TC03243

Appeal number: TC/2012/02250

CAPITAL GAINS TAX – expenditure incurred on an asset.

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR JULIAN BLACKWELL **Appellant**

- and -

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

TRIBUNAL: JUDGE RICHARD BARLOW
DUNCAN McBRIDE

Sitting in public at London on 29 and 30 May 2013.

Kevin Prosser QC and Charles Bradley for the Appellant instructed by Shipleys.

Michael Jones of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. Mr Blackwell appeals against a decision contained in a letter dated 28 September 2011 which is a closure notice in respect of a self-assessment tax return for the year ended 5 April 2007.

2. By that notice the Commissioners notified Mr Blackwell that they were amending his return to increase, by £2,662,510.80, a liability to capital gains tax declared by him. The decision to increase the liability was based on the Commissioners' decision that expenditure of £25m claimed by Mr Blackwell as a deduction from the consideration received on the disposal of shares was not allowable under section 38(1)(b) of The Taxation of Chargeable Gains Act 1992 (TCGA). At the hearing it was conceded on Mr Blackwell's behalf that the amount claimed as a deduction should have been £17.5m but he maintains that that sum is deductible under section 38(1)(b).

3. The relevant history is complicated but the primary facts are not in dispute. The conclusions to be drawn from those primary facts are in issue.

4. Mr Blackwell owned shares in classes A, B and C in what had been a family business, Blackwell Publishing (Holdings) Limited (BP Holdings), and he held two subscriber shares. His holding in the A shares was over 25% of the total and so his vote was necessary to secure any special resolution of the company and for certain other potentially important decisions in relation to the company.

5. In 2003 Taylor and Francis Group plc became interested in acquiring BP Holdings. (Taylor and Francis Group plc later became Informa plc but for convenience we will refer to it as Taylor and Francis). Taylor and Francis made an unsuccessful hostile takeover bid. Mr Blackwell sold some of his B shares to a subsidiary of that company but he retained his A shares and therefore his ability to veto, for example, a special resolution that would have been needed to approve a sale of the company to any bidder.

6. In an agreement dated 28 April 2003 with Taylor and Francis, Mr Blackwell undertook to do or not to do certain things connected with his A shares in return for a payment of £1m.

7. He agreed to accept any takeover offer by Taylor and Francis if made up to 31 December 2023, not to dispose of or encumber his A shares or agree to do so and not to solicit, encourage or accept any other offer for the A shares or any other shares in BP Holdings. He also gave undertakings not to vote in favour of resolutions of various types which, in summary, can be classified as resolutions likely to undermine Taylor and Francis's prospects of taking over BP Holdings. Under the terms of the agreement if a takeover bid were to be made by someone else Taylor and Francis would then have had to match it with a higher bid or else Mr Blackwell would then have ceased to be bound by the agreement.

8. Taylor and Francis agreed not to seek specific performance of any of Mr Blackwell's obligations under the agreement. Both parties agreed to treat the information known to each other in respect of the agreement and, indeed its existence, as confidential. Mr Blackwell agreed to give to Taylor and Francis information about developments likely to be relevant to a potential purchaser of the shares but only if giving the information would not breach any obligations of confidentiality owed by him to any third party.

9. Following an approach from two of the directors of BP Holdings acting on behalf of that company, Mr Blackwell signed a confidentiality agreement with those directors on 8 August 2006 and was given information about an approach from a US firm, John Wiley & Sons Inc (Wiley), offering to take over BP Holdings for a very much higher sum than had been considered but rejected from Taylor and Francis in 2003.

10. Mr Blackwell would have liked to have accepted the Wiley offer and to have supported it but, of course, he was in a dilemma because unbeknown to the directors of BP Holdings he could not agree to the proposed take-over without breaking his agreement with Taylor and Francis. In principle, he could have given Taylor and Francis notice of the Wiley bid and have required them to match it with a better bid under the agreement, failing which he would have been released from his obligations and could have voted for the new bid. However the confidentiality agreement with the directors precluded his doing that. Equally the confidentiality aspects of the agreement with Taylor and Francis precluded his informing the directors of BP Holdings why he could not immediately vote for any resolution supporting the new bid.

11. Mr Blackwell took advice from his solicitors and they advised on 13 October 2006 that in the circumstances: "The only course of action which will not result in [a risk of litigation from either Taylor and Francis or the BP Holdings directors] is no action at all, i.e. not to take any step in respect of the third party offer for [BP Holdings]".

12. Mr Blackwell did then obtain permission from BP Holdings to give Taylor and Francis limited information about the new bid and Taylor and Francis offered to release him from their agreement in return for a payment of £25m which would then enable him to vote in favour of the necessary resolutions to enable the new bid to go ahead. In negotiations it was envisaged that £7.5m of the £25m would in fact be paid to Taylor and Francis by the shareholders of BP Holdings rather than by Mr Blackwell himself.

13. A director of BP Holdings agreed to pay the £7.5m and Wiley agreed to make a payment of that sum to the director on the basis that the price agreed to be paid by Wiley for the shares in BP Holdings would be reduced by the same amount. The consequence of that would then be that, in effect although the money was routed through the director, the body of shareholders would fund it by the reduction in the share price.

14. Later, it was agreed that rather than the £7.5m being paid to a director of BP Holdings by Wiley and then by that director to Taylor and Francis, that payment would be made by Wiley to Mr Blackwell and he would pay it to Taylor and Francis but still on the basis that the share price payable by Wiley would be reduced to take account of the £7.5m with the consequence that the shareholders as a whole bore the cost. Mr Blackwell therefore made the payment of £25m to Taylor and Francis and it is in those circumstances that he claimed the deduction of £25m rather than £17.5m in his tax return. It is now accepted on his behalf that the amount claimed should only have been £17.5m.

15. It was agreed between the parties to this appeal that the £7.5m received by Mr Blackwell from Wiley and paid over to Taylor and Francis does not affect the capital gains tax analysis because it was not consideration for the disposal of the shares and nor was it expenditure incurred by him. It is for that reason that it is accepted by Mr Blackwell that his claim for a deduction of £25m under section 38(1)(b) should be reduced to £17.5m.

16. The sequence of the agreements and other relevant actions for this appeal which led to the takeover by Wiley were as follows:

- 28 April 2003, agreement between Mr Blackwell and Taylor and Francis
- 8 August 2006, confidentiality agreement between Mr Blackwell and BP Holdings
- 21 August 2006, the confidentiality agreement between Mr Blackwell and BP Holdings was extended to apply to him in his capacity as a director of a BP Holdings subsidiary
- 17 November 2006, Mr Blackwell and Taylor and Francis agreed that Mr Blackwell's obligations under the 28 April 2003 agreement would be terminated on his agreeing to pay £17.5m (and he then became free to vote in favour of the takeover)
- 17 November 2006 (or thereabouts), the director of BP Holdings agreed to pay £7.5m to Taylor and Francis in connection with the release of Mr Blackwell from his obligations under the 28 April 2003 agreement
- 22 December 2006, the shareholders of BP Holdings passed a special resolution implementing the scheme of arrangement which would give effect to the takeover
- 30 January 2007 (but see below a discussion of this date), Taylor and Francis and Mr Blackwell entered into a deed treating the 17 November release as "null and void from the time of its execution"
- 31 January 2007, the High Court approved the scheme of arrangement

- 1 February 2007, Mr Blackwell agreed to pay Taylor and Francis £25m to release him from the 28 April 2003 agreement [it is assumed that the director's obligation to pay £7.5m was also negated at this time].

17. The agreement to treat the 17 November 2006 release agreement as null and void is said, in the body of that agreement, to have been executed as a deed "on the date set out at the head of this agreement" and it is also stated to be executed "in any number of counterparts, each of which, when executed and delivered, shall be an original and all the counterparts together shall constitute one and the same instrument". Only the Taylor and Francis copy actually has a date set out at the head. Mr Blackwell's copy is undated. In view of the term referring to any number of counterparts we hold that the date of that agreement is 30 January 2007.

18. In paragraph 46(a) of their Statement of Case the Commissioners argued that, when Mr Blackwell voted for the resolution on 22 December 2006 he was, so far as the parties were concerned, acting in breach of the agreement of 28 April 2003 because the release dated 17 November 2006 was later declared null and void. The Commissioners argument was not that his vote was invalid but that he had been able to vote in favour of the resolution despite the agreement being in force (because of the voiding of the release) and that therefore the payment of the £17.5m (or seemingly the £25m) was not a payment necessary to enable the vote to be cast but rather only to release Mr Blackwell from a personal liability should he cast the vote in a way not permitted under the 28 April agreement.

19. The facts relating to the sequence of events do not support that argument at all because, at the time the vote was cast, Mr Blackwell could not have anticipated that the agreement would be voided at a later date and although the voiding of it was then backdated that cannot be said to prove that the original agreement had no effect. As a matter of fact the voiding and replacement of the release agreement was only done to replace the £17.5m figure payable by Mr Blackwell with the one of £25m and that was only done to re-arrange the route by which the additional £7.5m was paid.

20. That is not to say that there remains no issue about the effect of the 28 April 2006 agreement and what it means in the context of section 38. But we do hold that the sequence of events itself does not demonstrate one way or the other what the answer to that question is.

21. We find, based on the evidence, that at all material times Mr Blackwell and Taylor and Francis believed that Mr Blackwell was under an obligation to Taylor and Francis to abide by the 28 April 2003 agreement. We find that Mr Blackwell held a rational and well founded belief that the 28 April agreement amounted to an impediment to his acting freely to vote as he would have wished when the Wiley bid came to his attention. In his undisputed witness statement he said "I was also caught between two confidentiality agreements. I decided I had to break the deadlock somehow. … it was necessary to pay [the £25m] to allow the much larger overall deal to go through, both for me and the other shareholders in BHP." We also find that the payment of £25m to Taylor and Francis was made to secure the release of that obligation.

22. We heard argument that Taylor and Francis may not have been able to obtain an injunction to stop Mr Blackwell breaking the agreement of 28 April 2003. Whether they could have done so is at least partly a matter of law rather than of fact. However, we find that the threat of litigation, whether in the form of an attempt to obtain an injunction or some other action, could well have had a detrimental effect on the prospect of a successful acceptance of the takeover offer or at least to have delayed it. Mr Blackwell and BP Holdings and indeed for that matter Wiley all had a real interest in avoiding such a problem arising.

23. It was common ground between the parties that it is not necessary for expenditure actually to enhance the value of an asset before it can be claimed as a deduction under section 38. Section 38(1)(b) requires the expenditure to be "for the purpose of enhancing the value" and clearly "for the purpose of" may include a failed or unnecessary attempt to enhance the value. Equally clearly the person incurring the expenditure must have had a genuine belief and intention that it would enhance the value before it could be said to be its purpose. We find as a fact that Mr Blackwell did believe that the payment would enhance the value of his shares because that would enable the Wiley bid to be accepted which was considerably higher than the Taylor and Francis bid.

24. On the basis of those facts we turn to consider the legal arguments.

25. Mr Prosser QC cited several authorities dealing with the general approach to be taken to interpreting capital gains tax legislation. In particular, he relied upon passages from the speech of Lord Wilberforce in *Aberdeen Construction –v- Commissioners of Inland Revenue* (1977) TC 52 281 at page 296 F to 297 E. Those passages mention that the guiding principle for the application of the concept of allowances is that it ought to be arrived at "upon normal business principles". In *Stanton –v- Drayton Commercial Investment co Ltd* [1982] STC 585 at page 588 e-f Lord Fraser of Tullybelton referred to how a businessman would have seen a transaction and to it commercial reality. He added that he agreed that the correct legal analysis is not for businessmen but rather for lawyers but he said that the lawyers "should have regard to the businessman's view". Mr Prosser also cited *Barclays Mercantile –v- Mawson* [2005] STC 1 at page 11 c-e where Lord Nicholls emphasised the correctness of the purposive construction of a statute.

26. Mr Jones rightly pointed out that a purposive interpretation cannot override the actual provisions of the Act being interpreted. He pointed out and relied upon the fact that the overall effect of section 38 was to restrict rather than enlarge the allowances that can be claimed. That is clear from its opening words which include the phrase "shall be restricted to". Expenditure is only allowable if it falls within one or more of the items referred to in the section.

27. Mr Jones argued that three concepts required consideration in analysing this case and the application of section 38 to the transactions. First was the question whether the expenditure was "on the asset" namely the shares "on" being the vital word. Second was the question whether the expenditure was "for the purpose of

enhancing the value of the asset". Third was whether the expenditure was "reflected in the state or nature of the asset at the time of its disposal".

28. We will deal first with the second question. This is at least in part a question of fact. The asset in question is the shares and Mr Blackwell undoubtedly had the purpose of increasing their value when he paid his £17.5m to Taylor and Francis. If his intention in that respect can be judged purely subjectively then that is the end of that particular point.

29. However Mr Jones argued that the real purpose of the payment was to release him from his personal obligations to Taylor and Francis which should not be conflated with the value of the shares even if there was an indirect effect on the value of the shares to be achieved by releasing him from those obligations. That argument appears to us to amount to saying that the purpose can only be judged according to its proximate effect without looking at an indirect effect on the value. Clearly it is the value that is in issue and if the effect is indirect then it is reasonable to say that the expenditure is still for the purpose of enhancement even if the enhancement operates indirectly, as long as the enhancement is to the value of the asset. For example, if the asset was a very valuable vintage motor car which was un-roadworthy could it really be said that expenditure on making it roadworthy would not be for the enhancement of its value because its proximate effect would be to enable it to be driven on the road? It seems to us, and we so hold, that Mr Jones's argument about this adds nothing to the questions raised in the first and third arguments and that the purpose of the expenditure was to increase the value whether viewed subjectively or even if viewed objectively because it did in fact contribute to the increase in value of the shares by making it possible to sell to the new higher bidder.

30. We will deal with the third question next. It was common ground between the parties that the change to the state or nature of the asset must be something identifiable about the asset that has enhanced its value. Mr Jones argued that the enhancement of the value itself cannot be the change to the state or nature of the asset contemplated by the legislation because otherwise the words "being expenditure reflected in the state or nature of the asset at the time of disposal" add nothing to the reference to the enhanced value itself. We agree with that argument.

31. We do not agree that the case of *Trustees of Fenton Will Trusts –v- Revenue and Customs Commissioners* [2007] STC (SCD) 316 is in point in considering the question about what form the change to an asset must take before it falls within the words "state or nature". In that case the Special Commissioners repeatedly misquoted the Act as reading "state and nature" rather than the correct "state or nature". Nor was that error based on a reading of "or" as meaning "and" in its effect because they misquoted the Act both when referring to the phrase in speech marks and when paraphrasing. That error appears to be relevant to the applicability of the decision in that case as a persuasive authority because there must be a distinction between the concepts "state" and "nature" otherwise the draftsman would not have used both terms. The facts of that case were also far removed from the facts of this case which are unusual and unlikely to recur often.

32. Mr Jones argued that the state or the nature of the shares remained unchanged as a result of the payment of £25m to Taylor and Francis because Mr Blackwell could have voted in favour of the resolution albeit in breach of his agreement with Taylor and Francis and that his obligations to Taylor and Francis were personal obligations which did not in any way affect either the state or the nature of the shares themselves.

33. We do not agree. Mr Jones pointed out that the state or nature of a share is the rights attaching to a share and we would add that there may also be obligations. We hold that a share is an intangible asset rather than a real object and that conceptually it consists of the rights and obligations that attach to it and derives its value from those rights. Mr Jones argued that the rights and obligations of Mr Blackwell as a shareholder were the same both before and after he entered into the agreement with Taylor and Francis. As a shareholder he could have voted for the resolution and if he had been liable to Taylor and Francis for doing so that would have been a breach of a personal obligation owed by him to them and that was not part of the state or nature of the shares themselves.

34. Looking at the situation in that way is unrealistic in the sense of what might happen in the real world. We have already pointed out that, even if Mr Jones is right that Taylor and Francis could not have obtained an injunction to stop Mr Blackwell voting for a resolution in breach of his agreement, the threat of litigation or an attempt to obtain an injunction could well have had a detrimental effect on the takeover process and could easily have at least delayed it. It is easy to see that the price could have been affected or even that the deal could have fallen through altogether.

35. Mr Jones may well be right that the "nature" of the shares was not affected by the Taylor and Francis agreement with Mr Blackwell but their "state" was affected. We repeat our analogy of the un-roadworthy motor car. The car would not cease to be a car just because it would be un-drivable but its state would be changed once the repairs were done and it became driveable. So with the shares, their state changed when Mr Blackwell became free to vote as he wished without risk of litigation by means of payment of the £17.7m.

36. The first question, whether the payment can be said to have been expenditure incurred "on" the shares, is really bound up with the other two questions. We hold that "on" in that context, being a normal word without any special definition attached to it, should be given a normal meaning. In the context of the legislation and given what we have said about the approach to interpretation of the statute we hold that the expenditure was "on" the shares in the sense that it was incurred in respect of those shares.

37. We hold that the expenditure was on the shares, that it was for the purpose of enhancing their value and that it was reflected in the state or nature of the shares, the last point being that it is more accurate to say it was their state than their nature.

38. Accordingly Mr Blackwell's appeal is allowed to the extent that we hold he was entitled to deduct £17.5m from his gain (not the £25m originally claimed).

39. 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.

RICHARD BARLOW
TRIBUNAL JUDGE

RELEASE DATE: 20 January 2014