was a sham. That is a fair point, but in my judgment it is not sufficient for Mr Barnes. Undoubtedly, for example, Mr Barnes did buy the Margin Gilts with which he was able to satisfy the obligation to transfer to CVL 100.01% of what CVL had transferred to him.

52. But as regards the true nature and scope of Mr Barnes' obligation of re-delivery, it seems to me that Mr Gammie is correct in contending that the obligation is to be read in the light of the known facts and surrounding circumstances, including the whole pre-ordained structure. Read in that light, it seems to me that the provision allowing for the return of any securities other than those which had been transferred by CVL (leaving aside the additional 0.01%) was unreal, and should be ignored. Undoubtedly Mr Barnes was subject to a legally binding obligation to transfer securities back to CVL. In my judgment that obligation, properly understood in the light of the circumstances, was to transfer back the very same securities as he had received, together with the extra 0.01%, because that was the only thing that he could possibly have done in order to comply with the obligation.

53. It seems to me that it would be possible to justify that conclusion on ordinary principles of contractual construction, given the compelling effect of the surrounding circumstances. The point does not seem to have been addressed in the FTT, so that we do not have findings from the FTT on the point. That being so, I understand the

reluctance of Vos LJ to decide the case on the basis either that there was a collateral contract binding Mr Barnes to return the very same securities, despite the wider terms of the written document, or that the written document should be construed in a more limited way because of the surrounding circumstances which are relevant to the construction of the document. He therefore relies on the proposition set out in paragraphs 27 and 28 above. I do not dissent from that. If the point had been taken below, and addressed accordingly, it seems to me that it might very well have been possible and proper to analyse Mr Barnes' obligation as being contractual on one or other of the bases put forward by Mr Gammie. But it is not necessary to decide either way on that point.

54. For those reasons I agree with Vos LJ's conclusion that Mr Barnes was under a legally binding obligation to re-transfer to CVL the very same securities as CVL had transferred to him, that obligation being within section 263B(1)(b), and that his obligation to transfer an additional 0.01% of such securities, though not itself within section 263B, did not take the rest of the transaction outside the section.

55. It is reasonably plain that both the requirement for the return of the additional 0.01% of securities, and the provision (unreal in practical terms) for the possibility of returning other securities than the Borrowed Securities were intended to take the transaction outside the scope of section 263B. In my judgment, for the reasons given by myself and by Vos LJ, neither of these provisions is sufficient for that purpose.

56. That is the reason why I would dismiss this appeal.

57. As for the other issue in the case, the resolution of which is unnecessary if I am right on this first point, I note that, when he gave permission to appeal, Briggs LJ said that one of his reasons for doing so was Mr Ewart's contention, elaborated before us, that the decision of the UT had wider implications because of the use of the same or very similar language in relation to, for example, loss relief.

58. I am not persuaded that there are any such wider implications, for reasons given by Vos LJ at paragraph 38 above, above all that the statutory words "chargeable to income tax" must be construed in the particular context, and may not mean at all the same in one context as they do in another.

59. I see force in Vos LJ's conclusion on this aspect of the case. However, since a decision on it is not necessary for the disposition of the appeal I prefer to leave the point open to be addressed in a case in which it does matter.

60. Either way, issue 3 does not need to be decided.

61. Accordingly I would dismiss the appeal, but only on the stock-lending point, leaving the question of the meaning of "chargeable to income tax" in paragraph 3(2A) of Schedule 23A to ICTA open for argument in another case.

Lord Justice McFarlane

62. I too would dismiss the appeal for the reasons advanced by Vos LJ.

63. Sir Timothy Lloyd, who does not disagree with Vos LJ on the meaning of 'chargeable to income tax' in paragraph 3(2A) of Schedule 23A of ICTA, takes a cautious

approach, preferring to leave the issue open to be addressed in any later case. The point with respect to paragraph 3(2A) was, however, fully argued before this court, and it is a point upon which both the FTT and the UT concurred. Despite understanding the need for caution in these matters, I am positively in agreement with the analysis given by Vos LJ at paragraphs 38 to 41 and I do not consider that the counter-arguments raised on behalf of Mr Barnes in fact establish grounds to be cautious on this point. In agreeing with Vos LJ, I am therefore in agreement with each of the two substantive grounds upon which he has held that the Scheme has failed.