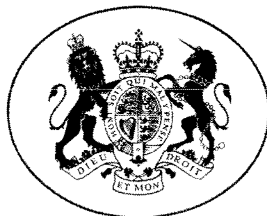


Appeal numbers: FTC/47/2012 &
FTC/50/2012

CGT – s.49 TCGA 1992 – contingent liability – capacity – representation made of a disposal – costs as a contingent liability

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

ON APPEAL FROM THE
FIRST-TIER TRIBUNAL (TAX CHAMBER)

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS
Appellants

v.

SIR ALEXANDER FRASER MORRISON
Respondent

TRIBUNAL: LORD GLENNIE

Sitting in public at George House, 126 George Street, Edinburgh on 9 September 2013

Mr Iain Artis, Advocate, instructed by the Office of the Advocate General for Scotland, for the Appellant (HMRC)

Mr Julian Ghosh QC and Ms Elizabeth Wilson, counsel, instructed by Ernst & Young LLP for the Respondent (Sir Alexander Fraser Morrison)

DECISION

LORD GLENNIE

Introduction

[1] There are two issues in dispute in this appeal from the First-tier Tribunal ("FTT").

[2] The first, in respect of which HMRC are the appellants, is whether a payment of £12 million made by Sir Fraser Morrison ("SFM") to settle an action arising out of representations made or allegedly made by him with respect to Morrison plc ("MPLC") in connection with an offer for the purchase of the company by Anglian Water plc (later renamed AWG Group Limited) ("AWG") was a "contingent liability in respect of a … representation made on a disposal by way of sale of [SFM's shares in MPLC]" within the meaning of section 49(1)(c) of the Taxation of Chargeable Gains Act 1992 ("the Act"), requiring an adjustment to be made in terms of section 49(2) thereof.

[3] The second issue, on which SFM is the appellant, is whether SFM's costs of defending that action (amounting to over £5 million) were themselves also such a contingent liability within the meaning of section 49(1)(c), requiring an adjustment in terms of section 49(2).

[4] The FTT decided the first issue in favour of SFM in principle, though it stopped short of holding that the whole payment of £12 million fell within section 49(1)(c). HMRC appeal against that decision with leave of the FTT. In the course of argument, as foreshadowed in his skeleton argument, SFM submitted that the FTT should have gone further and decided that the whole payment of £12 million fell within the section. Objection was taken to this submission on the ground that SFM had not obtained leave to appeal on this point. On a very narrow view there might be something to be said for this objection, but on balance I consider that, once the FTT granted HMRC leave to appeal on the first issue, it opened up this ancillary point too. Accordingly, I shall consider the point on its merits. Had it been necessary to do so, I would myself have granted leave to argue this point as part of this appeal.

[5] The FTT decided the second issue in favour of HMRC. SFM appeals against that decision with leave of the FTT.

Outline facts

[6] The following facts were among those agreed between the parties in a Statement of Agreed Issues and Facts. I only recite those which appear to me to be of direct relevance to the issues in the appeal.

AWG's acquisition of MPLC

[7] In June 2000 SFM was a major shareholder in, and the chairman and chief executive of, MPLC, a publicly listed company whose shares were traded on the London Stock Exchange. On or about 20 June 2000 AWG expressed an interest in acquiring MPLC. Discussions took place and certain information was made available to AWG by MPLC.

[8] On or about 3 July 2000, as chairman of MPLC, SFM authorised the sending to AWG of MPLC's Five Year Strategic Plan. That Plan included the profit forecast for the year to March 2001 ("the profit forecast"). It is agreed that, in providing the profit forecast, SFM represented to AWG that he had an honest belief in its accuracy.

[9] On 24 August 2000, AWG announced that it would make an offer ("the Offer") to acquire all issued and to-be-issued ordinary shares in MPLC. The Offer was for 385p in cash for each MPLC share. The terms of the Offer permitted MPLC shareholders, in respect of up to 50% of the MPLC shares for which they accepted the Offer, to elect to receive their consideration in the form of AWG shares on the basis of one AWG share for each 630p of cash consideration. As an alternative to the cash consideration to which they would otherwise be entitled, the terms of the Offer allowed accepting MPLC shareholders to receive loan notes issued by AWG on the basis of £1 nominal value of Loan Notes for each £1 of cash consideration.

[10] At the time the Offer was made, SFM and his immediate family and related trusts held over 14 million MPLC shares of which SFM was the beneficial owner of over 8 million MPLC shares. By letter dated 23 August 2000, SFM irrevocably undertook to accept the Offer in respect of his 8 million shares and all shares of which he became the registered or beneficial owner thereafter.

[11] The Offer document provided additional information about MPLC and AWG. In particular it intimated that SFM and other MPLC directors accepted responsibility for the information in the document relating to MPLC's Group, to the directors of MPLC and to members of their immediate families and related trusts, and stated that "to the best of the knowledge and belief of the directors of [MPLC] (who have taken all reasonable care to ensure that such is the case), the information contained in this document for which they take responsibility is in accordance with the facts and does not omit anything likely to affect the import of such information." By a further letter in September 2000, in response to a request from AWG, SFM provided further information and gave an assurance that there were no other matters of which AWG should be aware.

[12] The Offer was declared unconditional on 21 September 2000. AWG acquired MPLC. The price paid by AWG for the whole issued share capital of MPLC was approximately £263.3 million. As a result of accepting the Offer, SFM received consideration for his shares (in the form of a combination of AWG shares and AWG loan notes) with an approximate value of £33.4 million. Subsequently AWG was acquired by awg plc, as a result of which SFM ceased to be a holder of shares in AWG and instead became the holder of an identical number of shares in awg plc. The shares and loan notes were later transferred into a trust ("the 2002 Trust").

Legal proceedings against SFM

[13] In August 2002 solicitors acting on behalf of AWG wrote to SFM informing him that AWG was considering pursuing a claim against him in relation to its acquisition of MPLC. Proceedings were commenced in the High Court of Justice, Chancery Division, London, against SFM and another director. In those proceedings AWG alleged that it had been induced by a number of allegedly false representations and misstatements to offer more for the company than it was worth. It sought damages of £132 million, which was said to be the difference between the price paid by AWG for the whole issued share capital of MPLC (on the basis that the representations made by SFM were true) and the actual value of MPLC at the date of acquisition, plus consequential losses. AWG alleged fraudulent misrepresentation, misrepresentation under the Misrepresentation Act 1967 and/or negligent misrepresentation, negligent misstatement and interference with AWG's business interests. In the same action MPLC sought damages from SFM for breach of fiduciary duty and duties of care owed by him as its director and employee.

[14] Those proceedings were defended. SFM filed a defence denying the claims. He admitted that he had made an implicit representation that he honestly believed that a profit forecast of £30.5 million was substantially achievable overall, assuming reasonable continuity of management and business and accounting practice. He asserted that the assurance given in his letter of 11 September 2000 that there were no other matters of which AWG should be aware was given by him as chairman of MPLC and not in his personal capacity, and that it was not a representation by him about the profit forecast.

The settlement

[15] In February 2006, shortly before the action was due to come on for trial, an agreement was entered into ("the Settlement Agreement") in terms of which AWG and MPLC undertook to release SFM and the other director and each of the persons listed in a Schedule thereto as "the Morrison Interests", including SFM's immediate family and related trusts, from any liability that he or they might have (and whether or not known about at the date thereof). Without accepting liability, SFM was required by clause 2.1 of the Settlement Agreement to pay the sum of £12 million to AWG.

The claim under section 49 of the Act

[16] SFM's disposal of his shares in awg plc and the AWG loan notes to the 2002 Trust gave rise to a Capital Gains Tax liability. In August 2006, accountants acting for SFM wrote to HMRC claiming an adjustment to that liability under section 49 of the Act, that adjustment being required, so they claimed, because the payment of £12 million in settlement of the High Court action was the enforcement of a contingent liability in respect of representations made on the disposal of his shares in MPLC. That claim was refused by HMRC and a closure notice was issued in June 2010. It is from that decision that the appeal was brought to the FTT, giving rise to this further appeal from the FTT to the Upper Tribunal.

Procedure

[17] The hearing before the FTT took place in private pursuant to the order of a Tribunal Judge following an application SFM in terms of Rule 32 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. As I understand it, the Tribunal Judge was concerned to protect commercially sensitive information and to respect the agreement of the parties to the Settlement Agreement that its terms should remain confidential. As a result, the decision of the FTT was issued in an anonymised form, though the parties were provided with a full version. An application was made to me in advance of the hearing before the Upper Tribunal that that hearing too should take place in private, for substantially the same reasons. I refused that application. So far as the protection of sensitive information was concerned, while this is always a concern of any court, it seemed to me to be unrealistic to think that disclosure of allegations about events back in 2000 could give rise to any issues of commercial sensitivity now, some 13 years later. Further, the fact that the parties to the Settlement Agreement had agreed that it should remain confidential cannot be allowed to prevail over the requirement for open justice. The circumstances in which the court will depart from that principle will be many and varied. Obvious examples are in cases involving children, in asylum cases where there is a genuine fear of danger to life, or where measures are required for the protection of genuinely sensitive information. That list is by no means exhaustive. There are a variety of ways (including conducting the hearing in private or anonymising decisions) in which the court will act to safeguard legitimate concerns. However, the court will not depart from the principle of open justice simply to save one or other party from embarrassment. It will certainly not do so simply because parties have entered into a confidentiality agreement between themselves – as has been said in other cases, that is when the court has to be at its most vigilant to ensure openness.

Statutory provisions

[18] The charging provision for Capital Gains Tax under the Act is contained in section 1, which provides, so far as material, as follows:

> "(1) Tax shall be charged in accordance with this Act in respect of capital gains, that is to say chargeable gains computed in accordance with this Act and accruing to a person on the disposal of assets.
>
> ...
>
> (3) ... capital gains tax shall be charged for all years of assessment in accordance with the following provisions of this Act."

Section 15, which is the first section in Part II of the Act, identifies what is meant by a "chargeable gain":

> "(1) The amount of the gains accruing on the disposal of assets shall be computed in accordance with this Part, subject to the other provisions of this Act.
>
> (2) Every gain shall, except as otherwise expressly provided, be a chargeable gain."

Section 16 mirrors this by providing that the amount of a loss accruing on a disposal of an asset is to be computed in the same way as the amount of a gain.

[19] Part II contains a number of provisions relating to the computation of gains. I should refer to section 38, which deals with acquisition and disposal costs. It provides, so far as material, as follows:

> "(1) Except as otherwise expressly provided, the sums allowable as a deduction from the consideration in the computation of the gain accruing to a person on the disposal of an asset shall be restricted to –
>
> > (a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset, together with the incidental costs to him of the acquisition or, if the asset was not acquired by him, any expenditure wholly and exclusively incurred by him in providing the asset,
> >
> > (b) the amount of any expenditure wholly and exclusively incurred on the asset by him or on his behalf for the purpose of enhancing the value of the asset, being expenditure reflected in the state or nature of the asset at the time of the disposal, and any expenditure wholly and exclusively incurred by him in establishing, preserving or defending his title to, or to a right over, the asset.
> >
> > (c) the incidental costs to him of making the disposal.
>
> (2) For the purposes of this section and for the purposes of all other provisions of this Act, the incidental costs to the person making the disposal of the acquisition of the asset or of its disposal shall consist of expenditure wholly and exclusively incurred by him for the purposes of the acquisition or, as the case may be, the disposal, being fees, commission or remuneration paid for the professional services of any surveyor or valuer, or auctioneer, or accountant, or agent or legal adviser and costs of transfer or conveyance ..."

[20] The sections of the Act directly relevant to this appeal are sections 48 and 49. They provide, so far as material, as follows:

> "48 Consideration due after time of disposal
>
> (1) In the computation of the gain consideration for the disposal shall be brought into account without any discount for postponement of the right to

receive any part of it and, in the first instance, without regard to a risk of any part of the consideration being irrecoverable or to the right to receive any part of the consideration being contingent; and if any part of the consideration so brought into account subsequently proves to be irrecoverable, there shall be made, on a claim being made to that effect, such adjustment, whether by way of discharge or repayment of tax or otherwise, as is required in consequence.

...

49 Contingent liabilities

(1) In the first instance no allowance shall be made in the computation of the gain –

(a) in the case of a disposal by way of assigning a lease of land or other property, for any liability remaining with, or assumed by, the person making the disposal by way of assigning the lease which is contingent on a default in respect of liabilities thereby subsequently assumed by the assignee under the terms and conditions of the lease,

(b) for any contingent liability of the person making the disposal in respect of any covenant for quiet enjoyment or other obligation assumed as vendor of land, or of any estate or interest in land, or as a lessor,

(c) for any contingent liability in respect of a warranty or representation made on a disposal by way of sale or lease of any property other than land.

(2) if any such contingent liability subsequently becomes enforceable and is being or has been enforced, there shall be made, on a claim being made to that effect, such adjustment, whether by way of discharge or repayment of tax or otherwise, as is required in consequence. ..."

At one stage SFM sought to advance an argument relying on section 48(1). In face of opposition from HMRC that was not pursued. Accordingly, the argument on this appeal remains focused on sections 49(1)(c) and 49(2).

The hearing before the FTT and the FTT's decision

[21] Before the FTT the parties proceeded on the basis of the Statement of Agreed Issues and Facts to which I have referred. No evidence was called by either party. However, the FTT was referred both to the Settlement Agreement and to the very extensive pleadings in the English High Court litigation. It was agreed that those pleadings could be taken into account by the FTT to help it understand the Settlement Agreement. However, the FTT noted (at paragraph 36) that there was no judicial determination of liability in that action. It considered that the evidential value of the

pleadings, in an action which did not progress and would have depended on oral evidence in a matter which was subject to English Private Law, was limited. The approach which it took was summarised as follows:

> "This Tribunal cannot make findings in fact about the various assertions and counter assertions in the Pleadings, not least since, in the main, they were denied and not put to proof as the matter did not proceed to a Hearing. What the Tribunal can do, having due regard to the Tribunal Procedure Rules and in particular Rule 2, and at the request of both Counsel did do, is to note the salient issues in the Pleadings to which they were directed by both Counsel and on which both had the opportunity to comment. The Tribunal accepted the argument advanced for HMRC that, in noting the Pleadings, firstly, it should be assumed that both parties knew what they were doing and had carefully considered the whole position when framing their cases in this very substantial litigation; secondly, that therefore SFM's case had been accurately pled by his advisors and that lastly, the pleadings, whether they would ever have been proven or not, speak to the positions that SFM (and AWG) took in regard to the matters which led to the Settlement Agreement. For the avoidance of doubt, wherever reference in this decision is made to the Pleadings, it is unequivocally accepted that the matters referred to have not been tested in Court."

[22] It is necessary to note paragraphs 7 and 8 of the FTT's decision. They record agreement between the parties in the following terms:

> "7. It is common ground that, if the payment and costs are to be treated as contingent liabilities within section 49(1)(c) TCGA, then ESC D52 will apply.
>
> 8. It is common ground that, if the settlement payment and costs are to be treated as contingent liabilities within section 49(1)(c) TCGA, they were enforced by AWG's action and its settlement."

At paragraphs 43 and 44 of its decision, the FTT noted the impact of those matters of agreement set out in paragraphs 7 and 8. These are of some importance and I quote those two paragraphs (omitting references therein to other paragraphs of the decision):

> "43. ... As far as paragraph 7 is concerned, it is common ground between the parties that the 'disposal' to be considered in the context of the relevant legislation is the share for the share exchange on 21 September 2000 and in respect of which SFM made the alleged representation. A share for share exchange is not a disposal for CGT purposes. The relevant disposal for CGT was on 29 July 2002 when the shares were transferred into the 2002 Trust. The impact of the application of ESC D52 is that HMRC accept that if a payment falls within section 49 in respect of a share for share exchange then the application of the section will be extended to the shares involved in the disposal in 2002 which gave rise to the CGT exposure.
>
> 44. As far as paragraph 8 is concerned, the impact is that the Tribunal need not consider the application of section 49(2) since if the Tribunal finds in the appellant's [i.e. SFM's] favour in respect of issues 1 and/or 2, then it follows

that the sum or sums involved would be deductible in the computation of the capital gain."

[23] The point made in paragraph 43 is important and is the basis on which, subject to the determination of the issues for decision in this appeal, SFM can claim to use a contingent liability in respect of a representation made on the sale of the MPLC shares to AWG to reduce his Capital Gains Tax liability incurred on the transfer of his awg plc shares and AWG loan notes into the 2002 Trust.

[24] Issues 1 and 2 referred to in paragraph 44 of the FTT's decision were the same as the first and second issues identified in paragraphs [2] and [3] of this judgment, namely whether (1) the settlement payment of £12 million and (2) the costs of the High Court action were to be treated as contingent liabilities within section 49(1)(c) of the Act. Since it was a matter of agreement that, if they were contingent liabilities, they were enforced by AWG's High Court action and its settlement, then it follows that the payment of £12 million was a payment in respect of the contingent liability. The only live question, therefore, is whether any representation or representations in respect of which the contingent liability arose (including the Profit Forecast representation) were representations made by SFM "on a disposal by way of sale or lease of" shares in MPLC. There is no further question to be answered under section 49(2).

[25] The FTT dealt with the first issue in this way. It first considered whether there was a "representation" made by SFM on the disposal of the shares in MPLC so as, potentially, to give rise to a contingent liability; and, if so, in what capacity that representation was made. Having recited the respective contentions on this issue, the FTT found first (at paragraph 49) that SFM did make a representation (the "Profit Forecast representation") and did so in his capacity as director of MPLC, albeit as a matter of fact he was also a minority shareholder in MPLC. It went on, second, to find (at paragraph 53) that, for the purposes of section 49(1)(c) of the Act, although SFM made the representation *qua* director and not *qua* seller, he nonetheless made that representation on the disposal of the shares. The FTT then, third, addressed the question of contingent liability and, having considered the definition of a contingent liability in the speech of Lord Guest in *Winter* v. *IRC* [1963] AC 235 at 262, found (at paragraph 54) that the representation gave rise to a contingent liability, since any liability thereon depended both upon how the company actually traded and upon AWG raising an action. These three conclusions were summarised in paragraph 55 where the FTT said this:

> "It is clear from the Pleadings [in the High Court action] that there had been reliance on the Representation (and the other alleged representations) and that the litigation was founded *inter alia* thereon. It is beyond doubt that there was litigation in regard thereto. The Tribunal therefore finds that as far as section 49 is concerned:
>
> (a) ... the Profit Forecast was a representation;
>
> (b) it was made on the disposal of the shares; and
>
> (c) there was a contingent liability in respect of that representation."

Accordingly, the FTT found that, in principle, SFM was entitled to the benefit of the adjustment referred to in section 49(1)(c) and 49(2).

[26] The fourth and final question addressed by the FTT concerned quantum: what did that contingent liability amount to? Was it the whole of the £12 million paid under the Settlement Agreement or only a part, possibly only a very small part, of it? The argument for HMRC was that since the Settlement Agreement not only released SFM but also the other director and the Morrison Interests, and since it settled not only the claims by AWG (based on a number of representations, not just that relating to Profit Forecast) but also claims brought by MPLC for breach of fiduciary duty as director, the amount paid thereunder could not all be attributable to the Profit Forecast representation. Separately, HMRC also argued that even if the settlement was to be regarded as the realisation of a contingent liability within section 49(1)(c) of the Act, it should be apportioned in the same proportion as SFM's shares bore to the whole of the shareholding formerly owned by SFM, the other director and the Morrison Interests, since by the terms of the Settlement Agreement the £12 million was paid for the release of all of them from any actual or potential liability. The argument for SFM was that the whole of the £12 million should be brought into account because there was only one admitted representation, namely the Profit Forecast representation, on the basis of which AWG had sued for £132 million. Even if there was no admission of liability, and even if the £12 million settlement could be regarded as a "nuisance value" settlement to dispose of public, expensive and time consuming litigation, nevertheless the settlement would still be "in respect" of the representation in terms of that subsection of the Act.

[27] The FTT found this question difficult. There was no court decision on the issues raised in the High Court litigation, nor was there any evidence as to how the settlement had been arrived at. Parties were agreed that in those circumstances it was not for the FTT to make findings of fact about the underlying litigation. It appears that the FTT was not prepared to find that the whole £12 million was attributable to the contingent liability on the Profit Forecast representation. Accordingly, it restricted itself to a finding in principle that the provisions of section 49(1)(c) were satisfied but that quantum could not be assessed. It left it to the parties to endeavour to reach some agreement on quantum.

[28] The FTT dealt with the second issue (relating to costs in the High Court litigation) more briefly. The starting point, with which both parties agreed, was that SFM had been sued in relation to the Profit Forecast representation, amongst other things, and had incurred legal expenses in connection with defending that action. The FTT was invited to come to a decision on the principles involved and then, if appropriate (i.e. depending upon that decision), remit the matter to the parties to discuss what legal costs were in fact attributable to the relevant claim or claims. The FTT noted that there was no appeal against the decision (taken by HMRC) that, since they were not "wholly and exclusively" incurred in relation to the disposal of the shares, the legal costs were not allowable as a deduction in terms of section 38. It went on to reject SFM's argument that the costs were "incidental to the contingent liability". After referring to the fact that this was an "extremely expensive litigation" and that "legal costs in excess of those now being sought by SFM have already been met under the insurance policy" (the relevance of which remarks both parties before me were at a loss to understand) it concluded that there was "not a close enough nexus

between the legal costs incurred and the contingent liability to allow any costs to form part of a contingent liability within the meaning of section 49". The appeal therefore failed on this issue.

Submissions

The first issue – the £12 million paid under the Settlement Agreement

[29] The submissions before me were broadly similar to those advanced before the FTT. For HMRC, Mr Artis submitted that sections 48 and 49 were to do with timing. In terms of section 48, tax was due in the first instance on the whole consideration, even if payment of part of that consideration was deferred. In the event that the deferred consideration was (for some relevant reason) not paid, an adjustment would be made to the amount of tax paid or to be paid. Similarly, in terms of section 49, tax was due in the first instance on the whole consideration, and an adjustment was to be made to the tax thereafter if, in the event, a contingent liability led to part of the consideration being repaid. Further, section 49(1) was carefully drafted so as to deal with three specific types of contingency only. Those were set out in sub-paragraphs (a), (b) and (c). Any other form of contingent liability, if relevant to the computation of the chargeable gain, had to be taken into account as part of valuing the consideration for the disposal. This showed that section 49 was not a complete scheme for dealing with contingent liabilities. It was not to be assumed that Parliament intended that section to cover all such liabilities; there might be contingent liabilities which did not fall within it. It was not necessary, therefore, to construe sub-paragraph (c) of that section with any particular presumption in mind. Section 49(1)(c) was concerned with a case where the seller of goods, who received the consideration for the disposal of the goods, had to pay out on a contingent liability arising from a representation made or warranty given by him in the course of selling the goods. Clearly the intent was that the contingent liability would arise out of a representation made by the seller in the period leading up to the sale, or a warranty given by him in the sale contract. That contingent liability could properly be set against the consideration received for the disposal of the goods. However, in the present case the payment under the Settlement Agreement, at its highest for the taxpayer, was a payment made to settle a contingent liability arising out of a representation made not by SFM *qua* seller but by SFM as chairman of MPLC who, it so happened, was also a seller of some of the shares in it. Section 49(1)(c) required the seller of the goods to be the person liable on the representation, and for him to be so liable in that same capacity (i.e. as seller of the goods and not as chairman of the company). It followed that sub-paragraph (c) did not entitle SFM to an adjustment of the tax paid by him on the price received by him for his shares, since any liability was not a liability incurred in his capacity as seller but was simply a liability incurred by him when acting in his role as chairman of the company in its dealings with AWG.

[30] In addition, Mr Artis pointed out that the High Court litigation had in fact included a number of claims on different representations, including claims against SFM by MPLC (for breach of fiduciary duty), and the Settlement Agreement had released not only SFM but also another director and SFM's various family interests. In those circumstances, Mr Artis submitted, it was difficult to link the settlement to

the particular representation that SFM honestly believed in the accuracy of the profit forecast.

[31] For the taxpayer, Mr Ghosh submitted that "capacity" was irrelevant. The tax was payable on a chargeable gain in whatever capacity that gain was made. Nor did the language of section 49(1)(c) of the Act provide any justification for introducing the concept of "capacity". Sections 48 and 49 had to be read together, as part of a single scheme to reduce a chargeable gain in the event of certain contingent liabilities occurring. "Capacity" had nothing to do with the relief under section 49(1)(c). That could be seen by a comparison with sub-paragraphs (a) and (b). Sub-paragraph (a) was very precise in referring to a liability remaining with or assumed by "the person making the disposal by way of assigning the lease" contingent on a default by the assignee under the terms of the lease. Section 49(1)(b) was equally precise in referring to a contingent liability of "the person making the disposal" in respect of any covenant for quiet enjoyment or other obligation "assumed as vendor law of land ... or as a lessor". Both of those sub-paragraphs were concerned to identify the person on whom the contingent liability rested, the source of that liability and the capacity in which it attached to him. By contrast, section 49(1)(c) referred to "any contingent liability in respect of a warranty or representation made on a disposal by way of sale or lease...". It did not in terms place a limit on the category of persons who might be subject to that liability, though to make sense of the section it would have to be the person receiving the consideration for the disposal. More importantly, the use of the passive tense ("... in respect of a warranty or representation made on a disposal ...") was designed to avoid the need to identify the person who made the warranty or representation or any capacity in which he did so. It did not, for example, say (as might have been expected in light of the drafting on sub-paragraphs (a) and (b): "... in respect of a warranty or representation made by the person making the disposal". There was no need to read subparagraph (c) as though that had been written in.

[32] In the present case there was a contingent liability, which arose in respect of a representation made by SFM as to his honest belief in the profit forecast. That contingent liability was in respect of a representation made on a disposal of shares in MPLC. The representation as to SFM's belief in the truthfulness of the profit forecast was a matter of admission – it was the only representation admitted by SFM. Although the falsity of the representation was denied, and there were no admissions as to liability at all, as a matter of common sense the settlement of the action was a settlement of the contingent liability in respect of that representation. However, it did not matter if one were to look at all the various representations alleged and relied on by AWG in their action in the High Court, since all of them were representations made on a disposal by way of sale of the shares. Although the Settlement Agreement disposed of all claims raised by AWG and MPLC against SFM and others, in reality it was a settlement of the action against SFM on the representation or representations made by him on the sale of the shares. That was enough to bring the case within section 49(1)(c).

[33] That "textual" submission reflected the reality of the situation. The fact was that SFM had made a representation on the disposal of the shares and incurred a liability in respect of that representation. As a result, the proceeds to him of his disposal of his shares were less than it expected. The transaction left him £12 million worse off than he would otherwise have been; or, to put it another way, better off by

£12 million less than he would have been. Accordingly, it made good business and fiscal sense that he should be entitled to bring this "loss" into account so as to reduce the chargeable gain and, in consequence, his liability to capital gains tax on that gain.

Discussion

[34] The scheme of the statutory provisions is not in dispute. By section 1 of the Act, tax is charged in respect of capital gains. That is explained ("that is to say") as meaning "chargeable gains computed in accordance with this Act and accruing to a person on the disposal of assets". Section 2(1) provides that capital gains tax shall be charged on the total amount of chargeable gains accruing to a person in a particular year of assessment after deducting "allowable losses". Section 15, which is at the beginning of Part II of the Act, provides that, subject to other provisions of the Act, the amount of the gains accruing on the disposal of assets "shall be computed in accordance with this Part". So, too, the amount of a loss accruing on the disposal of an asset: see section 16. Mr Artis submitted that these provisions indicated that the computation mechanism is an intrinsic part of the charge to tax. That seems to me to be correct.

[35] However it does not follow from that that the approach to construction must be purely mechanistic. The oft-cited words of Lord Wilberforce in *Aberdeen Construction Group* v. *Inland Revenue* 1978 SC (HL) 72, 78-9, remain as apposite today as they did when capital gains tax was relatively new:

> "The capital gains tax is of comparatively recent origin. The legislation imposing it, mainly the Finance Act 1965, is necessarily complicated, and the detailed provisions, as they affect this or any other case, must of course be looked at with care. But a guiding principle must underlie any interpretation of the Act namely, that its purpose is to tax capital gains and to make allowance for capital losses, each of which ought to be arrived at upon normal business principles. No doubt anomalies may occur but in straightforward situations such as this, the courts should hesitate before accepting results which are paradoxical and contrary to business sense. To paraphrase a famous cliché, the capital gains tax is a tax upon gains: it is not a tax upon arithmetical differences."

These remarks point against a purely textual approach to construction of the statute where such an approach produces a result which is contrary to business sense. What is a capital gain and what is an allowable loss ought to be arrived at "upon normal business principles", so far as is consistent with the words in the statute. Lightman J made the same point in *Spectros International plc* v. *Madden (Inspector of Taxes)* [1997] STC 114, 136h-j, in the first of three principles which he took from the speeches of Lord Wilberforce and Lord Fraser in *Aberdeen Construction Group*.

[36] Sections 48 and 49 of the Act are to be found within Chapter III of Part II, under the heading "Miscellaneous Provisions". They are both part of the mechanism for computing gains. Both cover the case of contingencies. Mr Ghosh submitted that the circumstances covered by the two sections overlapped, and that where they did so

section 49 trumped section 48. I do not think that that is right, though in the event nothing much turns on it. It seems to me that the two sections cover different situations. Section 48 applies to a case where there is an agreed consideration for the disposal but, by agreement, payment of some or all of that consideration is to be made after the disposal has taken place. In those circumstances, the risk that some or all of the payments to be paid at a later date may not in fact be paid (whether due to its being contingent or because of other matters arising which may make further payment irrecoverable) is disregarded in the first instance; the full consideration for the disposal is brought into account "without regard to a risk of any part of the consideration being irrecoverable". However, if the consideration or part of it subsequently proves to be irrecoverable, then an adjustment requires to be made, whether by way of discharge or repayment of tax or otherwise. Section 49, by contrast, deals with the case where the whole consideration is paid at the time of disposal but where the person making the disposal is under some contingent liability which subsequently becomes enforceable against him. In those circumstances, the risk of the contingency (in this case the contingent liability in respect of the warranty or representation) becoming enforceable is disregarded in the first instance, with the result that no allowance is made for that risk in the initial computation of the gain. The full nominal consideration for the disposal is brought into account; but if the contingent liability subsequently becomes enforceable and is enforced, then an adjustment is made by way of discharge or repayment of tax or otherwise as may be necessary.

[37] Absent some such provisions, it would be necessary in each case to take the contingency into account in establishing the amount of the consideration received by the taxpayer, so as to arrive at a value for the consideration which truly reflects the contingency to which it is subject. As Walton J recognised in *Randall* v. *Plum (Inspector of Taxes)* [1975] 1 WLR 633, 637H, such an approach is complex, if it is achievable at all, and does not do ideal justice

> "... because obviously the valuation of the contingency must lie between the extremes of its happening and its not happening, whereas finally it will either happen or not happen".

Sections 48 and 49, by providing in each case that the whole consideration is in the first instance assessed to tax, and that the contingencies are dealt with, if they arise, by later adjustment, provides a nearer approximation to the just result.

[38] However, it should be noted that section 49 is carefully drafted to deal with only three specific types of contingency. Any other form of contingent liability, if it is relevant to the computation of the chargeable gain, will have to be dealt with in the manner described in *Randall.*

[39] On the strength of that last point, Mr Artis submitted that sections 48 and 49 did not provide a complete scheme for dealing with contingent liabilities. Not only was there the possibility of some contingent liability which was not within the defined categories set out in section 49 (as in *Randall*), but the case of an uncertain future consideration was not covered either (see *Revenue and Customs Commissioners* v. *Collins* [2009] STC 1077 at para.5). That may be right, but it does not mean (as I understood him to submit) that in construing those detailed provisions one should not

have regard to the whole scheme (such as it is) of those two sections. They provide the context in which any particular part must be understood.

[40] Before the FTT, and in argument before me, the real focus of the dispute was as to whether, for the purpose of section 49(1)(c), the warranty or representation in respect of which the contingent liability arose had to be made by the person disposing of the property in his capacity as the person making the disposal. This was referred to, for short, as the "capacity" argument, though it is important not to allow that label to suggest a more formalistic submission than was advanced.

[41] Mr Artis's argument relating to "capacity" was a simple one. He submitted that what section 49(1)(c) was getting at was a case where a seller of goods – it is useful to remind oneself that the sub-section is not limited to or even primarily focused on the disposal of shares – makes a representation or gives a warranty in the course of that sale, for example as to the condition of the goods or perhaps as to title, on the strength of which he secures a favourable price. Such a representation or warranty gives rise to a contingent liability upon which the seller might or might not be sued. In the event that he is subsequently sued, the amount of his liability (if any) is set against the price received by him for the goods, the chargeable gain is reduced and an adjustment to the tax liability is made in terms of section 49(2). The key element of this, according to Mr Artis, is that it is the seller who makes the representation affecting the price which he obtains for the goods; and who is liable *qua* seller if the representation or warranty turns out to be false. In those circumstances, his liability incurred in the course of selling his goods can properly be set against the price which he has received for them, with a consequent reduction of the chargeable gain; and it is appropriate that an adjustment be made to the tax paid or to be paid to reflect the fact that because of that the transaction has proved less profitable than originally anticipated. In the present case, by contrast, it was not in dispute that any representation made by SFM in the course of the acquisition by AWG of MPLC was made by him as chairman of MPLC and not in his role (or "capacity") as seller of his parcel of shares. He made no representation about his own particular shares. He would have made the same profit forecast representation as chairman of the company even if he had not owned any shares. His liability on that representation, therefore, was not a liability incurred as seller of his shares. The liability was not of the same character as the price which he received for his shares. It was a liability which reflected the fact that AWG, so it alleged, had been induced to pay more than it ought to have paid for the totality of the shares in MPLC, including (as it happened) the shares owned by SFM. That liability did not in any ordinary business sense go to reduce the price obtained by SFM for his shares. He still received the offer price, as did every other shareholder.

[42] Mr Artis accepted that it might conceivably have been possible for the deal to have been structured so that any liability for misrepresentation or misstatement (whether negligent or fraudulent) was reflected by a downward adjustment of the price payable to SFM for his shares. If so, the case might have fallen within section 49(1)(c). But, he said, it was not structured in that way, and that was the end of it. He referred me to a number of cases in which it was recognised that the way the deal was structured was of importance and could be decisive. (Before turning to consider those cases, I should say that, for my part, I am not at all sure that it would have been possible in such a transaction legitimately to structure the deal in such a manner that

some shareholders were paid a higher price than others, but I put that doubt to one side for present purposes.)

[43] In *Spectros International* v. *Madden*, at pp.135j-136e, Lightman J said this:

> "The same rules apply for computing the corporation tax payable by companies on chargeable gains as for calculating capital gains tax payable by individuals .... In calculating the chargeable gain arising on the taxpayer company's disposal of the shares, the starting point is to find the consideration for the disposal: ...
>
> What is the relevant consideration may depend upon the terms and form of the transaction adopted by the parties. The parties to a proposed transaction frequently can achieve the same practical and economic result by different methods. ... The law respects the freedom of the parties to a transaction to frame and formulate their agreement as they wish and to suit their own legitimate interests (taxation and otherwise) and, so long as the form adopted is genuine, and not a sham, honest, and not a fraud on someone else, and does not contravene some established principle of public policy, the court will give effect to the method adopted. But as a corollary to this freedom, where the parties have chosen one method, it is not open to them to invite the court to treat as adopted some other method because it is more advantageous to them, because it leads to the same practical and economic result and because it is the more obvious and sensible method to have adopted. If the question is raised what method has been adopted and the transaction is in writing, the answer must be found in the true construction of the document or documents read in the light of all the relevant circumstances. If the terms of the documents are clear, that is the end of the question. If however there is any doubt or ambiguity upon the language used read in its proper context, it may be possible to resolve that doubt or ambiguity by reference to the inherent probabilities of businessmen entering into the transaction in one form rather than another."

Lightman J took the relevant principles from the speeches in *Aberdeen Construction Group* and other cases.

[44] Henderson J followed this approach in *Revenue and Customs Commissioners* v. *Collins*, at paragraphs [26]-[29]. That was a case of a share sale agreement in terms of which the taxpayer and other shareholders agreed to sell all the shares in a company to the purchaser. The terms of the agreement provided *inter alia* that on completion the purchaser would, on account of the consideration for the shares, pay £15,000 to the taxpayer and £95,179 to the company at the direction of the taxpayer, and would also procure that the company would make a pension contribution on behalf of the taxpayer of £120,000 to a scheme or policy designated by the taxpayer. There was also an agreement for deferred consideration of part of the purchase price. In his tax return the taxpayer declared the sale of his shareholding but did not include the sum of £95,179 as part of the disposal proceeds. One of the issues in the case was whether he should have done. Henderson J had no difficulty in concluding that the £95,179 formed part of the consideration for the disposal of the shares. Having set out the "guiding principles" to which I have referred, he said this (at paragraph [29]):

> "In the light of these guiding principles, there can in my judgment be no doubt about the answer to the question whether the £95,179 formed part of the consideration for the disposal of Mr Collins' shares. The answer has to be found in the true construction of the Share Sale Agreement, read in the light of the relevant surrounding circumstances. The terms of the agreement are clear and unambiguous. The £95,179 was part of the consideration payable on completion for Mr Collins' shares. That is what para 3.1 of Sch 2 expressly provided. The fact that the sum was not payable to Mr Collins himself, but to the Company at his direction, is irrelevant. The sum still formed part of the consideration agreed between the parties for the sale of his shares. It is equally irrelevant that the agreement went on to specify what the Company was to do with the payment. If I dispose of an asset on terms that the purchase price is to be paid, at my direction, to a third party, and then applied by the third party in a specified way for my benefit, none of that alters the fact that the agreed purchase price is the consideration for my disposal of the asset."

[45] Mr Artis deployed this approach in two different ways. First, as already set out, he argued that in this case the share sale agreement was structured in a way which did not allow the potential liability for this misrepresentation (or negligent misstatement) to be set off against the consideration payable for the shares. That seems to me to be correct. Indeed, I did not understand Mr Ghosh to demur from it.

[46] Secondly, and this is an entirely different point, he submitted that the structure of the Settlement Agreement did not allow SFM to say that the payment of £12 million was as a result of the enforcement of a contingent liability in respect of the profit forecast representation (or indeed any representation). In terms of the Settlement Agreement, the £12 million was paid on the basis that no liability was accepted by SFM. There was an admission that SFM had impliedly made the representation as to the truth of the profit forecast, but breach of that implied representation was denied. It was not admitted that any other representations had been made. The £12 million was paid in return for AWG giving up <u>all</u> its claims for reparation, claims which arose out of statements allegedly made by SFM as chairman and which were wholly unrelated to the fact that SFM was a shareholder in MPLC. In addition AWG gave up its claims against others, including but not limited to the Morrison Interests; and MPLC gave up its claims against SFM for breach of fiduciary duty. The Settlement Agreement settled a large number of claims and lacked anything which might show any causal link to the sale by SFM of his shares in MPLC (as opposed to the acquisition by AWG of the whole shareholding in the company).

[47] I have two responses to this latter argument. First, it is not clear to me how this argument sits with the agreement between the parties recorded in paragraph 8 of the FTT's decision to which I have referred in paragraphs [22]-[24] above. It was a matter of agreement that, if the liabilities in respect of the false representation(s) were contingent liabilities within the meaning of section 49(1)(c), they were "enforced" by AWG's High Court action and its settlement. On that basis, the only live question is whether the representation(s) in respect of which the contingent liability arose were representations giving rise to contingent liabilities within that section. Secondly, and this is perhaps part of the same point, it seems to me that this argument, focusing on the terms of the Settlement Agreement, really amounts to just another way of putting the "capacity" argument, since it depends for its force on pointing out that the claims

against SFM were all on the basis of a global liability arising from his representations as chairman of the company rather than as seller of a sizeable parcel of shares. Indeed, I understood Mr Artis to recognise this. His purpose of putting it forward was, as I understood it, to emphasise the point that SFM was not sued in the High Court in London in his personal capacity as seller of his own shares but in his capacity as chairman of MPLC, unrelated to the fact that he was a shareholder.

[48] In *Goodbrand (Inspector of Taxes)* v. *Loffland Bros North Sea Inc* [1998] STC 930 the question, as stated by Millett LJ at p.932c, was: "how should the consideration for a disposal be calculated for the purpose of corporation tax on chargeable gains when the consideration is payable in foreign currency by instalments over several years during which the rate of exchange has been subject to considerable fluctuation?" The taxpayer had purchased four drilling rigs at a total cost of US $44 million and subsequently leased them under a rental purchase agreement to Chevron. The purchase element of the rental payments made by Chevron amounted to US $38.6 million, which was received in full in monthly instalments over a period of nine years. For the purpose of capital gains tax, the rental purchase agreement constituted an entire disposal of the rigs by the taxpayer company as at 1 January 1985. Under section 40 (2) of the Capital Gains Tax Act 1979 (the equivalent of section 48 here) the whole of the consideration for the disposal (US $38.6 million) required to be brought into account without any discount for the postponement of the right to receive some parts of it. For the purposes of capital gains tax, foreign currency is not regarded as "money" but as "money's worth". Accordingly, both the acquisition costs of the rigs and the disposal consideration had to be translated into sterling at the spot rates of exchange prevailing at the relevant dates. At the date of disposal the dollar rate was just under $1.16 to the pound. On that basis, the sterling value of the disposal consideration was £33.3 million. After deducting the acquisition cost and taking into account indexation allowance that would have produced a chargeable gain of £6.7 million. However, over the nine-year period during which the instalments were received, the rate of exchange between the pound and the dollar fluctuated between $1.06 and $1.98 to the pound. Applying the spot rate month by month to the purchase element of the dollar payments actually received by the taxpayer, the sterling value of the total amount received was only £23.8 million, some £9.5 million less than the amount brought into account in the original computation. The taxpayer argued, and the Special Commissioners held, that that difference of £9.5 million had become "irrecoverable" within the meaning of section 40(2) of the 1979 Act (now section 48). The Court of Appeal found this analysis to be flawed. It was not the case that the taxpayer expected to receive £33.3 million but only received £23.8 million. It expected to receive <u>and did receive</u> a certain number of dollars. It expected those dollars to be worth £33.3 million but in fact they were worth only £23.8 million. The taxpayer in fact received exactly the same number of dollars as it expected to receive. Nothing had changed. It received the whole consideration; no part of the consideration was irrecoverable. The fact that the taxpayer might, on one view, have suffered a loss by reason of the fluctuation of the exchange rate was irrelevant to that question. The court emphasised that in reaching this conclusion it was applying the tax legislation in accordance with commercial reality and business common sense.

[49] Mr Artis sought to apply that reasoning here. The taxpayer, SFM, had received everything for his shares that he had contracted to receive. He had received the whole consideration. The fact that he was subsequently sued in respect of

representations allegedly made by him in his role as chairman of MPLC, and settled those claims, is neither here nor there. It did not detract from the fact that he had still received, and had kept, the whole of the consideration for the disposal of his shares.

[50] In *Garner (Inspector of Taxes)* v. *Pounds Shipowners and Shipbreakers Ltd* [2000] 1 WLR 1107, the taxpayer company granted an option to M to purchase property owned by it in return for a consideration of £399,750. The taxpayer undertook to use its best endeavours to secure releases from restrictive covenants and to obtain a lease dealing with other rights. If the releases or the lease were not procured, and the option was not exercised, the £399,750 was to be repaid to M; otherwise, in the event of no purchase notice being served before the expiry of the option period, it would not be repayable. On service of a purchase notice, the full purchase price would be £4,490,000. The taxpayer did in fact procure releases from the restrictive covenants on payment to the covenantees of £90,000 and obtained the grant of the lease, and the £399,750 was paid over to it. In the event, however, the option to purchase was not exercised by M. The revenue assessed the taxpayer company to corporation tax on the basis that the consideration for the disposal of the option was £399,750. An individual taxpayer who had entered into a similar option agreement with M was assessed to capital gains tax on the same basis. The taxpayers both appealed against the assessments, maintaining in each case that the payment of £90,000 should be taken into account either in computing the consideration or as an allowable deduction from for the purpose of assessing the chargeable gain. Their arguments failed in the Court of Appeal and the House of Lords. It was held that the value of the cash sum of £399,750 paid by M and received by the taxpayers as the consideration for the disposal, i.e. the grant of the option, was not reduced because the taxpayers had paid another sum, namely the £90,000, to a third party. The consideration for the disposal remained £399,750. In the course of his speech, with which the other members of the House agreed, Lord Jauncey of Tullichettle first identified the argument for the taxpayer company (see p.1110F-G):

> "Mr Ewart for the company in a well presented and forceful argument advanced two propositions. First he submitted that since contingent obligations which were not mentioned in section 40(2) and 41 of the Act of 1979 [the equivalents of sections 48 and 49 in the present case] were to be taken into account in computing the consideration for the disposal, a fortiori must the immediate obligation to procure the release of the restrictive covenants be taken into account. Any obligation undertaken by a seller to a buyer which involves payment has to be taken into account in computing the consideration for the disposal."

None of the specified contingencies were relevant to the appeal: see at p.1111B. Lord Jauncey observed that Mr Ewart relied strongly on the decision in *Randall* v. *Plumb* to which I have already referred, which involved paragraph 15 of Schedule 6 to the Finance Act 1965, the predecessor of section 41 of the 1979 Act and section 49 of the present Act. Walton J had said in that case that unless the contingency was one which was expressly mentioned in that paragraph then

> "... it must (if it can as a matter of valuation) be taken at once into account in establishing the amount of the consideration received by the taxpayer, this being the only possible method of arriving at a figure for the amount of the

> consideration which truly reflects the contingency to which the matter is subject."

Lord Jauncey considered that the decision in *Randall* v. *Plumb* was correct. But he distinguished it on the basis that in that case "the contingency went directly to the value of the consideration". He went on to say this (at p.1111H):

> "However, this is not a case, as in *Randall* v. *Plumb*, of tax being assessed on a consideration which has been received but which may ultimately have to be repaid in whole or in part by reason of a contingent liability provided for contractually. Rather was there an immediate obligation involving probable payment of an unknown sum to third parties to procure release of restrictive covenants. The agreed sum of £399,750 has been received by the company and no part thereof has been repaid to [M]. How can the value of a specific sum of cash paid by [M] to the company be reduced because the company has paid another sum to a third party? In my view it cannot be. No payment by the company to a third party can alter the value of the cash sum of £399,750 paid by [M] in terms of the agreement as the consideration for the disposal, i.e. the grant of the option."

While approving the remarks of Lord Wilberforce in *Aberdeen Construction Group* about the need to hesitate before accepting results which are "paradoxical and contrary to business sense", Lord Jauncey observed that however important commercial reality might be, "it cannot be invoked to alter the unambiguous terms of an agreement negotiated at arm's length". He concluded by making this comment on *Randall* v. *Plumb* (see p.1112E-F):

> "In conclusion on this branch of the case I must refer once again to the passage above cited in *Randall* v. *Plumb* where Walton J states that unless the contingency is one expressly mentioned in [section 41, i.e. section 49 of the current Act] it should be taken into account in establishing the amount of consideration. In my view this proposition is too widely stated. If the contingency is directly related to the value of the consideration it may be appropriate, as it was in that case, to have regard to it in computing that value. If on the other hand it is related to matters which do not directly bear upon that value it does not follow that it must necessarily be taken into account."

[51] Mr Artis placed some reliance upon this passage in particular. It emphasised the need for a direct relationship between the consideration for the disposal on the one hand and, on the other, the payment or liability sought to be brought into account in reduction of it. In a case such as the present where the disposal was effected in one capacity (as shareholder) but the contingent liability was incurred in a different capacity (as chairman of the company, making a representation pertaining to the purchase of the entire share capital of MPLC), there was not that direct relationship so as to require the amount of the contingent liability to be taken into account in establishing the amount of the consideration.

[52] I was referred also to *Burca* v. *Parkinson (Inspector of Taxes)* [2001] STC 1298 and *Gray's Timber Products Ltd* v. *Revenue and Customs Commissioners* [2010] STC 782. They are to much the same effect. In *Burca* the taxpayer sold all his

shares in a company established by him, and, pursuant to the terms of a pre-existing loan agreement with them, immediately paid to his parents 60% of the proceeds of sale. He contended that that 60% of the proceeds of sale should not be taken into account in calculating his capital gains tax liability; either that part of the proceeds of sale belonged to his parents (he having received that part of the purchase price as trustee for them) or, alternatively, he had made a disposal to his parents in satisfaction of a continent liability under the loan agreement to pay them 60% of any price received by him on a future sale of the company. Both arguments failed. In disposing of the second argument, Park J said this (at p.1306):

> "The whole of the consideration for [the disposal of the shares] was payable by [the purchaser] to the taxpayer, and the circumstances that he was contractually bound to his parents to pay an amount of money to them does not exclude the amount so payable from the consideration for his disposal of his asset. In my opinion that point is conclusively settled by the decision of the House of Lords in *Garner (Inspector of Taxes)* v. *Pounds Shipowners and Shipbreakers Ltd* [2000] 1 WLR 1107, which was indeed a stronger case for the taxpayer than this case, but in which the taxpayer still lost."

[53] The issue in *Gray's Timber Products* was rather more complex. The taxpayer company was a subsidiary in another company ("Group"). All the ordinary issued shares in Group were acquired by an outside purchaser. In terms of a subscription and shareholders agreement to which Group and other shareholders were parties, the managing director of the taxpayer company (G) was entitled to an enhanced part of the consideration for the sale of the shares. He received about £1.4 million, whereas a rateable part would have been just under £400,000. The Revenue contended that the difference between those two figures was taxable in G's hands as income and therefore subject to income tax and national insurance contributions. G contended that it was taxable as a chargeable gain subject to capital gains tax. The matter went to the Court of Session and to the Supreme Court, in both of which the Revenue were successful. From the point of view of the purchaser, it had agreed to buy all the shares in Group; and those shares were all of equal value to it. As was acknowledged in the subscription agreement, G's right to an enhancement on the sale of the shares was peculiar to his position as director of Group and managing director of the taxpayer company. The majority of the Court of Session took the view that G's rights were personal to him in his capacity as director and managing director of Group and the taxpayer company respectively, and did not attach to the shares. The Supreme Court agreed: see in particular per Lord Walker (at para.[40]). He added that even if the rights did in some sense attached to the shares, they were of no value to the hypothetical purchaser. Lord Hope took a similar view (see paras.[49] – [50]). In terms of the subscription agreement, G was entitled to an enhanced price. It was for that reason that the terms agreed with the purchaser extended to how the price was to be divided up between the shareholders. They were designed to give effect to the rights enjoyed by G. But those rights, which were extinguished by the payment which G received, "were not part of the assets acquired by the purchaser". In other words, using the concept of "capacity" upon which Mr Artis placed reliance on the present case, the enhanced value which he received was attributable not to the shares themselves, or to his rights as seller of the shares, but to his rights as director and managing director of the relevant companies. As such, the enhanced value was not

treated as part of the capital gain realised on the disposal of his shares but as part of his income from his employment.

[54] Mr Artis argued that these cases all tended to show that in order to be taken into account for the purposes of calculating the consideration for a disposal, or making necessary an adjustment in terms of section 49(2), there had to be some nexus between the contingent liability, or payment, or loss, whatever it might be, on the one hand and, on the other, the initial consideration. Thus in *Goodbrand*, the currency fluctuations resulting in the seller not receiving the full sterling equivalent of the agreed dollar payments was wholly extraneous to the consideration received for the disposal, which was and always had been a certain amount of dollars. In *Garner*, the consideration was the full consideration received notwithstanding that the vendor had had to spend a considerable sum of money to release the restrictive covenants. *Burca* and *Gray's Timber Products* each show a similar lack of nexus between the contingency and the value of the consideration. The same applied to *Spectros* and *Collins*. As Lord Jauncey put it in *Garner* (in a passage already cited from p.1112)

> "If the contingency is directly related to the value of the consideration it may be appropriate, as it was in that case, to have regard to it in computing that value. If on the other hand it is related to matters which do not directly bear upon that value it does not follow that it must necessarily be taken into account."

Such a nexus or direct relationship between the contingency and the value of the consideration was essential. In the present case the lack of nexus was created by the different capacity in which SFM had received the purchase price for his shares on the one hand and, on the other, in which he had incurred a liability to AWG.

[55] Mr Ghosh had no difficulty with any of those authorities. However, he submitted that they went to a different point, namely: what was the consideration for the disposal? The thrust of section 49 was that one was not looking to identify the net consideration, in the strict sense of that word. What one was looking to identify for the purpose of section 49 was the chargeable gain, of which the consideration received was but one element. For this purpose the question that had to be asked was whether the contingent liability in any particular case was a contingent liability of the sort specified in one of sub-paragraphs (a), (b) and (c) of section 49(1). That was a different question.

[56] Mr Ghosh submitted that of the authorities to which Mr Artis had referred only *Randall* v. *Plumb* directly raised an issue under section 49 or its predecessor. That is strictly correct, though that section and the remarks made about it in *Randall* v. *Plumb* were the subject of detailed comment in *Garner*. The contingency in *Randall* v. *Plumb* was the grant or otherwise of planning permission to develop the land for extraction of sand, gravel or hoggin. On a failure to obtain such planning permission, the deposit of £25,000 was repayable. It was held that that contingency did not fall within any of the sub-paragraphs of what is now section 49. In those circumstances, the case had to be remitted to the commissioners for determination of the value of what the taxpayer had obtained, namely the right to an immediate deposit of £25,000 with the incident that it may fall to be repaid under the provisions of the agreement.

[57] I accept Mr Ghosh's submission that in none of the cases cited by Mr Artis, with the exception of *Randall* v. *Plumb*, was the construction of section 49 directly in issue. The other cases were focused on identifying the chargeable gain in circumstances in which that section did not come into play. However, in some of those cases, as I explain below, the analysis is put in terms of identifying the net consideration. In those circumstances, I consider that Mr Artis was generous in describing the distinction drawn by Mr Ghosh as "subtle". To my mind it is a distinction without any real substance.

[58] The term "consideration" is not defined in the Act, though it features as an ingredient of the chargeable gain in a number of sections, for example sections 38 and 48, though not section 49. But it is noteworthy that in *Randall* v. *Plumb*, which was considering a contingent liability and the relationship of that contingent liability to the terms of what is now section 49, Walton J clearly regarded the matter as going to the question of consideration. At p. 637-638 he discusses the matter in essentially this way. If the contingency is one expressly mentioned in one or other of the sub-paragraphs under section 49(1), it is disregarded in the first instance and will be dealt with, if liability accrues, by an adjustment of tax in due course. If, on the other hand, the contingency is not one of those mentioned in those sub-paragraphs, then

> "... it must (if it can as a matter of valuation) be taken at once into account in establishing the amount of the consideration received by the taxpayer, this being the only possible method of arriving at a figure for the amount of the consideration which truly reflects the contingency to which the matter is subject."

In other words, the contingency, if relevant at all, is relevant to a calculation of the amount of the consideration. If that is true of a contingency not specifically mentioned in section 49, I do not see any basis for considering that it can be any less true of a contingency which is mentioned there. All relevant contingencies are relevant precisely because they do go to the establishment of the true amount of the consideration. Although the language of "consideration" is not used in section 49, it seems to me to be clear, both from the construction of that section and from the approach of Walton J in *Randall* v. *Plumb*, that that concept underlies the thinking behind that section. Both parties were agreed that sections 48 and 49 were to be read together. Section 48 is framed in terms of "consideration". It would be strange if section 49 excluded that concept. In those circumstances, the other cases to which Mr Artis drew my attention are, in my opinion, clearly relevant.

[59] I am reinforced in this view by the understanding that, as Mr Artis put it, sections 48 and 49 are concerned about issues of timing. That was his term. I accept that argument in substance, though, for myself, I would prefer to say that those sections are concerned with issues of timing and mechanics, i.e. how and when you take into account events which might affect the computation of the gain. In certain circumstances, i.e. when the contingency is one of those listed in the three sub-paragraphs under section 49(1), the contingent liability is ignored in the first instance in computing the chargeable gain, but is then taken account of later if the contemplated events lead to the enforcement of that contingent liability. In other circumstances, where the contingency is not one of those listed in those sub-paragraphs, the contingency has to be taken account in valuing the amount of the

consideration, in the manner described in *Randall* v. *Plumb*. But the point is that it will be taken account of one way or the other, and in those circumstances it would be surprising, to say the least, if the contingencies mentioned in the sub-paragraphs were of a different kind from those not mentioned. Those not mentioned clearly go to the question of consideration (provided they are closely enough related to the value of the consideration) and it is inconceivable, in my view, that the contingencies listed in the sub-paragraphs could include matters which did not go to the question of consideration.

[60] Having said that, the concept of consideration underlying sections 48 and 49, as illustrated by the cases to which I have been referred, is somewhat more elastic than the concept as it would be used in, say, the field of sale of goods. In the ordinary language of a sale of goods lawyer, the consideration is the price paid for the goods. If a representation is made or a warranty given in relation to that sale, and the seller is held liable for misrepresentation or breach of warranty, that liability may well be set up in diminution of the amount payable by the buyer; but it would not normally be regarded as going to reduce the consideration (or price) payable for the goods. In the field of capital gains tax, or at least this part of that field, the term appears to be used in a rather wider sense. Thus, in *Randall* v. *Plumb* the case was remitted to the commissioners to determine the value of the consideration received by the taxpayer for the grant of the option, having regard to the contingency that the deposit might be repayable in certain circumstances in 10 years' time. In *Goodbrand* the question of losses allegedly sustained by the taxpayer due to currency fluctuations was expressed, in the question as framed by the court, as going to the question of what consideration he received. That was a section 48 case, where the argument had to be put in terms of consideration. In *Garner* the argument for the taxpayer was that the payment of £90,000 to a third party to secure releases from restrictive covenants ought to be taken into account "in computing the consideration for the disposal"; and, although the argument failed, that way of putting it was not criticised in the speeches in the House of Lords. So also in *Burca*, the fact that the taxpayer had to pay 60% of the proceeds of sale to his parents did not mean that this sum should be excluded "from the consideration for his disposal of his asset".

[61] In my opinion, what the court has to assess in the case of a contingent liability in respect of a warranty or representation made on a disposal by way of sale is whether the liability is "directly related to the value of the consideration" received by the taxpayer on the disposal of the property: see per Lord Jauncey in *Garner* at p.1112E-F, restricting the application of the remarks of Walton J in *Randall* v. *Plumb*. This must be the test to apply in determining whether SFM's liability in respect of the profit forecast representation (or other representations made by him as chairman of MPLC in connection with the sale to AWG) is of a character that requires it to be taken into account in the computation of the chargeable gain, thus requiring an adjustment under section 49(2).

[62] If the question is framed in this way, as I consider it should be, it admits of only one answer. The liability of SFM on representations made by him as chairman of MPLC in connection with AWG's purchase of its whole share capital is wholly distinct from the consideration received by him for his shares in MPLC. He received his price for his shares by virtue of his ownership of the shares. It was the same price per share as was received by any other shareholder. Had he received more, because of

his position as chairman, he would have been in the same position as the taxpayer in *Gray's Timber Products*. So also, if he receives less at the end of the day because of things which he said or did as chairman of MPLC, that is equally unrelated to the price received by him as shareholder for his shares.

[63] Mr Ghosh emphasised in his submissions that capacity was irrelevant. The tax was a tax on a chargeable gain by SFM as an individual, and the capacity in which he was acting when he made that gain was irrelevant. In principle I agree. But the fundamental question, as I have sought to explain, is whether the liability is "directly related to the value of the consideration". Every case will turn on its own facts, but in the present case the question of capacity (in the sense of which "hat" SFM was wearing at what time) helps to show that that direct relationship is absent.

[64] Nor have I overlooked the submission made by Mr Ghosh that sub-paragraph (c) of section 49(1), in contrast to the other two sub-paragraphs, makes no reference to the capacity in which the person making the disposal makes the representation on which he is subsequently held liable. As a purely textual submission, there is obviously some force in that point, though my reasoning in the previous paragraph provides the answer to this point too. It seems to me that Mr Ghosh's argument, if correct, would involve a construction of sub-paragraph (c) which allowed a matter to be brought into account which was not directly related to the value of the consideration. If, for example, sub-paragraph (c) did not exist, it could hardly be argued that SFM's liability on the representation made by him as chairman should be taken into account in establishing the amount of the consideration received by him for his shares, requiring a valuation exercise similar to that canvassed in *Randall* v. *Plum*. Mr Ghosh's argument leads to the result that, by including sub-paragraph (c) within the contingencies dealt with in section 49(1), Parliament intended to extend the type of contingent liabilities which could be taken account of in assessing the consideration and the chargeable gain. This would run counter to what I perceived to be common ground between Mr Artis and Mr Ghosh – and whether common ground or not, it reflects my view of the matter – namely that the purpose and effect of sections 48 and 49 was simply to provide a mechanism for dealing with certain types of contingency, and not to innovate upon the type of contingency which might relevantly be taken into account.

[65] For these reasons, I consider that the FTT was wrong to conclude that SFM's contingent liability on the profit forecast representation made by him as chairman of MPLC was a contingent liability falling within section 49(1)(c) so as to require an adjustment under section 49(2). In those circumstances, the appeal on the first issue succeeds.

[66] In case the matter should go further, I should mention three other matters which were canvassed in argument before me.

[67] First, during the course of the hearing I raised some doubts about whether a liability for misrepresentation or negligent misstatement was in fact a contingent liability as explained by Lord Guest in *Winter* v. *Inland Revenue Commissioners* at p.262: "a liability which depends for its existence upon an event which may or may not happen". While a warranty might involve a promise as to the future, so that liability may be contingent upon what happens at a later date, an actionable

representation involves a representation of existing fact, in this case the existence of an honest belief in the accuracy of the profit forecast. It was either true or false when it was made, and there either was or was not when it was made the mental element (negligence, dishonesty, etc.) relevant to the question of actionability. On one view there is nothing contingent about liability on a misrepresentation or misstatement. Mr Ghosh answered this by pointing out that a misrepresentation or misstatement was only actionable in delict upon proof of damage. Liability was contingent on damage being suffered. Whether in general that is sufficient to make such a liability contingent is a matter on which I prefer to express no concluded view. But I consider that it is sufficient answer in this case. Whatever may be the position in other fields, section 49(1)(c) clearly contemplates that there may, for the purposes of that section, be a liability, which it describes as a "contingent liability", in respect of a representation made on a disposal by way of sale. Mr Artis confirmed that he was not advancing any argument to the effect that such a liability was not contingent within the meaning of section 49(1)(c) on the basis that there was no relevant contingency.

[68] Second, both before the FTT and before me some attention was focused on whether liability under the Settlement Agreement was attributable to the profit forecast representation alone (that being the only representation admitted by SFM) or was attributable in addition to the various other misrepresentations and misstatement pleaded against SFM in the High Court proceedings (which were not denied). For my part, I do not think that it matters, since all the representations and statements relied on by AWG in the High court action fall into the same category – if made, they were made by SFM as chairman and director of MPLC, and they fall to be considered in the same way as the profit forecast representation.

[69] Third, had I been in favour of SFM's position, I would have dealt with quantum in the same way as the FTT dealt with it. I would have remitted the matter for further discussion between the parties in the first instance to assess what part of the settlement payment related to the representation(s) or statements made by SFM as chairman of MPLC on the purchase by AWG of the shares in MPLC. For the reason given in the previous paragraph, I would not have limited it to the profit forecast representation. The relevant enquiry would be what part of the £12 million was paid in settlement of the claims by AWG for misrepresentation or negligent misstatement as a whole, covering <u>all</u> the various representations and statements relied on by AWG in the High Court action, but obviously not the other claims by AWG, whether against SFM or others, and not the claim by MPLC.

The second issue – costs of defending the High Court action

[70] This issue relates to SFM's costs of defending the High Court action.

[71] It was not suggested that SFM could succeed on this issue if he failed on the first. Accordingly, his appeal on this issue must be refused.

[72] In case the matter should go further, I should just say this. Mr Ghosh argued that if the amount of the settlement payment fell within section 49(1)(c), so obviously must the legal costs incurred in defending the action up to that point. It was simply

inconsistent to arrive at any other result. There was no reason in principle why legal costs should not be brought into account as forming a basis for adjustment under section 49(2). The only question was whether there was a sufficient nexus between the legal costs on the one hand and the contingent liability and its enforcement on the other. The answer was plainly: Yes. Conceptually, legal costs went hand in hand with liability.

[73] I am not persuaded that that is necessarily correct. A helpful comparison might be made with the position under section 38 which provides that a person making a disposal is entitled for the purposes of computing the taxable gain to deduct from the consideration received by him the amount which he paid to acquire the asset and, subject to certain qualifications, the amount of any expenditure "wholly and exclusively incurred on the asset" and any expenditure "wholly and exclusively incurred by him in establishing, preserving or defending his title to, or to a right over, the asset", together with the incidental costs of making the disposal, those incidental costs themselves being confined to expenditure "wholly and exclusively incurred by him for the purposes of the acquisition or, as the case may be, the disposal". Those incidental costs include the professional services of lawyers and others. If the rationale behind allowing the amount of a contingent liability to be brought into account under section 49(1)(c) is that such a liability is to be regarded, in a broad sense, as being akin to a cost incurred on the disposal, why should the other incidental costs (including lawyers' fees) escape the "wholly and exclusively" regime to be found in section 38? It is true that section 49 contains no reference to the "wholly and exclusively" test, but it has no need to do so. The contingent liabilities themselves are sufficiently clearly defined to avoid the need for any such reference. But it would be odd, to my mind, if legal costs were recoverable as an incident of the contingent liability referred to in any of the sub-paragraphs of section 49(1) without having to satisfy the "wholly and exclusively" test applicable when they are considered under section 38. It is not possible to read that test into section 49. In those circumstances, it is highly arguable that the proper construction of that section would limit the deduction to the amount enforceable as a contingent liability and not include the legal costs involved in arriving at that settlement figure.

[74] This point would clearly be relevant here, where SFM incurred legal costs in relation not only to AWG's claims against him but possibly also to their claims against others, including family interests (though I do not know whether and to what extent he in fact paid for the legal costs of other defendants); and where the legal costs incurred by SFM presumably related also to his defence of the claim brought against him by MPLC.

[75] However, standing my decision on the first issue, and the effect of that on the second issue, I do not need to resolve this problem. I therefore say no more about it.

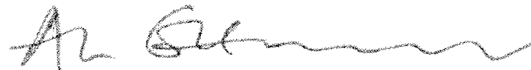
Disposal

[76] For all the above reasons, I shall make the following order:

(1) I shall allow the appeal by HMRC on Issue 1 and find that no adjustment requires to be made in terms of section 49(2) of the Act in respect of the £12 million paid by SFM under the Settlement Agreement or any part of it;

(2) I shall refuse the appeal by SFM on Issue 2, and find that no adjustment requires to be made in terms of section 49(2) in respect of legal expenses incurred by SFM in defending the High Court action brought by AWG and MPLC.

[77] I shall reserve all questions of expenses. I was not specifically addressed on that issue. I am grateful to counsel for their very helpful written and oral submissions.



Lord Glennie

Release Date 11 October 2013