[2014] UKFTT 695 (TC)

TC03816

Appeal numbers: TC/2012/05367 & TC/2012/05372

Capital gains tax – redemption of qualifying corporate bonds (QCBs) - scheme to avoid the application of s 116, TCGA to a conversion of non-QCBs into QCBs – s 116(1)(b) - whether a single conversion of non-QCBs and QCBs into QCBs or two separate conversions – whether the conversion and redemption should be treated as a single composite transaction of the disposal/redemption of non-QCBs – the Ramsay principle

FIRST-TIER TRIBUNAL
TAX CHAMBER

(1) ANTHONY HANCOCK
(2) TRACY LEE HANCOCK **Appellants**

- and -

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

TRIBUNAL: JUDGE ROGER BERNER
MR NIGEL COLLARD

Sitting in public at 45 Bedford Square, London WC1 on 21 May 2014

Michael Sherry, instructed by Haines Watts, for the Appellants

Richard Vallat, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. As a general rule, disposals of assets within the scope of capital gains tax ("CGT") give rise to a chargeable gain (or allowable loss). But special rules apply to certain types of asset, such as, in this case, debts having certain characteristics, namely qualifying corporate bonds ("QCBs"), which are exempt and thus cannot give rise to either chargeable gains or allowable losses, and to certain types of transaction, such as corporate reorganisations and similar transactions, where one holding of securities is replaced by another, which are not treated as disposals. These appeals raise the question of the application of those special rules to the transactions entered into by Mr and Mrs Hancock.

Statement of Agreed Facts

2. We had a helpful statement of agreed facts, which is a useful introduction and which we reproduce below (edited by us for consistency):

> (1) Mr and Mrs Hancock held in total 100% of the share capital in a limited company, Blubeckers Limited. On 24 August 2000 the company was sold to Lionheart Holdings Limited ("Lionheart").
>
> (2) At the date of disposal the issued share capital of Blubeckers Limited consisted of 5,219 £1 ordinary shares. Mr Hancock held 2,611 shares and Mrs Hancock held 2,608 shares.
>
> (3) The initial consideration payable by Lionheart in the form of HSBC bank guaranteed loan notes was £9,270,000, with provision for payment of further consideration depending on the subsequent performance of the business.
>
> (4) The loan notes were:
>
> (a) £500,000 A Loan Notes 2007, which were issued to Mr Hancock;
>
> (b) £4,137,664 B Loan Notes 2004, which were issued to Mr Hancock; and
>
> (c) £4,632,336 B Loan Notes 2004, which were issued to Mrs Hancock.
>
> (5) This appeal is concerned with the tax consequences arising from subsequent actions taken with B Loan Notes 2004. The A Loan Notes 2007 are not directly involved in the case.
>
> (6) The B Loan Notes 2004 bore interest at 0.5% per annum below HSBC's base rate and were repayable on 24 August 2004 or at such earlier time (so long as not less than six months after issue) as the note holder might require. Clauses 1.3 and 5.3 of the conditions provided that the note holder could require repayment in US dollars, with the exchange rate to be the spot rate obtained or obtainable by Lionheart twenty days before repayment. It is agreed that the provision for payment in a currency other than sterling and at an exchange rate other than that prevailing at redemption, prevents the B Loan Notes 2004 from

being qualifying corporate bonds for the purposes of Taxation of Chargeable Gains Act 1992 ("TGCA"), section 117.

(7) Additional purchase consideration became payable and was paid on 22 March 2001, as follows:

(a) £477,516 B Loan Notes 2004 were issued to Mr Hancock; and

(b) £477,135 B Loan Notes 2004 were issued to Mrs Hancock.

(8) Deeds of variation removing the rights to redemption in US dollars from the £477,516 B Loan Note 2004 and the £477,135 Loan Note 2004 were executed on 9 October 2002. For convenience, these notes are subsequently referred to as "Revised B Loan Notes 2004". The Revised B Loan Notes 2004 were qualifying corporate bonds within s 117 TCGA.

(9) On 7 May 2003 the B Loan Notes 2004 issued on 24 August 2000 and the Revised B Loan Notes 2004 issued on 22 March 2001 beneficially owned by Mr and Mrs Hancock were exchanged for two Secured Discounted Loan Notes 2004; one with a nominal value of £4,615,180 (in the case of Mr Hancock) and one with a nominal value of £5,109,471 (in the case of Mrs Hancock). After this exchange, the Secured Discounted Loan Notes 2004 were qualifying corporate bonds within s 117 TCGA 1992.

(10) The Secured Discounted Loan Notes 2004 provided for redemption on 30 April 2004 or for early redemption on either 30 June 2003 or 31 December 2003 on 30 days notice. An early redemption notice was given and the loan notes were redeemed on 30 June 2003 together with the payment of the associated redemption premium.

Evidence

3. In addition to the statement of agreed facts, we had a witness statement from Mr Hancock who gave oral evidence and was cross-examined by Mr Vallat for HMRC. Mrs Hancock also provided a witness statement, essentially confirming what Mr Hancock had said in his statement. In those circumstances counsel helpfully agreed that it was not necessary for Mrs Hancock to give oral evidence, and that Mr Sherry would take no point that HMRC's case had not been put to Mrs Hancock. We were happy to proceed on that basis.

4. We shall consider the evidence of Mr Hancock shortly, but before doing so we think it would be helpful if we set out the issues that the parties had agreed were in dispute in this case, and the applicable legislation.

The issues

5. This case is concerned with the chargeable gain arising on the redemption of the Secured Discounted Loan Notes 2004 on 30 June 2003.

6. There are two technical issues in dispute:

(a) Whether or not the conversion of the B Loan Notes 2004 issued on 24 August 2000 and the conversion of the Revised B Loan Notes 2004 issued on 22 March 2001 into the Secured Discounted Loan Notes 2004 on 7 May 2003 are to be treated as a single conversion or two distinct conversions for the purposes of s 116(1) TCGA.

(b) Whether or not on a purposive construction of the relevant provisions, and taking a realistic view of the facts, the conversion(s) on 7 May 2003 and redemption on 30 June 2003 should be taxed as a single composite transaction (namely a redemption of the B Loan Notes 2004 and the Revised B Loan Notes 2004).

The law

7. A reorganisation of share capital, where the original shares are replaced by a new holding (which can include some or all of the original shares), is not treated as a disposal of the original shares. Instead, the effect is that any gain on the original shares is "rolled over" into the new holding. This is achieved, in broad terms, by the new holding being equated with the original shares such that the new holding has the same acquisition cost as the original shares.

8. So far as material, s 126 and s 127 TCGA provide:

> **126 Application of sections 127 to 131**
>
> (1) For the purposes of this section and sections 127 to 131 "reorganisation" means a reorganisation or reduction of a company's share capital, and in relation to the reorganisation—
>
> *(a)* "original shares" means shares held before and concerned in the reorganisation,
>
> *(b)* "new holding" means, in relation to any original shares, the shares in and debentures of the company which as a result of the reorganisation represent the original shares (including such, if any, of the original shares as remain).
>
> …
>
> **127 Equation of original shares and new holding**
>
> Subject to sections 128 to 130, a reorganisation shall not be treated as involving any disposal of the original shares or any acquisition of the new holding or any part of it, but the original shares (taken as a single asset) and the new holding (taken as a single asset) shall be treated as the same asset acquired as the original shares were acquired.

9. These rules apply to a conversion of securities, such as loan stock or loan notes, as they apply to a reorganisation of share capital. Section 132 TCGA provides:

> **132 Equation of converted securities and new holding**
>
> (1) Sections 127 to 131 shall apply with any necessary adaptations in relation to the conversion of securities as they apply in relation to a

reorganisation (that is to say, a reorganisation or reduction of a company's share capital).

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

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

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

(i) a conversion of securities of a company into shares in the company, and

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

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

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

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

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

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

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

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

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

(a) is not a security; and

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

10. Where an asset is a qualifying corporate bond (or QCB) within the meaning of s 117 TCGA, a gain accruing on the disposal of that asset is not a chargeable gain (and a loss is not an allowable loss). This is the effect of s 115 TCGA. It can readily be appreciated, therefore, that without more a gain that is rolled over into a QCB under the reorganisations rules we have described would escape capital gains tax.

11. Accordingly the legislation provides for different rules on reorganisations involving QCBs. In broad terms, where the legislation applies, its effect is not to roll over a gain into the QCB, as would be the case under the reorganisations rules, but to freeze the gain that would have accrued on a disposal of the original shares or securities at market value at the time of the reorganisation, and to deem that gain, as a chargeable gain, to accrue on a subsequent disposal of the QCB. Section 116 TCGA relevantly provides:

> **116 Reorganisations, conversions and reconstructions**
>
> (1) This section shall have effect in any case where a transaction occurs of such a description that, apart from the provisions of this section—
>
> *(a)* sections 127 to 130 would apply by virtue of any provision of Chapter II of this Part; and
>
> *(b)* either the original shares would consist of or include a qualifying corporate bond and the new holding would not, or the original shares would not and the new holding would consist of or include such a bond;
>
> and in paragraph (b) above "the original shares" and "the new holding" have the same meaning as they have for the purposes of sections 127 to 130.
>
> (2) In this section references to a transaction include references to any conversion of securities (whether or not effected by a transaction) within the meaning of section 132 and "relevant transaction" means a reorganisation, conversion of securities or other transaction such as is mentioned in subsection (1) above, and, in addition to its application where the transaction takes place after the coming into force of this section, subsection (10) below applies where the relevant transaction took place before the coming into force of this section so far as may be necessary to enable any gain or loss deferred under paragraph 10 of Schedule 13 to the Finance Act 1984 to be taken into account on a subsequent disposal.
>
> (3) Where the qualifying corporate bond referred to in subsection (1)*(b)* above would constitute the original shares for the purposes of sections 127 to 130, it is in this section referred to as "the old asset" and the shares or securities which would constitute the new holding for those purposes are referred to as "the new asset".
>
> (4) Where the qualifying corporate bond referred to in subsection (1)*(b)* above would constitute the new holding for the purposes of

sections 127 to 130, it is in this section referred to as "the new asset" and the shares or securities which would constitute the original shares for those purposes are referred to as "the old asset".

(4A) In determining for the purposes of subsections (1) to (4) above, as they apply for the purposes of corporation tax—

(a) whether sections 127 to 130 would apply in any case, and

(b) what, in a case where they would apply, would constitute the original shares and the new holding,

it shall be assumed that every asset representing a loan relationship of a company is a security within the meaning of section 132.

(5) So far as the relevant transaction relates to the old asset and the new asset, sections 127 to 130 shall not apply in relation to it.

(6) In accordance with subsection (5) above, the new asset shall not be treated as having been acquired on any date other than the date of the relevant transaction or, subject to subsections (7) and (8) below, for any consideration other than the market value of the old asset as determined immediately before that transaction.

…

(9) In any case where the old asset consists of a qualifying corporate bond, then, so far as it relates to the old asset and the new asset, the relevant transaction shall be treated for the purposes of this Act as a disposal of the old asset and an acquisition of the new asset.

(10) Except in a case falling within subsection (9) above, so far as it relates to the old asset and the new asset, the relevant transaction shall be treated for the purposes of this Act as not involving any disposal of the old asset but—

(a) there shall be calculated the chargeable gain or allowable loss that would have accrued if, at the time of the relevant transaction, the old asset had been disposed of for a consideration equal to its market value immediately before that transaction; and

(b) subject to subsections (12) to (14) below, the whole or a corresponding part of the chargeable gain or allowable loss mentioned in paragraph *(a)* above shall be deemed to accrue on a subsequent disposal of the whole or part of the new asset (in addition to any gain or loss that actually accrues on that disposal); and

(c) on that subsequent disposal, section 115 shall have effect only in relation to any gain or loss that actually accrues and not in relation to any gain or loss which is deemed to accrue by virtue of paragraph *(b)* above.

…

12. Mr and Mrs Hancock's case, in essence, is that s 116 TCGA does not have effect in relation to the conversion of the B Loan Notes 2004 and the Revised B Loan Notes 2004 into the Secured Discounted Loan Notes 2004, with the consequence that the gain on the B Loan Notes 2004 (non-QCBs) was rolled over into the Secured

Discounted Loan Notes 2004 (QCBs), and is not taxable on a disposal of those Secured Discounted Loan Notes 2004 on their redemption. It is accepted that s 116 had effect in relation to the conversion of certain of the B Loan Notes 2004 (non-QCBs) into the Revised B Loan Notes 2004 (QCBs), so that on the ultimate redemption of the Secured Discounted Loan Notes 2004, which in this respect are treated under the reorganisations provisions as the same asset as the Revised B Loan Notes 2004, the frozen gain attributable to a part disposal of the B Loan Notes 2004 at the time of that earlier conversion is a chargeable gain brought into charge by s 116(10).

Mr Hancock's evidence

13. In his evidence, Mr Hancock explained that, at the time of the original sale of Blubeckers Limited to Lionheart, it had been helpful to the purchaser that consideration was provided in the form of loan notes. Mr Hancock had agreed to this course provided that the notes were guaranteed by a bank. He told us that he also understood at that time that receiving consideration in the form of loan notes meant that there would be no immediate disposal for CGT purposes. As a result, he and Mrs Hancock would benefit from an interest return on gross proceeds for a time, and the time to reflect on the next phase of their lives before making any substantial decisions concerning the loan notes. There was, at that time, no suggestion that the loan notes might later be restructured.

14. The A Loan Notes 2007 were issued only to Mr Hancock. They provided what Mr Hancock described as enhanced commercial protection to Lionheart in respect of claims arising in relation to the acquisition of Blubeckers Limited. They were intended not to be redeemable for an extended period of seven years.

15. Mr and Mrs Hancock raised finance on the security of the B Loan Notes 2004 from Barclays Private Bank Limited. The B Loan Notes 2004 were accordingly transferred by way of security to Barclays' nominee company, Zeban Nominees Limited.

16. The B Loan Notes 2004 had a final redemption date of 24 August 2004 but were redeemable, in whole or in part (at least as to £10,000) on two occasions in each year, 30 September and 31 March. No notice for repayment could be given within six months of the issue of the Notes. As 30 days' notice was required for repayment, the earliest date for redemption of the Notes was 30 September 2001.

17. In early 2002 Mr and Mrs Hancock resolved that they would seek redemption of the B Loan Notes 2004. Mr Hancock explained to his accountants, Haines Watts, in March 2002 that he was seeking to agree an early redemption of the Notes, but (for unspecified tax reasons) with the date of redemption deferred from 31 March 2002 to a date after 5 April 2002. It was then that Haines Watts explained to Mr Hancock that, with the cooperation of Lionheart, it might be possible to restructure the B Loan Notes 2004 with a view to obtaining a more beneficial CGT treatment when the restructured Notes were redeemed.

18. In a letter of 19 March 2002, Mr Stephen Edwards of Haines Watts explained to Mr Hancock that one of the commercial issues to be considered by him was the inevitable delay in the ability to redeem the Notes. Mr Edwards estimated that, assuming reasonable cooperation from Lionheart, the earliest realistic date for the redemption of the Notes would be December 2002, but there was a risk of "slippage" of a month or two.

19. The cooperation of Lionheart was sought. It was readily obtained in respect of the variation of those B Loan Notes 2004 that had been issued on 22 March 2001 by way of additional purchase consideration, subject to Lionheart being indemnified in respect of its costs. At the time of agreeing to cooperate in this way, Lionheart had been informed by PricewaterhouseCoopers, also acting on behalf of Mr and Mrs Hancock, that following the variation it was proposed that Lionheart would be approached with a view to amending the Notes for a second time.

20. According to Mr Hancock, the more substantial restructuring exercise that was then required, with Lionheart's cooperation, turned out to be an altogether more difficult and expensive process than the first restructuring exercise. There was no guarantee that Lionheart would agree to this more substantial restructuring of the B Loan Notes 2004 and the Revised B Loan Notes 2004 and, as it turned out, the process required a number of related commercial issues to be addressed.

21. One of the issues related to redemption of the A Loan Notes 2007. Contrary to Mr Hancock's original understanding, he became aware around December 2002 that he might be able, under the terms of the A Loan Notes 2007, to redeem those Notes earlier than in 2007. Having been advised by Mr Edwards on 18 December 2002 that the earliest available date for redemption of those Notes was 31 March 2003, and that 30 business days' notice was required, Mr Hancock gave notice of redemption on 12 February 2003. As part of the commercial negotiation for the restructuring, Mr Hancock agreed, on 31 March 2003, to withdraw that notice.

22. Another issue was that Haines Watts identified that a substantial amount of Jersey income tax had wrongly been deducted from interest payments on the various classes of Notes. That error formed part of the commercial negotiations connected with the Note restructuring. Mr Hancock's understanding was that this provided an added commercial incentive for Lionheart to complete the restructuring in order to obviate a claim for recovery of the amounts deducted. That issue was resolved under the terms of the agreement dated 7 May 2003 which provided for the issue by Lionheart of the Secured Discounted Loan Notes 2004 in exchange for the cancellation of the B Loan Notes 2004 and the Revised B Loan Notes 2004.

23. The agreement of 7 May 2003 was between Lionheart (then called Blubeckers Holdings Limited), Mr and Mrs Hancock and Zeban Nominees Limited. Recital (D) (amended by us to reflect the terms used in this decision) provided:

> "At the request of [Mr and Mrs Hancock and Zeban Nominees Limited] [Lionheart] has agreed to issue and [Zeban Nominees Limited] has agreed to accept the nominal amount of Secured

> Discounted Loan Note 2004 in exchange for the cancellation of [the Revised B Loan Notes 2004] and [the B Loan Notes 2004]."

That agreement was reflected in the operative part of the agreement, at clause 2.1:

> "In consideration of the issue by [Lionheart] to [Zeban Nominees Limited] of the nominal amount of Secured Discounted Loan Note 2004 each of [Mr and Mrs Hancock] and [Zeban Nominees Limited] hereby agree to the cancellation of [the Revised B Loan Notes 2004] and [the B Loan Notes 2004]."

24. In his witness statement Mr Hancock said that, prior to the restructuring on 7 May 2003, it had been his intention, and Mrs Hancock's statement also confirmed that it had been her intention, to give notice for the Secured Discounted Loan Notes 2004 to be redeemed at the earliest opportunity. Notice was duly given for those Notes to be redeemed at the first opportunity after their issue, and redemption took place on 30 June 2003.

25. In cross-examination, Mr Hancock was asked questions concerning his desire to encash his debt securities at the earliest possible opportunity. He was taken to a letter dated 26 March 2003 to Mr and Mrs Hancock from Mr Edwards. In that letter, Mr Edwards had explained that the Secured Discounted Loan Notes 2004 would not carry interest, but that a redemption premium would be paid on the redemption date of 30 April 2004, or an earlier date on which the Note became payable. The bank guarantee would run until 31 May 2004. Mr Edwards went on to say that the notice period for redemption had been reduced from 30 business days to 20 business days and accordingly he advised that, on the assumption (which did not happen) that the restructuring was completed on 26 March 2003, the earliest redemption date would be 31 May 2003.

26. Mr Edwards wrote by email to Mr Hancock on 31 March 2003, referring to "last minute complications". He pointed out a number of commercial problems for Mr Hancock, referring first to the fact that any delay in the restructuring beyond a couple of days meant that Mr and Mrs Hancock "could miss the opportunity to redeem at the end of May". Another point was the issue concerning withdrawal of the redemption notice with respect to the A Loan Notes 2007; as we have described, that withdrawal took place on that day, even though the restructuring had not at that stage been completed.

27. The delay led to a further proposal by Mr Edwards, in an email to Mr Hancock of 9 April 2003, that instead of early redemption of the Secured Discounted Loan Notes 2004 being permitted on 31 May 2003 and 30 November 2003 (with final redemption on 30 April 2004), the terms of the Notes be revised so as to provide for the first possible redemption date to be 30 June 2003. Mr Edwards went on to advise that if Mr and Mrs Hancock should decide not to redeem early, the ultimate redemption date was 30 April 2004, and the bank guarantee would expire on 31 May 2004.

28. In the same email Mr Edwards referred to an issue of Jersey law (Lionheart was a Jersey company) which necessitated the number of holders of the Notes to be

limited to 10. Mr Edwards explained that, if Lionheart were to issue additional notes, this could restrict the marketability of the Notes. However, Mr Edwards did not regard this as a major issue for Mr and Mrs Hancock, "as you intend to redeem your loan notes at the earliest opportunity". But Mr Edwards also said that he was bringing this drafting change to the attention of Mr and Mrs Hancock so that they would have the full picture should they "for any reason … wish to hold the loan notes for a longer time".

29. The changes to the early redemption dates were put forward and accepted by Lionheart. In a letter of 1 May 2003 to Mr and Mrs Hancock, Mr Edwards advised that "assuming that you still wish to redeem the loan notes at the earliest possible date" it was calculated that a redemption notice would have to be posted by 12 May 2003. For this reason it was recognised that the documents would need to be signed as soon as possible.

30. Following the signing of the restructuring documents on 7 May 2003, Mr Edwards wrote to Mr and Mrs Hancock on 13 May 2003 to send them the relevant documents and to confirm that Zeban Nominees Limited had issued notices of redemption in relation to the Secured Discounted Loan Notes 2004 that were held by them, with a redemption date of 30 June 2003.

31. Mr Hancock confirmed that he and Mrs Hancock wished to redeem the Notes at the earliest opportunity, but that they had an element of flexibility in the timing of a redemption in order to seek to achieve the best tax profile. In relation to the Secured Discounted Loan Notes 2004, which carried no interest coupon, but had a redemption premium, Mr Hancock accepted that there was a cash flow issue in that he and Mrs Hancock would be required to pay interest on the borrowings from Barclays, but that this was something they were willing to accept for some considerable time. Although he and Mrs Hancock would benefit from redeeming as soon as possible, they were under no pressure to do so. Their aim was to redeem when it was most cost-effective and financially viable to do so.

32. Our finding in this respect is that, at the date of the restructuring, Mr and Mrs Hancock had a settled intention to redeem the Secured Discounted Loan Notes 2004, and had a settled intention to redeem those Notes with the tax advantage that the restructuring was intended to bring about. It is clear that the ability to give an immediate notice of redemption was a material consideration in the negotiation of the drafting of the restructuring agreement; hence the steps that were taken to move the early redemption dates so as to accommodate a later restructuring whilst maintaining the earliest possible redemption. The correspondence demonstrates that redemption of the Secured Discounted Loan Notes 2004 was at the forefront of the thinking of Mr and Mrs Hancock, and that Mr Edwards was concerned to achieve that objective.

Issue (1) Single or two distinct conversions

33. It is common ground that the Secured Discounted Loan Notes 2004 were QCBs. The disposal of those Notes on their redemption on 30 June 2003 will therefore have been exempt under s 115(1) TCGA unless s 116 applies. If s 116 does apply, the

effect of s 116(10) is that the gain on a deemed disposal at market value of the B Loan Notes 2004 on 7 May 2003 would be brought into charge on the disposal of the Secured Discounted Loan Notes 2004.

34. The application of s 116 turns on the construction of s 116(1)(b). We set out s 116 earlier, but it is worth reminding ourselves of the terms of s 116(1):

> (1) This section shall have effect in any case where a transaction occurs of such a description that, apart from the provisions of this section—
>
> *(a)* sections 127 to 130 would apply by virtue of any provision of Chapter II of this Part; and
>
> *(b)* either the original shares would consist of or include a qualifying corporate bond and the new holding would not, or the original shares would not and the new holding would consist of or include such a bond;
>
> and in paragraph (b) above "the original shares" and "the new holding" have the same meaning as they have for the purposes of sections 127 to 130.

35. The argument of Mr Sherry, for Mr and Mrs Hancock, is essentially that there is a threshold condition for the application of s 116 in s 116(1)(b). Where the "new holding" is, as it is in this case, a QCB, the condition is not satisfied where the "original shares" also include a QCB. The presence of the Revised B Loan Notes 2004 (which are accepted to be QCBs) in the holdings cancelled in exchange for the issue to each of Mr and Mrs Hancock of the Secured Discounted Loan Notes 2004 means that the condition in s 116(1)(b) cannot be satisfied.

36. Mr Vallat submitted that at the time of the restructuring in May 2003 each of Mr and Mrs Hancock had two relevant assets, namely the B Loan Notes 2004 and the Revised B Loan Notes 2004. Those were separate assets for CGT purposes. Accordingly, he argued, the May 2003 restructuring comprised two transactions for each of Mr and Mrs Hancock: the first being the conversion of the B Loan Notes 2004 into Secured Discounted Loan Notes 2004; the second being the conversion of the Revised B Loan Notes 2004 into Secured Discounted Loan Notes 2004. While the second of those transactions would fall outside s 116, because both the "original shares" and the "new asset" would be QCBs, s 116 would apply to the first transaction, as the "original shares" in that respect would not consist of or include a QCB.

37. Going right back to basics, Mr Vallat reminded us that, by virtue of s 1 TCGA, CGT is a tax on the disposal of assets, and that, as Lord Wilberforce said in *Aberdeen Construction Group Limited v Inland Revenue Commissioners* 52 TC 281, at p 297, it is necessary to consider each asset separately in the light of the rules that apply to that asset. Furthermore, as Lord Wilberforce famously said at p 296, "the capital gains tax is a tax upon gains; it is not a tax upon arithmetical differences", and the courts should hesitate before accepting results that are paradoxical and contrary to business sense.

38. In support of an argument that to combine the effects of s 132 TCGA and s 116(1) in order to reach a conclusion that s 116 did not apply would be an odd result, as it would have the effect that a real gain, which was deferred in accordance with the reorganisation provisions, would vanish, in the sense of ceasing to be chargeable because the asset ultimately disposed of was a QCB, exempt under s 115, Mr Vallat referred us to what Hoffman J (as he then was) had said in the High Court in *Westcott (Inspector of Taxes) v Woolcombers Ltd* [1986] STC 182, at p 190d. There, when considering the effect of provisions relating to transfers of assets within a group and the reorganisation rules, Hoffman J made the point that it would be strange if the combination of the two provisions at issue in that case had a result different from the policy of each of the separate provisions.

39. Mr Vallat did not seek to place great weight on *Westcott v Woolcombers*. He put it forward as part of his explanation why the argument that the restructuring comprised two transactions of conversion was to be preferred. His arguments were based on the statutory provisions and the scheme of the legislation, rather than any case law authority.

40. We agree that the cases are of little assistance in this regard. The question with which issue (1) is concerned is one of construction of s 116(1) in the light of the facts of this case.

41. The starting point for s 116 is that the transaction in question must be one that, apart from the application of s 116, would fall within s 127 to s 130 TCGA. There is no dispute that, whether one regards the transaction as a single conversion, or two conversions in respect of each of Mr and Mrs Hancock, that condition is satisfied by virtue of s 132. But the reorganisation provisions set the scene for s 116, which accordingly must be construed in the context of those provisions.

42. That is made clear by s 116(1)(b) itself, which adopts the terms “original shares” and “new holding” from the reorganisation provisions. It is thus to the meaning of those terms in s 126, with the necessary adaptations required to enable conversions of securities to fall within those provisions, that we must look for guidance in the construction of s 116(1).

43. The meaning of “original shares” in s 126 is “shares held before and concerned in the reorganisation”. Adapting this to s 132, it must mean any securities held before and concerned in the conversion of securities. Likewise the meaning of “new holding” in s 126 is the shares or debentures that as a result of the reorganisation represent the original shares (including such, if any, of the original shares as remain). Adapting that provision to the conversion of securities, it means the shares or securities which represent the original securities as a result of the conversion. Mr Vallat argued that the way s 132 was expressed provided a strong pointer to a requirement that, when considering a conversion of securities, one should look at each conversion of each security separately from each other.

44. It is of course the case that certain of the (non-exhaustive) categories of event that are included for s 132 purposes within the meaning of the term “conversion of

securities” are expressed in the singular. But it is not possible, in our view, to conclude from that drafting that each security involved in such an arrangement (to use a neutral term) must be regarded as giving rise to a separate conversion, irrespective of the facts of the case. The drafting is merely descriptive of certain ways in which securities may be converted, and it is not surprising that it adopts the singular form when describing securities with individual characteristics.

45. It is evident that a “reorganisation” of share capital within s 126 is capable of encompassing a case where more than one class of shares is concerned in the reorganisation. Section 130 expressly envisages a new holding comprising more than one class of shares or debentures. Section 127 envisages shares that would not otherwise be treated as a single asset being taken to be a single asset. Any adaptation of s 127 to s 131 required by s 132 would have to encompass a similar result in the case of conversions of securities. In the context of the reorganisations rules, there is therefore, in our view, no bar in principle to a conversion of securities being a single conversion encompassing a conversion of more than one class of security into a different security.

46. Nor in our view does anything in s 116 itself preclude such a result. Mr Vallat argued in this respect that s 116(3) and s 116(4), by using the word “constitute”, also pointed to each security being regarded as concerned in a separate conversion. We agree that there appears to be an unfortunate mismatch between the introductory provisions of s 116(1)(b) on the one hand, and the definitional provisions of s 116(3) and (4) which feed into the operative provisions, including those in s 116(5), s 116(9) and s 116(10). Section 116(1) envisages a situation where either the original shares or the new holding would not consist entirely of a QCB, but would include both a QCB and a non-QCB. Sections 116(3) and (4) apply respectively where the original shares or the new holding would “constitute” the QCB in question. This appears, on its face, to preclude a case where either the original shares or the new holding would merely include a QCB.

47. In our judgment s 116(3) and (4) should be construed so as to apply both where the original shares or the new holding comprised only the QCB, and where the original shares or the new asset merely included a QCB. Only in this way could effect be given to circumstances that s 116(1) makes clear are intended to be governed by s 116. Given the meaning of “original shares” and “new holding” within s 126, as modified for s 132 purposes, the true construction of s 116(3) and (4) is, in our view, to encompass any QCB that, respectively, forms part of the description “original shares” or “new holding”, whether or not there is another asset included within the same description in respect of the same reorganisation or conversion.

48. If Mr Vallat were right in saying that a transaction which resulted in the conversion of two securities, one a QCB and the other not, into a single new security should as a matter of principle be regarded as two separate conversions, it becomes difficult to discern why s 116(1)(b) is couched in terms that recognise the possibility of the “original shares” not being wholly comprised of a QCB or a non-QCB. Mr Vallat sought to meet this conundrum by referring back to the introduction of the exemption for QCBs by s 64 of, and Sch 13 to, the Finance Act 1984. Part II of Sch

13 contained the provisions regarding reorganisations, conversions etc now found in s 116 TCGA, and s 64(7) set out the same conditions for the application of those provisions as are now in s 116(2).

49. Mr Vallat drew our attention to s 64(4) FA 1984, which made provision for a corporate bond (as defined) to be a "qualifying" corporate bond either if it was issued after 13 March 1984 or if it was issued before that date but was acquired after that date otherwise than as a result of an excluded disposal, such as one on which no gain or loss would arise. He submitted that because of these commencement and transitional rules, a single asset constituting corporate bonds issued both on or before and after 13 March 1984 could include both QCBs and non-QCBs, and that was the situation envisaged by s 64(7), and now by s 116(1)(b).

50. If Mr Vallat's submission is right in this respect, it would still mean that a conversion of a single asset comprised of QCBs and non-QCBs by virtue of s 64(4) FA 1984 into a QCB would fall outside both Sch 13 FA 1984 and s 116 TCGA, with the result that a gain on the non-QCB element which would be rolled into the new QCB on conversion would escape tax on the disposal of the new (exempt) QCB. Mr Vallat accepted that would be the case, but argued that this would represent a very narrow class of transaction.

51. In our judgment Parliament cannot have intended to enable gains on non-QCBs to escape taxation even in those limited circumstances. It cannot have reasoned that in every other case there would be separate conversions of securities such that it would only be in those circumstances that the provisions of Sch 13 would not have effect. We do not accept Mr Vallat's argument in this respect. It would have been straightforward for the drafting of s 64(7) to be confined to the circumstances envisaged in s 64(4) if that had been the intention of Parliament. But we do not consider that Parliament could have intended that Sch 13 would not apply even in that case. Our conclusion is that Parliament did not address the question of the scope of s 64(7) so as to confine it in the way suggested by Mr Vallat. It must, accordingly, be construed according to its own terms.

52. Although, in the light of Mr Vallat's argument, we have taken the view that Parliament cannot have intended to allow the non-QCB element of a conversion of securities into QCBs to escape taxation, that in our judgment is the effect of the clear words of s 116(1)(b). Whilst, as we shall describe in more detail later, the approach to be taken is one of purposive construction, that does not mean that we can ignore the clear words, and seek to re-write legislation based on what may be discerned as the true result intended by Parliament. We do not consider that s 116(1)(b) can be construed otherwise that on its own terms; it is the legislative expression of what Parliament enacted as the scope of s 116, and no purposive construction can fill the gap created by the fact that certain circumstances that might be thought to have been intended to be within s 116 fall outside it according to the clear words of s 116(1)(b).

53. That this leaves a loophole in s 116 TCGA is something we have considered in reaching our conclusion in this respect. But we do not consider that the language of s 116(1)(b) admits of an interpretation that can avoid what may be perceived as an

injustice or absurdity (see *Harding v Revenue and Customs Commissioners* [2008] STC 3499, per Lawrence Collins LJ at [51] and the cases there cited). So far as s 116 is concerned, this is, in our judgment, a case like *Revenue and Customs Commissioners v Bank of Ireland Britain Holdings Ltd* [2008] STC 398, at [44], where an anomaly cannot be avoided by any legitimate process of interpretation.

54. The question accordingly resolves itself into considering whether, in the particular circumstances of the case, there has been one conversion, or two or more conversions. In this case, there was a single agreement for the conversion of the B Loan Notes 2004 and the Revised B Loan Notes 2004 held by each of Mr and Mrs Hancock. The consideration for the issue to each of them of the Secured Discounted Loan Notes 2004 was the cancellation of the B Loan Notes 2004 and the Revised B Loan Notes 2004. There was a single issue of the Secured Discounted Loan Notes 2004, with no differentiation of such Notes as between the B Loan Notes 2004 and the Revised B Loan Notes 2004, nor any separate calculation of the numbers of Secured Discounted Loan Notes 2004 to be issued in respect of those securities.

55. In those circumstances we find that there was a single conversion of, on the one hand, the B Loan Notes 2004 and the Revised B Loan Notes 2004 into, on the other hand, the Secured Discounted Loan Notes 2004. For the purpose of s 116(1)(b) TCGA, the "original shares" were the B Loan Notes 2004 and the Revised B Loan Notes 2004, and so the "original shares" included a QCB; the "new holding" consisted of a QCB. Accordingly, neither of the conditions in s 116(1)(b) was met, and s 116 did not apply.

56. We arrive at this conclusion without having regard to an argument that, given the genesis of the B Loan Notes 2004 and the Revised B Loan Notes 2004, which were themselves issued by way of an exchange within the reorganisation provisions, those securities, taken together, must be regarded as a single asset. That issue surfaced during the hearing, and, following objection by Mr Vallat, we directed that Mr and Mrs Hancock should indicate, through Mr Sherry, whether that argument was to be pursued, in which case we would receive written submissions from both parties. In the event, Mr Sherry confirmed that the argument would not be relied upon in these proceedings, but he reserved the position of Mr and Mrs Hancock in this respect if the matter should go further on appeal.

Issue (2) Single composite transaction

57. The submission of Mr Vallat is that, on a purposive construction of the relevant provisions, and taking a realistic view of the facts, the conversion on 5 May 2003 and the redemptions on or about 30 June 2003 should be treated as a single composite transaction. That composite transaction, argues Mr Vallat, was the disposal/redemption (that is how it is described in his skeleton argument) of non-QCBs, and neither a disposal of QCBs within s 115 TCGA nor a conversion within s 132, and should be taxed accordingly.

58. This then is a submission that, on an application of the *Ramsay* principle, the transaction should be regarded as giving rise to a disposal for CGT purposes of the B

Loan Notes 2004 which, as non-QCBs into which a gain on the disposal of shares in Blubeckers Limited had been rolled under the reorganisations provisions, would result in a chargeable gain.

59. The reference to the *Ramsay* principle derives, of course, from the leading case of *W T Ramsay Ltd v IRC, Eilbeck (Inspector of Taxes) v Rawling* [1981] STC 174. That has quite recently been described, by Mummery LJ in *Mayes v Revenue and Customs Commissioners* [2011] STC 1269, at [71], as the "base camp" from which numerous subsequent authorities journey. But, as Mummery LJ said, for practical purposes the *Ramsay* principle can most conveniently be described by reference to the "significant judicial stocktaking" of that principle undertaken by the House of Lords in *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] STC 1 ("*BMBF*").

60. In *BMBF*, Lord Nichols delivered the opinion of the Appellate Committee. Whilst recognising that it was unlikely that any exposition would remove all difficulties in the application of the principles involved because it is in the nature of questions of construction that there will be borderline cases about which people will have different views, the House of Lords sought to "achieve some clarity" about the basic principles.

61. The modern approach to statutory construction is to have regard to the purpose of a particular provision and to interpret its language, so far as possible, in a way which gives best effect to that purpose (*BMBF*, [28], citing Lord Steyn in *IRC v McGuckian* [1997] 1 WLR 991, 999). Having regard in particular to the speech of Lord Wilberforce in *Ramsay*, the House of Lords in *BMBF*, at [32], described the essence of the new approach in the following way:

> "The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found. As Lord Nicholls of Birkenhead said in *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2001] UKHL 6 at [8], [2001] STC 237 at [8], [2003] 1 AC 311:
>
> 'The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case.'"

62. The two steps, first of deciding, on a purposive construction, exactly what transaction will answer to the statutory description and secondly, of deciding whether the transaction in question does so, are separate, and must not be elided. It is going

too far to say that in the application of *any* taxing statute, transactions or elements of transactions which have no commercial purposes are to be disregarded (*BMBF*, at [36]). The House of Lords expressly approved the pithy summary of the relevant question given by Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46, para 35:

> "the driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."

63. The House of Lords cautioned against "sweeping generalisations" such as those about disregarding transactions undertaken for the purpose of tax avoidance, and the distinction between "commercial" and "legal" concepts as had been described by Lord Hoffmann in *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2001] STC 237. The need is to focus carefully upon the particular statutory provision and to identify its requirements before deciding whether circular payments or elements inserted for the purpose of tax avoidance should be disregarded or treated as irrelevant for the purpose of the statute (*BMBF*, [38]). Likewise, although the House of Lords made no specific reference to it, a generalisation seeking to differentiate tax mitigation and unacceptable tax avoidance, such as was described in *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1992] STC 226, in particular by Lord Goff at p 244, in a passage to which Mr Sherry referred us, does not enable the essential two-step process to be sidestepped.

A realistic view of the transaction

64. Mr Vallat's case on the realistic view to be taken of the transaction was straightforward. The step whereby the B Loan Notes 2004 and the Revised Loan Notes 2004 were converted into the Secured Discounted Loan Notes 2004 was inserted solely for tax reasons, and had no commercial purpose. Accordingly, so far as the B Loan Notes 2004 were concerned, the single composite transaction was one of the disposal or redemption of those Notes.

65. Mr Sherry submitted that, although of course the B Loan Notes 2004 were inevitably going to be redeemed, on one of their redemption dates, or on the final date for redemption, the conversion into the Secured Discounted Loan Notes 2004 had taken place at a time when no notice could have been served to redeem the B Loan Notes 2004. The earliest date on which those Notes could have been redeemed was 30 September 2003; the Secured Discounted Loan Notes 2004, by contrast, enabled redemption to be achieved on 30 June 2003. In order to secure such an early repayment, therefore, a different security had to exist. If the conversion had not taken place, it would not have been possible for Mr and Mrs Hancock to have received the redemption proceeds when they did. Neither the Secured Discounted Loan Notes 2004 nor the conversion could be ignored.

66. Mr Sherry argued in addition that the Secured Discounted Loan Notes 2004 had an independent existence, albeit for a relatively short period. Notice of redemption

might have been given only five days after the conversion, but the Secured Discounted Loan Notes 2004 nonetheless were held for seven weeks from 7 May 2003 (date of the conversion) to 30 June 2003 (date of redemption). Those Notes were different from the B Loan Notes 2004; they carried no interest but were redeemable at a premium at a lower equivalent rate than the interest on the B Loan Notes 2004. This was not, argued Mr Sherry, equivalent to a post-dated cheque for the redemption of the B Loan Notes 2004.

67. On the basis of the evidence, we find that, at the time Mr and Mrs Hancock entered into the transaction whereby their B Loan Notes 2004 and Revised B Loan Notes 2004 were converted into the Secured Discounted Loan Notes 2004, they intended to redeem the Secured Discounted Loan Notes 2004 as soon as practicable after the conversion. There was no practical likelihood that such a redemption would not take place, as indeed it did. The earliest redemption date in the Secured Discounted Loan Notes 2004 had been specifically fixed so as to enable such a redemption.

68. However, such a finding does not lead us to conclude that a realistic view of the transaction is that it is somehow a redemption for cash of the B Loan Notes 2004 or the Revised B Loan Notes 2004. This was not a case of a redemption of those Notes being planned and executed by means of the insertion of the intermediate step of conversion into the Secured Discounted Loan Notes 2004. The intention to redeem was in respect of the Secured Discounted Loan Notes 2004 once they had been issued. Whilst it is the case that the proposals for the various conversions arose as a result of an original enquiry by Mr and Mrs Hancock in relation to a redemption of the B Loan Notes 2004, the intention to redeem at the particular time at which redemption took place crystallised only in relation to the Secured Discounted Loan Notes 2004.

69. The fact that the conversion process was intended to give rise to a tax advantage in enabling Mr and Mrs Hancock to make a disposal of a QCB without a charge to tax by virtue of s 116(10) TCGA does not result in the transaction, viewed realistically, being anything other than a redemption of the Secured Discounted Loan Notes 2004. It cannot be regarded as a disposal for cash of the B Loan Notes 2004 (or, though not relevantly, the Revised B Loan Notes 2004).

70. In reaching this conclusion we accept the submission of Mr Sherry that the Secured Discounted Loan Notes 2004, and the conversion of the B Loan Notes 2004 and the Revised B Loan Notes 2004, cannot be disregarded. Although they were held for a short time, and were intended to be redeemed at the earliest opportunity, the Secured Discounted Loan Notes 2004 did have an existence separate from the Notes they replaced. The B Loan Notes 2004 could not have been redeemed until at the earliest 30 September 2003. Any earlier redemption could only be achieved if the conversion had taken place. The emphasis throughout was on the need for an early redemption date to be included in the Secured Discounted Loan Notes 2004. No attempt was made to seek any change to the redemption dates of the B Loan Notes 2004, and it is clear, therefore, that if the conversion had not taken place, the B Loan Notes 2004 could not have been redeemed for cash at the time when the actual redemption took place.

The legislation purposively construed

71. We have already found that, even on a purposive construction, s 116 TCGA cannot apply to the conversion of the B Loan Notes 2004 and the Revised B Loan Notes 2004 into the Secured Discounted Loan Notes 2004. We have also concluded that the transaction is to be regarded as a conversion of the B Loan Notes 2004 and the Revised B Loan Notes 2004 into the Secured Discounted Loan Notes 2004, and a disposal for cash of the latter. This is not, therefore, simply a question of applying s 1 TCGA (the charge to tax on a disposal) to a disposal of the B Loan Notes 2004 for cash.

72. The question, therefore, is whether the conversion falls within s 132 TCGA, and the reorganisation provisions of s 127 to s 131, purposively construed. If it does, then those provisions would have the effect, as regards the B Loan Notes 2004, of rolling over the gain into the Secured Discounted Loan Notes 2004 without there being a disposal of the B Loan Notes 2004. If it does not, then the conversion will be a disposal of the B Loan Notes 2004, with the consequence that a chargeable gain will arise on that disposal.

73. In *Carreras Group Ltd v Stamp Commissioner* [2004] STC 1377, in the Privy Council, the question was whether certain provisions of the Transfer Tax Act (Jamaica), which had been modelled on the UK's reorganisation provisions, applied in a case where, on a transfer of all the issued shares in a company, the purchaser had issued a debenture in exchange, which was non-transferable, carried no interest and was repayable a few days later. The debenture was in fact paid, a matter of days after its specified repayment date. If the Jamaican provisions applied, the transfer of the shares would have been exempt from Jamaican transfer tax.

74. The Privy Council considered the scheme of the taxes in question to which the UK's reorganisation provisions, on the one hand, and Jamaica's transfer tax provisions, on the other, applied. It reasoned that the UK provisions, under which an exchange for a debenture and the redemption of the debenture would be considered separately, created a rational system of taxation. It reached this conclusion on the basis that the debenture would, on the exchange, be deemed to have been acquired for the acquisition cost of the shares, and on disposal of the debenture capital gains tax (or corporation tax) would have been chargeable on the gain.

75. This contrasted with the Jamaican provisions, which concerned a different type of tax. An interpretation according to which an exemption from tax could be obtained by a formal step inserted in the transaction for no purpose other than avoidance of tax would not be a rational system of taxation. The Jamaican legislation, purposively construed, did not therefore apply to the relevant transaction, which was a single transaction comprising both the issue and the redemption of the debenture.

76. The analysis by the Privy Council of the UK reorganisation provisions proceeded on the basis that the gain on an exchange of shares for a debenture would be rolled over into the debenture, and then brought into charge on a disposal of the debenture. That assumed, therefore, that the debenture in question was a non-QCB. In those circumstances, treatment of the exchange of the shares for a debenture and

the redemption of the debenture as separate transactions was accepted as a rational system of taxation. But a case where the debenture is a QCB, so that the application of the reorganisation provisions would result in an exemption, would be analogous to the position under the Jamaican transfer tax, where an exemption would be conferred.

77. According to that analysis alone, it might be concluded that the same result should obtain for Mr and Mrs Hancock's conversion of the B Loan Notes 2004 into the Secured Discounted Loan Notes 2004. As, according to our earlier finding, s 116 TCGA does not apply to that conversion, the effect of the reorganisation provisions would be that the disposal of the Secured Discounted Loan Notes 2004 would be exempt.

78. We do not consider that would be the right approach. By contrast with the Jamaican provisions at issue in *Carreras*, the UK's reorganisation provisions, viewed in their proper context, do not give rise to an irrational system of taxation. It was recognised in 1984, when the rules providing for an exemption from CGT for QCBs were enacted, that without more the application of the reorganisation provisions could result in gains on shares or securities being rolled over into exempt QCBs. The legislative response was to provide, by Part II, Sch 13 FA 1984, and now by s 116 TCGA, that the reorganisation provisions would not apply in the relevant circumstances. That was the way in which the UK legislature proposed to maintain the rational system of taxation.

79. We have found that, in the particular circumstances of this appeal, s 116 does not apply. That is an anomaly, but not one which we consider can be cured by any proper process of interpretation, or purposive construction, of s 116 itself. The question then is whether the effect of s 116 not applying necessitates that the reorganisation provisions, and in particular s 132 TCGA, are purposively construed so as not to have effect in relation to the conversion of the B Loan Notes 2004 into Secured Discounted Loan Notes 2004. For the reasons which follow, we do not consider that it does.

80. As we have described, there can be no doubt that the combination of the reorganisation provisions and s 116 TCGA do, in a normal case of conversion of securities, provide a rational system of tax. Gains on non-QCBs converted into other non-QCBs may be rolled over under the reorganisation provisions into the new non-QCBs, and the disposal of the new non-QCBs will not be exempt. On the other hand, gains on non-QCBs converted into QCBs will be subject to the separate regime under s 116; those gains will be held in abeyance under s 116(10), and will be deemed to accrue on a subsequent disposal of the QCBs. These provisions will operate on this rational basis irrespective of the intention of the parties or the proximity of the conversion to the redemption.

81. The legislative response to the possible use of the reorganisation provisions to exempt gains was to provide a separate regime, under which the reorganisation provisions would not apply and s 116 would. The legislature could have introduced a targeted anti-avoidance provision for reorganisations, including conversions, but it did not do so. By contrast, s 137 TCGA does contain such a provision in respect of

exchanges within s 135 and schemes of reconstruction within s 136. Section 137 disapplies those sections either if the exchange or scheme of reconstruction is not effected for bona fide commercial reasons, or if it forms part of arrangements of which the main purpose, or one of the main purposes, is the avoidance of tax. This anti-avoidance provision is limited to exchanges and reconstructions; it does not apply to other reorganisations, including conversions.

82. Taken in their context, the reorganisation provisions, along with s 116, provide a comprehensive code for the taxation of chargeable gains on reorganisations of securities, conversions, exchanges and reconstructions. Those provisions, taken together, constitute a rational system of taxation of the conversion of securities, which operates as such irrespective of the realistic view that might be taken of the facts. We do not consider that a purposive construction of the reorganisation provisions, including s 132, can produce any different result merely on the basis that the transactions that have been entered into were intended, for tax avoidance reasons, to exploit an anomaly in the application of those rules.

83. That, we consider, is the principled approach. It recognises that the expression "conversion of securities" must be considered in the context of s 116. Although the reorganisation provisions in s 127 to 130 TCGA, are disapplied where s 116 operates, it is a pre-requisite of s 116 that, but for the operation of that section, those provisions would apply. There is thus no basis on which any limited meaning can be given to "conversion of securities" within s 132 merely because s 116 does not apply because the condition in s 116(1)(b) is not satisfied. Furthermore, it is expressly provided, in s 132(3)(a)(ia) that a conversion of a non-QCB into a QCB is a "conversion of securities". The requirements of s 132 are by reference to the legal nature of the transaction and, in common with the discharge of a debt in *MacNiven v Westmoreland Investments Ltd* [2001] STC 237, the conversion of the B Loan Notes 2004 into the Secured Discounted Loan Notes 2004 has the requisite legal effect, whatever the purpose of the transaction might be.

84. It seems to us that the approach of HMRC to this case, and the burden of Mr Vallat's argument, is to do no more than assert that the conversion of the B Loan Notes 2004 and the Revised B Loan Notes 2004 into the Secured Discounted Loan Notes 2004 should simply be disregarded, as it was effected for tax avoidance reasons, and that consequently neither s 132 TCGA (because there has been no conversion), nor s 115 (because there has been no disposal of a QCB) can apply. That, with respect, appears to us to be an attempt to revert to the pre-*BMBF* thinking that transactions or elements of transactions that have no commercial purpose should simply be disregarded, whatever the statutory context. It is an example of the tendency, deprecated by Lord Hoffman in *MacNiven*, at [49], to treat what Lord Brightman had said in *Furniss v Dawson* [1984] STC 153, at p 166, in connection with inserted steps being disregarded for fiscal purposes as a "broad spectrum antibiotic which killed off all tax avoidance schemes, whatever the tax and whatever the statutory provisions."

85. This, in our view, is a case where, notwithstanding the tax avoidance motive of the taxpayers, no statutory construction can impose a charge to tax. The conversion

of the B Loan Notes 2004 and the Revised B Loan Notes 2004 into the Secured Discounted Loan Notes 2004 was a conversion of securities within the proper meaning of s 132 TCGA, and the reorganisation provisions, properly construed, applied so that the conversion was not a disposal of the B Loan Notes 2004 (or the Revised B Loan Notes 2004). There was a disposal of the Secured Discounted Loan Notes 2004, which were QCBs so that the disposal was exempt for CGT purposes.

86. That consequence is, in our view, the consequence of the legislation that Parliament has chosen to enact, and no purposive or other construction can give rise to a different result. It is true that the consequence results from what was no doubt an unintended effect of the way in which s 116(1)(b) is drafted, but that defect cannot simply be cured as a matter of construction, or by simply ignoring transactions. The position is clearly and succinctly put by Lord Hoffman, writing extra-judicially, in an article in the *British Tax Review* [2005] BTR 197 entitled "*Tax Avoidance*" (cited by Proudman J in the High Court in *Mayes* [2010] STC 1):

> ". . . Parliament may not be content to describe the economic event which should attract tax. . . . Instead, it enacts a mass of detailed rules which it is hoped will tie up the taxpayer in a net from which he cannot escape. But sometimes there are holes in the net and the courts find that they cannot plug them by appealing to the economic event which, at a higher level of generality, it appears that Parliament wished to tax. It is one thing to give a 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."

87. In our view the gap in the legislation thrown up by Mr and Mrs Hancock's transactions is not capable of being plugged by a process of purposive construction, nor by applying a broad spectrum antibiotic by means of disregarding any element of those transactions.

Decision

88. Accordingly, for the reasons we have given, we allow Mr and Mrs Hancock's appeals.

Application for permission to appeal

89. 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.

ROGER BERNER
TRIBUNAL JUDGE

RELEASE DATE: 21 July 2014