A HIGH COURT OF JUSTICE (CHANCERY DIVISION)—20 AND 21 FEBRUARY 1997

COURT OF APPEAL—12 OCTOBER AND 25 NOVEMBER 1998

B

HOUSE OF LORDS—9 MARCH AND 18 MAY 2000

C

Garner (H.M. Inspector of Taxes) *v*. Pounds Shipowners and Shipbreakers Ltd. Garner (H.M. Inspector of Taxes) *v*. Pounds([1])

D

Corporation tax—Capital gains tax—Chargeable gains—Consideration for disposal—Deductible expenditure—Option to buy land granted—Grantor to obtain release of restrictive covenants over land—Payment by grantee returnable if covenants not released—Whether consideration for grant of option net sum after allowing cost of obtaining release of covenants—Whether that
E *cost deductible expenditure—Capital Gains Tax Act* 1979, *ss* 32, 40 *and* 41.

Under an agreement made on 9 September 1988 M paid £399,750 and PSS granted M an option to buy certain land for £4.49m. PSS undertook to use its best endeavours to obtain the release by third parties of restrictive covenants over the land. The £399,750 was to be held by PSS's solicitors as
F "stakeholders" until such time as the covenants were released, and interest which accrued during that period was payable to PSS. If the covenants (and other covenants relating to land owned by P) were not released, the £399,750, was repayable to M, unless M chose to exercise the option nevertheless.

G On 18 May 1990 the third parties agreed to release all the covenants; PSS was required to pay £90,000; PSS's solicitors paid that sum to the third parties' solicitors and sent the balance of the £399,750 to PSS.

In the event M did not exercise the option.

H PSS appealed against corporation tax assessments for the accounting periods ended 31 December 1988 and 31 December 1990. The General Commissioners held that the disposal of the option took place in the earlier period, rejecting PSS's contention that the agreement of September 1988 was conditional, and there was no appeal on that point. The Commissioners upheld PSS's contention that the £90,000 was expenditure deductible under
I s 32 Capital Gains Tax Act 1979. The Commissioners came to the same decision on P's appeal against capital gains tax assessments in relation to identical facts. The Crown appealed.

The Chancery Division held, dismissing the Crown's appeals, that:—

([1]) Repored (Chd) [1997] STC 551; (CA) [1999] STC 19; (HL) [2000] 1 WLR 1107; [2000] STC 420.

(1) it was not possible to put the circumstances of the case into any of the categories of deductible expenditure in s 32; but

(2) the onerous obligation, to secure, if reasonable endeavours would achieve it, the release of the covenants, had to be taken into account in computing the consideration for the disposal; it would be contrary to business reality to have regard only to the nominal consideration stated in the agreement, without regard to the other incidents of the transaction which materially affected the value of that consideration to the grantor; the value to which PSS was entitled under the option was not £399,750, because that nominal entitlement was subject to the qualification that, if the covenants were not released, it would receive nothing, and, if the covenants were released, the net consideration in its hands would be the nominal amount less whatever was required to secure that release;

Randall v. *Plumb* [1975] 1 WLR 633: 50 TC 392 followed; *Aberdeen Construction Group Ltd.* v. *Commissioners of Inland Revenue* [1978] AC 885: 52 TC 281 considered;

(3) the best evidence of the value of that obligation was the £90,000 actually paid for it; nothing in the provisions relating to the computation of gains in the 1979 Act required an artificial valuation exercise as at 9 September 1988, where the value of the consideration received by PSS for the option was known.

The Bwllfa and Merthyr Dare Steam Collieries (1891) *Ltd.* v. *The Pontypridd Waterworks Co.* [1903] AC 426 applied.

The Crown appealed.

The Court of Appeal held, allowing the Crown's appeal, that:—

(1) the consideration for the disposal of the option was £399,750, because:—

(a) as the sum was to be held by stakeholders and was payable to PSS only once the covenants were released, failing which it was refundable, s 40(2) of the 1979 Act applied, because there was a postponement of PSS's right to receive the £399,750 and that right was contingent; it followed that the £399,750 was to be brought into account at its full value;

(b) that consideration was not the sum of £399,750 less the £90,000 paid for the releases of the covenants; on the facts, there was no relevant contingency outside those which fell within ss 40(2) and 41(1) of the 1979 Act; a contingency is an event which may or may not happen; an immediate obligation on the grant or of an option, such as PSS's obligation to use its best endeavours to procure the releases of the covenants, was neither an event nor, if it was, an event which might or might not happen, but was simply an obligation to do something which became binding on the grantor immediately it was entered into; further, it could not be concluded that part of the £399,750 was paid for that obligation when the option agreement stated that the price was to be paid for the grant of the option and did not state that it was to be paid for anything else;

A *Randall* v. *Plumb* [1975] 1 WLR 633: 50 TC 392 and *Aberdeen Construction Group Ltd.* v. *Commissioners of Inland Revenue* [1978] AC 885: 52 TC 281 distinguished;

(2) the £90,000 was not allowable as a deduction under s 32(1)(a); it was B not expenditure incurred in providing the asset, i.e. in the granting of the option, but was incurred later; further, the asset concerned was an option over the land subject to the covenants, and it could not be regarded as an option over the land free from the covenants so that the £90,000 was an expense in providing it.

C

PSS and P appealed.

Held, in the House of Lords, dismissing PSS's and P's appeals, that:—

D

(1) the obligation to procure release of the restrictive covenants was not to be taken into account in computing the consideration for the disposal; this was not a case in which a consideration which had been received might have to be repaid in whole or in part by reason of a contingent liability provided for contractually; rather, there was an immediate obligation involving probable payment of an unknown sum to third parties to procure release of E restrictive covenants; payment to a third party could not alter the value of the cash sum paid by M in terms of the agreement as the consideration for the disposal; commercial reality could not be invoked to alter the unambiguous terms of an agreement negotiated at arm's length;

F *Randall* v. *Plumb* [1975] 1 WLR 633; 50 TC 392 distinguished;

(2) the expenditure of £90,000 was not deductible under s 32(1) of the 1979 Act; to be within that provision, expenditure must be extraneous to the asset rather than part of it; as the implementation of the obligation to G procure release of the restrictive covenants was not a prerequisite of the option being exercised, the obligation could not be said to be "wholly and exclusively incurred by [PSS] in providing the [option]" within s 32(1)(a); s 32(1)(b) did not apply, because neither the obligation nor the subsequent payment of £90,000 could be said to have been reflected in the state or nature of the option at the date of disposal, that date being the date of the H agreement;

per curiam; the proposition stated in *Randall* v. *Plumb*, that unless a contingency is one expressly stated in [s 41 of the 1979 Act], it should be taken into account in establishing the amount of the consideration, is too I widely stated, if a contingency is directly related to the value of the consideration, it may be appropriate 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.

Garner (HMIT) v. Pounds Shipowners and Shipbreakers Ltd. A

CASE

Stated under the Taxes Management Act 1970, s 56 by the Commissioners for the General Purposes of the Income Tax for the Division of Portsmouth for the opinion of the Court of Justice. B

1. At a meeting of the Commissioners for the General Purposes of the Income Tax for the Division of Portsmouth held on 10 May 1995 Pounds Shipowners and Shipbreakers Ltd. (hereinafter called "the Taxpayer") appealed against the following assessments to corporation tax in respect of the disposal by the taxpayer to Mowat Group PLC of an option to purchase certain land:— C

Year ended 31.12.88	£399,750.00
Year ended 31.12.90	£339,785.00

2. The questions for determination by us were:— D

(a) On what date was the disposal of the option by the taxpayer for corporation tax purposes.

(b) Whether the sum of £90,000.00 paid by the taxpayer to the Crown Estates Commissioners an agreement for release dated 18 May 1990 should be included in the consideration for grant of the option by the taxpayer to Mowat Group PLC. E

3. Mr. E.H. Garner, Her Majesty's Inspector of Taxes and acting District Inspector of Portsmouth 1 District (hereinafter called "the Inspector") was represented by Miss F. Riddy of the Office of the Solicitor of Inland Revenue. The taxpayer was represented by Mr. Ewart of Counsel. Mr. Henry Frederick Pounds and Mr. Lawrence Justin Guyer gave oral evidence on behalf of the taxpayer. F

4. The following documents were admitted in evidence before us:— G

(a)	Corporation Tax Assessment and Appeal	1988, 1990
(b)	Statement of Agreed facts and Question for determination	Undated
(c)	Company Accounts	31.12.88
(d)	Company Accounts	31.12.90
(e)	Option Agreement	9.9.88
(f)	Agreement for Releases and Deed of Release	18.5.90
(g)	An Opinion of Mr. Geraint Thomas	3.7.89
(h)	Letter from The Crown Estate to Sherwin Oliver	15.6.89
(i)	Letter from Sherwin Oliver to The Crown Estate	7.8.89
(j)	Letter from Sherwin Oliver to the Lands Tribunal	8.9.89
(k)	Letter from the Lands Tribunal to Sherwin Oliver	13.9.89
(l)	Letter from Sherwin Oliver to the Lands Tribunal	20.9.89
(m)	Letter from Sherwin Oliver to Farrer & Co.	15.1.90
(n)	Letter from Sherwin Oliver to Robin Myddleton & Co.	13.2.90
(o)	Letter from Robin Myddleton & Co. to Sherwin Oliver	20.2.90
(p)	Letter from Farrer & Co. to Sherwin Oliver	27.2.90
(q)	Letter from Sherwin Oliver to Farrer & Co.	2.3.90

H

I

A The Option Agreement dated 9 September 1988 and the Agreement for Releases dated 18 May 1990 is annexed to this Case as Exhibit A([1]) and the Deed of Release dated 18 May 1990 is annexed to this Case as Exhibit B([1]). The remainder of the documents referred to above are available for production to the Court if required.

B 5. The following matters of fact were proved or admitted before us:—

(a) The taxpayer has at all material times been resident in the United Kingdom.

C (b) On 9 September 1988 Mowat Group PLC ("Mowat") entered into identical option agreements with each of the taxpayer, Mr. H.F. Pounds and Trafalgar Wharves Ltd. ("TWL"). The options entitled Mowat to purchase certain land ("the Land") owned by the taxpayer, Mr. Pounds and TWL, for a total sum of £4,490,000. The consideration for the grant of the option by the taxpayer was £399,750.

D (c) On 18 May 1990 the taxpayer and Mr. H.F. Pounds entered into an Agreement for Releases in relation to the Land with the Queens Most Excellent Majesty and the Crown Estate Commissioners. Under this agreement the consideration payable by the taxpayer for the release in respect of its part of the land was the sum of £90,000.00.

E (d) The consideration under the Option Agreement of £399,750.00 was paid to the taxpayer's solicitors on 9 September 1988 and held by them in a designated bank account as stakeholders pursuant to the terms of the Option Agreement. On 18 May 1990 the consideration for the release of £90,000.00 was sent by the taxpayer's solicitors to Messrs. Farrer & Co., solicitors for F the Crown Estate Commissioners and the balance held by the taxpayer's solicitors was sent by telegraphic transfer to the bank account of Mr. H.F. Pounds as agent for the taxpayer. Interest was paid periodically during the currency of the stakeholder account to Mr. H.F. Pounds as agent for the taxpayer.

G (e) Mowat did not exercise the options before the end of the option period.

6. The grounds of appeal by the taxpayer were as follows:—

H (a) The taxpayer did not become unconditionally entitled to the consideration for the grant of the option until he had procured the release required by Clause 1.3 of the Option Agreement.

(b) The obligation to procure the release was a liability under the contract for the disposal of the option. It was not a liability which was to be I disregarded by virtue of s 40 or 41 Capital Gains Tax Act 1979 ("CGTA").

(c) The disposal of the option took place when the taxpayer became unconditionally entitled to the consideration for the grant of the option on 18 May 1990.

([1]) Not included in the present print.

(d) In valuing the consideration received by the taxpayer for the disposal of the option account had to be taken of the value of the liabilities under the Option Contract to pay for a release of certain restrictions.

(e) The value of the liability at the time of the disposal of the option was the full amount which the taxpayer had to pay to obtain the release. Therefore, the full amount of £90,000.00 ought to be deducted in computing the consideration received by the taxpayer for the disposal of his option.

(f) The sum of £90,000.00 was paid to the Crown Estates Commissioners in order to allow the taxpayer to make a disposal of the option.

(g) The sum of £90,000.00 was not paid with the intention of enhancing the value of the land owned by the taxpayer and the payment did not in fact enhance the value of the land.

(h) The purpose of the payment was to enable the taxpayer to receive the option price. The release of the land from the various restrictions was an incidental result. Therefore the sum of £90,000.00 was deductible from the total consideration received by the taxpayer in computing the chargeable gain realised by the taxpayer on the disposal of the option. This deduction was authorised by s 32(1)(a) Capital Gains Tax Act 1979 since the payment was expenditure wholly and exclusively incurred by the taxpayer in providing the asset (ie. the option).

7. The contentions on behalf of the Inspector of Taxes were:—

(a) The Option Agreement was an unconditional contract effecting the grant of the option to the developer on that date. Accordingly 9 September 1988 was the date of the disposal of the option for capital gains tax purposes.

(b) The consideration for the disposal of the option was the right to receive £399,750.00 in certain circumstances (as defined in the Option Agreement). By virtue of s 40(2) Capital Gains Tax Act the entire sum of £399,750.00 must be brought into account in each case as the consideration for the disposal in computing the chargeable gain arising to the taxpayer on 9 September 1988.

(c) There was nothing contingent about the taxpayer's obligation to use his best endeavours to procure the release. Those obligations were immediately binding terms of the contract for the grant of the option. The potential cost of performing them would thus have already been taken into account in determining the amount of the consideration payable for the option (*vis* Clause 1.3 of the Option Agreement).

(d) The sum in question was only spent on procuring the release after the option had already been disposed of. That sum is therefore not allowable under s 32 Capital Gains Tax Act as a deduction from the consideration in computing the chargeable gain realised by the taxpayer on disposal of the option.

(e) It is immaterial to the question at issue in these proceedings (a) whether or not the sum paid for the release was paid with the intention of enhancing the value of the land or (b) whether or not as a matter of fact that sum did enhance the value of the land. The latter question is in any event

A one which, in the absence of agreement, only the Lands Tribunal could be asked to determine (s 47(1) Taxes Management Act 1970).

8. The following cases were cited to us in support of the taxpayer's contentions:—*Aberdeen Construction Group Ltd.* v. *Commissioners of Inland Revenue* (52 TC 281); *Chaney* v. *Watkiss* (1986) STC 89; *Randall* v. *Plumb*
B (1975) STC 191.

9. (a) We came to the conclusion that the date of the disposal of the option by the taxpayer for capital gains tax purposes was the 9 September 1988. We came to the conclusion that Clause 1.1 of the Agreement dated 9 September 1988 is not a condition precedent, that the Option Agreement was
C an unconditional contract and therefore the date of disposal was the date of the Option Agreement namely 9 September 1988.

(b) We came to the conclusion that in realistic terms the sum of £90,000.00 had to be expended for the release of the restrictive covenants
D before a sale of the land could take place. The reality of the situation was that no buyer would complete a purchase without the restrictive covenants being released. Without the release of the restrictive covenants the market value of the land would be very much less. We were unable to accept the contention of the Inspector that the potential cost to the taxpayer of obtaining the release of the restrictive covenants would have already have
E been taken into account in determining the amount of the consideration payable for the options. In these circumstances we came to the conclusion that the sum of £90,000.00 paid by the taxpayer under the Agreement dated 18 May 1990 is to be allowed as a deduction from the consideration of £399,750.00 pursuant to s 32 Capital Gains Tax Act as this amount had to be paid by the taxpayer to enable him to make a disposal of the option. In
F reaching this conclusion we were bearing in mind the *dicta* of Lord Wilberforce in the case of *Aberdeen Construction Group Ltd.* v. *Commissioners of Inland Revenue* (52 TC 281, at page 296F) where the noble and learned Lord stated

> "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
G 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."

H

10. We accordingly determined the appeal in principle in the taxpayer's favour, and adjourned the proceedings until a later date, to allow for agreement of the figures in which to determine the assessments in light of our decision. On 1 June 1995 we determined the further assessments to corporation tax for the year ended 31.12.1988 in the sum of £296,266 and we
I determined the assessment to corporation tax for the year ended 31.12.90 in the sum of nil. We caused our Clerk to send copies of our signed determination to the Inspector and to the Taxpayer by first class post on 1 June 1995. The Solicitor of Inland Revenue wrote to our Clerk on 6 June 1995 on behalf of the Inspector expressing dissatisfaction with our decision and requiring us to state and sign a Case for the opinion of the High Court

pursuant to s 56 of the Taxes Management Act 1970 which Case we have now stated and do sign accordingly. A

11. The question of law for the opinion of the High Court is:—

(a) Whether on the facts found as hereinbefore set forth there was evidence upon which we could properly arrive at our decision of principle in so far as they were questions of fact and B

(b) Whether on the facts found those decisions were correct in law.

1 November 1995 C

Garner (HMIT) v. Henry Frederick Pounds

D

CASE

Stated under the Taxes Management Act 1970, s 56 by the Commissioners for the General Purposes of the Income Tax for the Division of Portsmouth for the opinion of the High Court of Justice. E

1. At a meeting of the Commissioners for the General Purposes of the Income Tax for the Division of Portsmouth held on the 10 day of May 1995 Henry Frederick Pounds (hereinafter called "the Taxpayer") appealed against the following assessments to Capital Gains Tax in respect of the disposal by the taxpayer to Mowat Group PLC of an option to purchase certain land:— F

1988–1999	£399,750.00
1990–1991	£310,000.00

2. The questions for determination by us were:— G

(a) On what date was the disposal of the option by the taxpayer for capital gains tax purposes.

(b) Whether the sum of £90,000.00 paid by the taxpayer to the Crown Estates Commissioners under an agreement for release dated 18 May 1990 should be included in the consideration for grant of the option by the taxpayer to Mowat Group PLC. H

3. Mr. E.H. Garner, Her Majesty's Inspector of Taxes and acting District Inspector for Portsmouth 1 District (hereinafter called "the Inspector") was represented by Miss F. Riddy of the Office of the Solicitor of Inland Revenue. The taxpayer was represented by Mr. Ewart of Counsel. The taxpayer gave oral evidence and Mr. Lawrence Justin Guyer gave oral evidence on behalf of the taxpayer. I

4. The following documents were admitted in evidence before us:—

A

(a)	Capital Gains Tax Assessment and Appeal	1988, 1990
(b)	Statement of Agreed facts and Question for determination	Undated
(c)	Option Agreement	9.9.88
(d)	Agreement for Release and Deed of Release	18.5.90
(e)	An Opinion of Mr. Geraint Thomas	3.7.89
(f)	Letter from The Crown Estate to Sherwin Oliver	15.6.89
(g)	Letter from Sherwin Oliver to The Crown Estate	7.8.89
(h)	Letter from Sherwin Oliver to the Lands Tribunal	8.9.89
(i)	Letter from the Lands Tribunal to Sherwin Oliver	13.9.89
(j)	Letter from Sherwin Oliver to the Lands Tribunal	20.9.89
(k)	Letter from Sherwin Oliver to Farrer & Co.	15.1.90
(l)	Letter from Sherwin Oliver to Robin Myddleton & Co.	13.2.90
(m)	Letter from Robin Myddleton & Co. to Sherwin Oliver	20.2.90
(n)	Letter from Farrer & Co. to Sherwin Oliver	27.2.90
(o)	Letter from Sherwin Oliver to Farrer & Co.	2.3.90

B

C

D The Option Agreement dated 9 September 1988 and the Agreement for release dated 18 May 1990 is annexed to this Case as Exhibit A([1]) and the Deed of Release dated 18 May 1990 is annexed to this Case as Exhibit B([1]). The remainder of the documents referred to above are are available for production to the Court if required.

E 5. The following matters of fact were proved or admitted before us:—

(a) The taxpayer has at all material times been resident in the United Kingdom.

F (b) On 9 September 1988 Mowat Group PLC ("Mowat") entered into identical option agreements with each of the taxpayer. Pounds Shipowners and Shipbreakers Ltd. ("PSS") and Trafalgar Wharves Ltd. ("TWL"). The options entitled Mowat to purchase certain land ("the Land") owned by the taxpayer, PSS and TWL for a total sum of £4,490,000. The consideration for the grant of the option by the taxpayer was £399,750.

G (c) On 18 May 1990 the taxpayer and Pounds Shipowners and Shipbreakers Ltd. entered into an Agreement for Releases in relation to the Land with the Queens most Excellent Majesty and the Crown Estate Commissioners. Under this Agreement the consideration payable by the taxpayer for the release in respect of his part of the land was the sum of £90,000.00.

H

(d) The consideration under the Option Agreement of £399,750.00 was paid to the taxpayer's solicitors on 9 September 1988 and held by them in a designated bank account as stakeholders pursuant to the terms of the Option Agreement. On 18 May 1990 the consideration for the release of £90,000.00 was sent by the taxpayer's solicitors to Messrs. Farrer & Co., solicitors for the Crown Estate Commissioners and the balance held by the taxpayer's solicitors was sent by telegraphic transfer to the bank account of the taxpayer. Interest was paid periodically during the currency of the stakeholder account to the taxpayer.

I

([1]) Not included in the present print.

(e) Mowat did not exercise the options before the end of the option period. A

6. The grounds of appeal by the taxpayer were as follows:—

(a) The taxpayer did not become unconditionally entitled to the consideration for the grant of the option until he had procured the release required by Clause 1.3 of the Option Agreement. B

(b) The obligation to procure the release was a liability under the contract for the disposal of the option. It was not a liability which was to be disregarded by virtue of s 40 or 41 Capital Gains Tax Act 1979 ("CGTA"). C

(c) The disposal of the option took place when the taxpayer became unconditionally entitled to the consideration for the grant of the option on 18 May 1990.

(d) In valuing the consideration received by the taxpayer for the disposal of the option account had to be taken of the value of the liabilities under the Option Contract to pay for a release of certain restrictions. D

(e) The value of the liability at the time of the disposal of the option was the full amount which the taxpayer had to pay to obtain the release. Therefore, the full amount of £90,000.00 ought to be deducted in computing the consideration received by the taxpayer for the disposal of his option. E

(f) The sum of £90,000.00 was paid to the Crown Estates Commissioners in order to allow the taxpayer to make a disposal of the option.

F

(g) The sum of £90,000.00 was not paid with the intention of enhancing the value of the land owned by the taxpayer and the payment did not in fact enhance the value of the land.

(h) The purpose of the payment was to enable the taxpayer to receive the option price. The release of the land from the various restrictions was an incidental result. Therefore the sum of £90,000.00 was deductible from the total consideration received by the taxpayer in computing the chargeable gain realised by the taxpayer on the disposal of the option. This deduction was authorised by s 32(1)(a) CGTA since the payment was expenditure wholly and exclusively incurred by the taxpayer in providing the asset (i.e. the option). G

H

7. The contentions on behalf of the Inspector of Taxes were:—

(a) The Option Agreement was an unconditional contract effecting the grant of the option to the developer on that date. Accordingly 9 September 1988 was the date of the disposal of the option for capital gains tax purposes. I

(b) The consideration for the disposal of the option was the right to receive £399,750.00 in certain circumstances (as defined in the Option Agreement). By virtue of s 40(2) CGTA the entire sum of £399,750.00 must be brought into account in each case as the consideration for the disposal in computing the chargeable gain arising to the taxpayer on 9 September 1988.

A (c) There was nothing contingent about the taxpayer's obligation to use his best endeavours to procure the release. Those obligations were immediately binding terms of the contract for the grant of the option. The potential cost of performing them would thus have already been taken into account in determining the amount of the consideration payable for the option (*vis* Clause 1.3 of the Option Agreement).

B

(d) The sum in question was only spent on procuring the release after the option had already been disposed of. That sum is therefore not allowable under s 32 Capital Gains Tax Act as a deduction from the consideration in computing the chargeable gain realised by the taxpayer on disposal of the option.

C

(e) It is immaterial to the question at issue in these proceedings (a) whether or not the sum paid for the release was paid with the intention of enhancing the value of the land or (b) whether or not as a matter of fact that sum did enhance the value of the land. The latter question is in any event one which, in the absence of agreement, only the Lands Tribunal could be D asked to determine s 47(1) Taxes Management Act 1970).

8. The following cases were cited to us in support of the taxpayer's contentions:—*Aberdeen Construction Group Ltd.* v. *Commissioners of Inland Revenue* (52 TC 281); *Chaney* v. *Watkis* (1986) STC 89; *Randall* v. *Plumb* E (1975) STC 191.

9.(a) We came to the conclusion that the date of the disposal of the option by the taxpayer for capital gains tax purposes was 9 September 1988. We came to the conclusion that Clause 1.1 of the Agreement dated 9 September 1988 is not a condition precedent, that the Option Agreement F was an unconditional contract and therefore the date of disposal was the date of the Option Agreement namely 9 September 1988.

(b) We came to the conclusion that in realistic terms the sum of £90,000.00 had to be expended for the release of the restrictive covenants before a sale of the land could take place. The reality of the situation was G that no buyer would complete a purchase without the restrictive covenants being released. Without the release of the restrictive covenants the market value of the land would be very much less. We were unable to accept the contention of the Inspector that the potential cost to the taxpayer of obtaining the release of the restrictive covenants would have already have been taken into account in determining the amount of the consideration H payable for the options. In these circumstances we came to the conclusion that the sum of £90,000.00 paid by the taxpayer under the Agreement dated 18 May 1990 is to be allowed as a deduction from the consideration of £399,750.00 pursuant to s 32 Capital Gains Tax Act as this amount had to be paid by the taxpayer to enable him to make a disposal of the option. In reaching this conclusion we were bearing in mind the *dicta* of Lord I Wilberforce in the case of *Aberdeen Construction Group Ltd.* v. *Commissioners of Inland Revenue* (52 TC 281, at page 296F) where the noble and learned Lord stated

> "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."

10. We accordingly determined the appeal in principle in the taxpayer's favour, and adjourned the proceedings until a later date, to allow for agreement of the figures in which to determine the assessments in light of our decision. On 1 June 1995 we determined the capital gains tax assessment for the tax year 1988–89 in the sum of chargeable gains of £309,802 and we determined the capital gains tax assessment for the tax year 1990–91 in the sum of nil. We caused our Clerk to send copies of our signed determination to the Inspector and to the taxpayer by first class post on 1 June 1995. The Solicitor of Inland Revenue wrote to our Clerk on 6 June 1995 on behalf of the Inspector expressing dissatisfaction with our decision and requiring us to state and sign a Case for the opinion of the High Court pursuant to s 56 of the Taxes Management Act 1970 which Case we have now stated and do sign accordingly.

11. The question of law for the opinion of the High Court is:—

(a) Whether on the facts found as hereinbefore set forth there was evidence upon which we could properly arrive at our decision of principle in so far as they were questions of fact and

(b) Whether on the facts found those decisions were correct in law.

1 November 1995

The case was heard in the Chancery Division before Carnwath J. on 20 February 1997 when judgment was reserved. On 21 February 1997 judgment was given against the Crown, with costs.

Michael Furness for the Crown.

David Ewart for the Company and the taxpayer.

The cases cited in oral/skeleton argument were those referred to in the judgment.

Carnwath J.:—I have before me two appeals by Case Stated from decisions of the General Commissioners for Portsmouth. They both give rise to exactly the same considerations and the facts are for all material purposes identical. Unfortunately, the individual Respondent Mr. Pounds has died since the Commissioners' hearing and his estate has been substituted as Respondent. In this case I shall refer simply to the case involving the company.

The background is an agreement dated 9 September 1988 whereby the company granted to the Mowat Group plc an option to buy certain land in

A Portsmouth, the sale price being over £4m. The option was not exercised in the event. The issue before me is the correct treatment for CGT purposes of the option, viewed, as it has to be under the Act, as a distinct asset.

The relevant provisions of the agreement are as follows. Clause 1 provided:

B "In consideration of the sum of ... £399,750 ... paid by the intending purchaser to the First Company's Solicitors ... the First Company hereby grants to the intending purchaser an option to purchase the property subject to the following terms and conditions."

The option was exercisable during the option period, which was defined C by clause 2 as extending to 14 January 1991 or, if earlier, a date 62 days following the grant of planning permission for a development that Mowat was intending to pursue. As I understand it, in the event planning permission was not granted and so the option period would have extended to 14 January 1991.

By clause 1.3 the sum of £399,750 was to be held by the company's D solicitors as "stakeholders" until such time as the release had been secured of various covenants over the land held by the Crown Estate Commissioners and the Queen, and also the grant of a lease dealing with certain other rights. Clause 1.3 continues:

"Upon such releases (or agreements for such releases) and Lease ... E being delivered to the First Company's Solicitors the sum of ... £399,750 may be paid to the First Company together with the interest which has accrued thereto. The First Company undertakes with the intending purchaser that each of the Estate Owners shall use his or its respective best endeavours to procure such release (or agreement for such release) as soon as possible provided that in negotiating for the F releases of the above covenants the Estate Owner shall not be required to pay or commit themselves to pay more than ... £750,000 ... in total as the consideration for the releases but the Intending Purchaser shall be entitled to pay or commit itself to pay any excess over and above the sum of ... £750,000 ... In the event that the First Company shall not succeed during this option period in procuring either of the releases of such covenants or the said Lease then if the option shall not be exercised G the said sum of ... £399,750 ... shall be refunded to the Intending Purchaser but without interest thereon and such interest will be paid to the First Company."

The rest of the material facts can be taken from the Case Stated. The H Commissioners held as follows([1]):

"5(c) On 18 May 1990 the taxpayer and Pounds Shipowners and Shipbreakers Ltd. entered into an Agreement for Releases in relation to the Land with the Queen's Most Excellent Majesty and the Crown Estate Commissioners. Under this Agreement the consideration payable by the taxpayer for the release in respect of his part of the land was the I sum of £90,000.

(d) The consideration under the Option Agreement of £399,750 was paid to the taxpayer's solicitors on 9 September 1988 and held by them in a designated bank account as stakeholders pursuant to the terms of

([1]) Page 569 *ante*.

the Option Agreement. On 18 May 1990 the consideration for the release of £90,000 was sent by the taxpayer's solicitors to Messrs. Farrer & Co., solicitors for the Crown Estate Commissioners, and the balance held by the taxpayer's solicitors was sent by telegraphic transfer to the bank account of the taxpayer. Interest was paid periodically during the currency of the stakeholder account to the taxpayer.

(e) Mowat did not exercise the options before the end of the option period."

There were two issues before the Commissioners which they identified as follows:(1)

"(a) On what date was the disposal of the option by the taxpayer for capital gains tax purposes?

(b) Whether the sum of £90,000 paid by the taxpayer to the Crown Estates Commissioners under an agreement for release dated 18 May 1990 should be included in the consideration for grant of the option by the taxpayer to Mowat Group plc."

The Commissioners decided the first issue against the taxpayer. They expressed their conclusions as follows(2):

"9(a) We came to the conclusion that the date of the disposal of the option by the taxpayer for capital gains tax purposes was 9 September 1988. We came to the conclusion that Clause 1.1 of the Agreement dated 9 September 1988 is not a condition precedent, that the Option Agreement was an unconditional contract and therefore the date of disposal was the date of the Option Agreement namely 9 September 1988."

There has been no appeal against that conclusion.

On the second issue the Commissioners concluded as follows(3):

"We came to the conclusion that in realistic terms the sum of £90,000 had to be expended for the release of the restrictive covenants before a sale of the land could take place. The reality of the situation was that no buyer would complete a purchase without the restrictive covenants being released. Without the release of the restrictive covenants the market value of the land would be very much less. We were unable to accept the contention of the Inspector that the potential cost to the taxpayer of obtaining the release of the restrictive covenants would have already been taken into account in determining the amount of the consideration payable for the options. In these circumstances we came to the conclusion that the sum of £90,000 paid by the taxpayer under the Agreement dated 18 May 1990 is to be allowed as a deduction from the consideration of £399,750 pursuant to s 32 CGTA as this amount had to be paid by the taxpayer to enable him to make a disposal of the option."

The Commissioners went on to indicate that they had been assisted by the guidance of Lord Wilberforce in *Aberdeen Construction Group Ltd.* v. *Commissioners of Inland Revenue* [1978] AC 885; 52 TC 281, in particular, his Lordship's reference to the need to have regard to "normal business principles". I shall return to that case later.

---

(1) Page 568 *ante*. (2) Page 571 *ante*. (3) Page 571 *ante*.

The relevant statutory provisions were those contained in the Capital Gains Tax Act 1979. There are specific provisions dealing with options. Section 27 deals with the time of disposal. Under subs (1) it is provided that where an asset is disposed of under a contract the time at which the disposal is made is the time of the contract and not, if different, the time of the subsequent conveyance. Subsection (2) provides:

> "If the contract is conditional (and in particular if it is conditional on the exercise of an option) the time at which the disposal and acquisition is made is the time when the condition is satisfied."

That would have been relevant if there had been exercise of the option, but that did not take place.

Section 137 deals specifically with options:

> "(1) Without prejudice to section 19 above (general provisions about the disposal of assets), the grant of an option ... is the disposal of an asset (namely of the option), but subject to the following provisions of this section as to treating the grant of an option as part of a larger transaction.
>
> (2) If an option is exercised the grant of the option and the transaction entered into by the grantor in fulfilment of his obligations under the option shall be treated as a single transaction and accordingly—
>
> (*a*) if the option binds the grantor to sell, the consideration for the option is part of the consideration for the sale, and
>
> (*b*) if the option binds the grantor to buy, the consideration for the option shall be deducted from the cost of acquisition incurred by the grantor in buying in pursuance of his obligations under the option."

Subsection (2) applies only where the option is exercised, which is not this case. Subsection (1) makes clear that one must regard the disposal of the option as the disposal of a distinct asset, not (as might otherwise be the case) the part-disposal of the underlying asset, in this case the land.

Turning to the computation of the gain on such a disposal, that is governed by the provisions of Part II, Chapter II, beginning with s 28. The implication of these provisions, though nowhere stated expressly, is that in the case of an arm's length disposal for a monetary consideration such consideration is the starting point for the computation of the gain. There is no basic rule indicating how that consideration is to be identified, but there are various provisions indicating the matters to be taken into or left out of account. There is also a detailed provision indicating the deductions which may be made.

In the present case the relevant provisions are the following. Section 32 deals with expenditure:

> "(1) Except as otherwise expressly provided, the sums allowable as a deduction from the consideration in the computation under this Chapter 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."

Section 40 (the sidenote to which reads "Consideration due after time of disposal") provides:

"(2) In the computation under this Chapter 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 is subsequently shown to the satisfaction of the inspector to be irrecoverable, such adjustment, whether by way of discharge or repayment of tax or otherwise, shall be made as is required in consequence."

Section 41 (the sidenote to which reads "Contingent liabilities") provides that in the first instance no allowance shall be made in the computation for certain categories of contingent liabilities specified in paras (a) to (c). Subsection (2) provides:

"If it is subsequently shown to the satisfaction of the inspector that any such contingent liability has become enforceable, and is being or has been enforced, such adjustment, whether by way of discharge or repayment of tax or otherwise, shall be made as is required in consequence."

It is not suggested in this case that the facts bring it within any of the paras (a) to (c). This section has been referred to by way of analogy. It is also relevant to one of the authorities to which I will turn in a moment.

Section 43 provides:

"(1) No deduction shall be allowable in a computation under this Chapter more than once from any sum or from more than one sum ...

(4) For the purposes of any computation under this Chapter any necessary apportionments shall be made of any consideration or of any expenditure and the method of apportionment adopted shall, subject to the express provisions of this Chapter, be such method as appears to the inspector or on appeal the Commissioners concerned to be just and reasonable."

I have also been referred to two authorities that show that in identifying the "consideration", which is the starting point of the exercise, the Court should look at the particular transaction as a whole, to see what in practical

A terms the disponer received for the asset. The leading authority is *Aberdeen Construction Group Ltd. (supra)*[1]. In that case there was a sale of shares in a company for £250,000 on conditions which included the waiver by the vendor of a loan to the company amounting to £500,000. The House of Lords by a majority held that it was wrong to treat the £250,000 as the consideration for the shares alone without regard to the "business reality" of B the transaction as a whole which included the waiver of the loan.

At page 296F, Lord Wilberforce made some general comments about the Act which have often been cited (and were cited by the Commissioners in this case)[2]:

C "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 D 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."

E Lord Wilberforce went on to say that in that case there was in effect a composite obligation. The contract was that (i) the Appellants should transfer the shares and waive the loan and (ii) that Westminster would pay £250,000. He went on to say (at page 297D)[3]:

"The effect of this is that Westminster was paying £250,000 not F only for the shares, but for the composite obligation undertaken by the Appellants. If this is right, in order to ascertain what Westminster was paying and the Appellants receiving for their shares, an apportionment would have to be made of the sum of £250,000 between these two obligations."

G The case of *Randall* v. *Plumb*[4] 50 TC 392, though earlier, is perhaps closer to the present case in that it involved the grant of an option which was not exercised, at any rate by the time the case was heard. In 1966 the taxpayer had granted an option to a gravel company in consideration of an immediate deposit of £25,000 to purchase certain land for £100,000 within a period of 20 years, but subject to the condition that the company had the H right to require the return of the £25,000 if planning permission for gravel extraction was not obtained within 10 years.

The taxpayer was assessed to capital gains tax on a gain of £25,000, that being the immediate deposit. The Crown argued that the potential repayment obligation was either a contingent liability under the predecessor of s 41, and, I therefore, to be left out of account initially, or, if not covered by a specific provision, it was a liability that had to be ignored altogether. Walton J. rejected both arguments, reserving his most forceful language for the second. As to that he said (at page 400G–I)[5]:

---

(1) 52 TC 281. (2) [1978] AC 885, at pages 892H/893A.
(3) [1978] AC 885, at page 893G/H. (4) [1975] 1 WLR 633. (5) *Ibid*, at page 637F/H.

"I cannot accept this submission for one moment. I draw precisely the opposite conclusion, namely that unless the contingency is one which is expressly mentioned in one or other of these sub-paragraphs, in which case the contingency is to be disregarded but justice will be done to the taxpayer if the contingency actually turns out the wrong way by an adjustment of tax, 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 consideration which truly reflects the contingency to which the matter is subject. Of course this will not do ideal justice, or even such justice as an adjustment to the tax actually paid will effect, 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; but this is a chance which may redound to the advantage or to the disadvantage of either party.

He concludes by saying (at page 402A)[1]:

"I therefore reach the conclusion that there are no special provisions in Sch. 6 which require the contingency of repayment in the present case to be disregarded. Accordingly, it appears to me that the exercise which now falls to be carried out is that the value of what Mr. Randall obtained for the grant of the option under the agreement falls to be ascertained; that is to say, the right to an immediate deposit of £25,000 with the incident that it may fall to be repaid under the provisions of clause 10(i) or (ii) thereof."

That judgment was not subject to appeal, and it has not been submitted before me that there is anything wrong with that approach.

Turning to the present case, the Revenue's submission is reasonably simple. The consideration for the option was that stated in the agreement, namely £399,750, and the taxpayer cannot bring himself within any of the provisions that allow a qualification or deduction. Admittedly, that would plainly be subject to the risk that it might not be paid if the covenants were not released, but that is governed by s 40(2). Accordingly, the amount is chargeable initially but adjusted if the risk materialises. In this case it did not. As far as s 41 is concerned, there is an obligation to use best endeavours in securing release, but that is not a contingent liability within s 41. Indeed, it is not a contingent liability at all but an immediate obligation.

As far as s 32 is concerned, say the Revenue, the option as an asset in its right was not acquired and there was no consideration for its acquisition. The money was not incurred in "providing the asset" because the option as a separate asset was provided when it was disposed of in September 1988. As far as s 32(b) is concerned, it is questionable whether the money can be said to have been incurred "on the asset", but in any event it was not reflected in the value of the asset at the time of disposal. In this respect one may draw a comparison with the decision in *Chaney* v. *Watkis*[2] 58 TC 707 where, on a conveyance following a contract, expenditure on the property after contract but before conveyance was treated as reflected in the value "at the time of disposal", notwithstanding the provision to make the date of the contract the date of the disposal. Such a stretching of the language may be possible when

(1) [1975] 1 WLR 633, at pages 638H/639A. (2) [1986] STC 89.

A dealing with a two-stage disposal of that kind but not the disposal of an option which the Act treats as a distinct and single event, unless and until the option is exercised.

Finally, the Crown say that the money was not expended in establishing, preserving or defending the title to the option or a right over it. Indeed, the B Revenue say that in truth this was money spent on enhancing the value of the land, not the option as a distinct asset, and it would be properly taken into account as a deduction if and when the land is disposed of.

The taxpayer's case before me falls under two heads. First, Mr. Ewart relies on the s 32 deduction provisions; and, secondly, on an argument as to C the identification of the "consideration". As I have said, the Commissioners relied on s 32 but did not specify a particular part of the detailed provisions. Mr. Ewart relies on the second part of s 32(1)(a). He submits that this was "expenditure wholly and exclusively incurred" in providing the asset. As to that, I agree with the Crown's analysis. It is not possible to put the circumstances of the case into any of the categories specified in s 32. In D particular, they do not fit the second part of para (a). The asset was provided long before the expenditure was incurred. The expenditure may have been incurred pursuant to the option, but not in providing it.

I turn to the second, though logically the primary, submission of the taxpayer, namely as to the identification of the consideration. Mr. Ewart E submits that by analogy with *Randall* v. *Plumb*[1] the onerous obligation under clause 1(3) to secure, if reasonable endeavours will achieve it, the release of the covenants, must be taken into account in computing the consideration. He submits that the best evidence of the value of the obligation is the £90,000 actually paid for it.

F

In principle, I agree with that approach. As in the two cases referred to, it is contrary to business reality to have regard only to the nominal consideration stated in the agreement, without regard to the other incidents of the transaction which materially affect the value of that consideration to the grantor. The value to which the company was entitled under the option G was not £399,750. That nominal entitlement was qualified in two ways. First, it was dependent on the company being able to secure the release of the relevant covenants. Failing that, it would receive nothing. Secondly, assuming release, the net consideration in its hands would be the nominal amount less whatever was required to secure that release. If the release cost £399,750, in practical terms it would receive nothing. Applying the approach H of Walton J. and asking what value the company obtained by the grant of the option, the answer would be £399,750 less whatever was necessary to secure the release of the covenants.

Mr. Furness, for the Crown, makes three points in response. First, he submits that the risk that the nominal sum will not be received is a I contingency that must be disregarded in the first instance under s 40(2) and taken into account only in the light of subsequent circumstances. I agree so far as it applies to the first qualification I have mentioned, that is the risk that the release will not be obtained resulting in the right to payment being lost altogether. That is a future contingency. If the release had not been

(1) 50 TC 392.

possible there would have been no right to the £399,750. Therefore, the prior assessment would have to be discharged. But the same does not apply to the second qualification. The need to obtain the release of the covenants is not a contingent liability or future risk. From the outset it is an essential incident of the right to consideration. The amount may be uncertain, but as in *Randall* v. *Plumb* that is a matter of valuation, not principle.

Secondly, Mr. Furness says that payment of the £90,000 is reflected in the enhanced value of the land and, therefore, does not represent a pure loss to the grantor. There is some uncertainty about this on the facts. The Case records the submission by the taxpayer that the £90,000 was not paid with the intention of enhancing the value of the land and that the payment did not in fact enhance the value of the land. However, there is no reference to any evidence on the point. The Revenue's submissions as recorded were that it was immaterial whether the money was paid with the intention of enhancing the value of the land or whether in reality it did. The Revenue says that in the absence of agreement it is a question which can be determined only by the Lands Tribunal under s 47(1) of the Taxes Management Act 1970. The Commissioners do not discuss this matter in any detail, although it appears to be implicit in their conclusions that the expenditure had an effect on the value since they say:

> "Without the release of the restrictive covenants the market value of the land would be very much less."

On the other hand, it is not clear whether this would have been their view assuming that no planning permission was granted, as was the case.

Mr. Ewart has told me that evidence was prepared to deal with a potential submission by the Revenue, relevant to s 32, that the payment was in part intended for the improvement of the land and, therefore, was not "wholly and exclusively" directed to the option viewed as a separate asset. As he told me, that argument was not advanced by the Revenue and the evidence was, accordingly, not called. It seems to me that the matter is left somewhat uncertain on the case as it stands. If it were material it might be necessary to remit it.

However, I bear in mind that I am looking at the option as a separate asset distinct from the land. In relying on s 32 the Commissioners have implicitly accepted that the £90,000 was wholly and exclusively directed to that. The contrary does not appear to have been argued before them. It is right, therefore, to regard the whole of the £90,000 as a deduction from the consideration without regard to the incidental benefit to the land, if any. That benefit would be taken into account if and when a gain is realised on the sale or disposal of the land itself. As Mr. Ewart says, the £90,000 cannot be treated as a deduction at that point. Having been accepted as referable to the option as a distinct asset, it cannot be claimed to have been expended wholly and exclusively on the land.

Thirdly, Mr. Furness says that, even if the cost of obtaining release is to be taken into account, the right deduction is the value properly put on the obligation as at the date of the option agreement, not what was found to be the cost almost two years later. For that he relies on the approach in *Randall* v. *Plumb*. However, in that case the contingency had not been worked out. Therefore, it was necessary to attempt a valuation, however unsatisfactory

A that might be, as Walton J. acknowledged. On the other hand, in this case, we know what it cost. I referred the parties to the so-called *Bwllfa* principle derived from the case of *The Bwllfa and Merthyr Dare Steam Collieries (1891) Ltd.* v. *The Pontypridd Waterworks Co.* [1903] AC 426. In that case Lord Macnaghten referred to the use of hindsight in a valuation exercise, where not precluded expressly or implicitly by the particular statute. At page B 431, he said:

> "If the question goes to arbitration, the arbitrator's duty is to determine the amount of compensation payable. In order to enable him to come to a just and true conclusion it is his duty, I think, to avail himself of all information at hand at the time of making his award C which may be laid before him. Why should he listen to conjecture on a matter which has become an accomplished fact? Why should he guess when he can calculate? With the light before him, why should he shut his eyes and grope in the dark?"

Those words have been quoted on many occasions and in many D different contexts. (I note that in *Simpson* v. *Jones*(1) [1968] 2 All ER 929 Megarry J. applied them in a somewhat different tax context.)

Clearly, one needs to have regard to the particular statutory context, but I see nothing in the provisions relating to the computation of gains under E the Capital Gains Tax Act 1979 which requires me to insist on an artificial valuation exercise as at 9 September 1988, when the value of the consideration which the taxpayer received for this option is known.

Accordingly, it seems to me that the Commissioners arrived at the correct answer, albeit by a slightly different route from that which I have F followed, and the appeal fails.

Appeals dismissed, with costs.

G

The Crown's appeals were heard in the Court of Appeal (Nourse, Waller L.JJ. and Sir Iain Glidewell) on 12 October 1988 when judgment was reserved. On 25 November 1988 judgment was given unanimously in favour of the Crown, with costs. Leave to appeal to the House of Lords was refused.

H

Launcelot Henderson Q.C. and *Michael Furness* for the Crown.

David Ewart and *Richard Vallat* for the Company and the taxpayer.

I The following case was cited in oral/skeleton argument in addition to the cases referred to in the judgment:—*Goodbrand* v. *Loffland Brothers North Sea Inc.* TC Leaflet 3561; [1998] STC 930.

---

(1) 44 TC 599.

Nourse L.J.:—

A

In issue on these appeals is the correct method of ascertaining, for capital gains tax purposes, the consideration for the grant of two options to purchase freehold land. The primary question for decision, as it has come to be seen in this court, is whether these cases are governed by *Randall* v. *Plumb* [1975] 1 WLR 633.

B

The appeals are by the Crown against a decision of Mr. Justice Carnwath [1997] STC 551([1]). All references to page numbers are to the pages in that report. In the light of a minor concession made by the Crown there is no material distinction between the two appeals, each of the taxpayers having granted an option in identical terms to the same grantee for an identical consideration. Moreover, although the assessment on the taxpayer company was to corporation tax on chargeable gains rather than to capital gains tax, the chargeable gains of a company are computed in accordance with capital gains tax principles. In the circumstances, I can, like the judge, refer simply to the case involving the taxpayer company.

C

D

The material facts are summarised in the case stated by the General Commissioners of the Portsmouth Division (page 553). It is necessary to refer in some detail to the agreement by which the option was granted. It was dated 9 September 1988 and was made between the taxpayer company (called "the First Company") and Mowat Group Plc (called "the intending purchaser"), to which I will refer as "Mowat". It recited, first, that the taxpayer company was the owner of the freehold property in Portsmouth described in the schedule thereto (called "the property"); secondly, that the individual taxpayer and another company (together with the taxpayer company called "the Estate Owner") were the freehold owners of the adjoining land; thirdly, that the taxpayer company had agreed with Mowat to grant to Mowat the option thereinafter contained; and, fourthly, that Mowat was simultaneously entering into option agreements in the same form with the individual taxpayer and the other company. Clause (1) of the agreement was in these terms:

E

F

> "In consideration of the sum of ... £399,750 paid by the intending purchaser to the First Company's solicitors (receipt of which is hereby acknowledged) the First Company hereby grants to the intending purchaser an option to purchase the property subject to the following terms and conditions."

G

Subclause 1.1 provided for the option to be exercisable by the service of a notice in writing during an option period defined by clause (2) as ending not later than 14 January 1991. Subclause 1.2 provided that in the event of no such notice having been served before the expiry of the option period then the agreement should cease to be of any effect whatsoever save that, subject to clause 1.3, the £399,750 should not be or become repayable to Mowat.

H

Subclause 1.3 provided that the £399,750 should be held by the taxpayer company's solicitors "as stakeholders" until such time as certain covenants had been released by the Crown Estate Commissioners and the Crown respectively and the taxpayer company had used its best endeavours to procure the entry by a third party into a lease of a right of way as specified in clause (20) of the agreement. Subclause 1.3 continued:

I

([1]) Page 572 *ante*.

A "Upon such releases (or agreements for such releases) and Lease (as referred to in clause 20) being delivered to the First Company's Solicitors the sum of ... £399,750 may be paid to the First Company together with the interest which has accrued thereto. The First Company undertakes with the intending purchaser that each of the Estate Owners shall use his or its respective best endeavours to procure such release (or B agreement for such release) as soon as possible provided that in negotiating for the releases for the above covenants the Estate Owner shall not be required to pay or commit themselves to pay more than ... £750,000 in total as the consideration for the releases but the Intending Purchaser shall be entitled to pay or commit itself to pay any excess over and above the sum of ... £750,000. In the event that the First Company C shall not succeed during this option period in procuring either of the releases of such covenants or the said Lease then if the option shall not be exercised the said sum of ... £399,750 shall be refunded to the Intending Purchaser but without interest thereon and such interest will be paid to the First Company."

D Subclause 1.4 provided for the constitution, on the service of the purchase notice, of an immediately binding contract for the sale of the property by the taxpayer company to Mowat for the price of £4,490,000, the £399,750 being taken into account as part payment of the purchase price. Subclause 1.5 provided that completion of the purchase should then take place on 14 January 1991. No other provision of the option agreement need E be referred to.

The material provisions of the option agreement may be summarised as follows:

(1) The consideration for the grant of the option was expressed to F be £399,750.

(2) The £399,750 was not immediately payable to the taxpayer company, but was to be held by its solicitors as stakeholders until such time as the covenants were released and the lease granted, at which time the £399,750 might be paid to the taxpayer company.

G (3) The taxpayer company was to use its best endeavours to procure the releases of the covenants and the grant of the lease as soon as possible, provided that in negotiating for the releases the taxpayer company and the other two adjoining owners should not be required to pay more than £750,000 in total.

H (4) If the taxpayer company was unsuccessful during the option period in procuring the release of either covenant or the grant of the lease then, if the option was not exercised, the £399,750 was to be refunded to Mowat.

(5) If the option was not exercised, then, subject to (4) above, the I £399,750 would be payable to the taxpayer company.

(6) If the option was exercised, the £399,750 would be payable to the taxpayer company as part of the purchase price.

Pursuant to the option agreement the £399,750 was duly paid to the taxpayer company's solicitors on 9 September 1988, the date on which it was

entered into. Thereafter it was held by them in a designated bank account as stakeholders. On 18 May 1990 the taxpayer company and the individual taxpayer entered into an agreement with the Crown Estate Commissioners and the Crown for the release of the two covenants for a consideration of which the taxpayer company's half share was £90,000. On the same day the taxpayer company's solicitors paid £90,000 to the solicitors for the Crown Estate Commissioners out of the designated bank account and the balance was paid to the taxpayer company. Mowat did not exercise the option.

In 1988 the relevant statutory provisions were contained in the Capital Gains Tax Act 1979. It is common ground both that an option is an asset for the purposes of the Act (s 19(1)(a)) and that the grant of an option is the disposal of an asset (s 137(1)). Since the option was not exercised, s 137(2), which treats the grant of an option and the transaction entered into by the grantor in fulfilment of his obligations under it as a single transaction, was inapplicable. The option agreement having been unconditional, the option was disposed of on 9 September 1988 (s 27(1)). That too is now common ground (page 557G).

We have to decide what was the consideration for the disposal of the option. The Crown claims that it was the full £399,750. The taxpayer company claims that it was that sum less the £90,000 paid for the release of the covenants, either on the basis of a principle which it seeks to extract from the decision in *Randall* v. *Plumb* or on the ground that the £90,000 is a permissible deduction under s 32 of the Act. The commissioners held in favour of the taxpayer company on the second of those grounds. Mr. Justice Carnwath disagreed with them, but held in favour of the taxpayer company on the first ground. I will deal with the two questions in the same order.

A valuable introduction to the first question is to be found in the judgment of Lightman J. in *Spectros International Plc* v. *Madden* [1997] STC 114, 135J:

> "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: that is implicit in sections 31 and 32 of the Capital Gains Tax Act 1979 ...
>
> What is the relevant consideration may depend on 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 ... 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."

Lightman J. then referred to four authorities which fully support his observations, including *Aberdeen Construction Group Ltd.* v. *IRC* [1978] AC 885, *Booth (E V) Holdings Ltd.* v. *Buckwell* [1980] STC 578, and *Stanton* v. *Drayton Commercial Investment Co. Ltd.* [1983] AC 501.

For present purposes, the most important provision of the Act is s 40, to which the marginal note is "Consideration due after time of disposal". Subsection (1) deals with the case where the consideration is payable by instalments. Subsection (2) provides:

A "In the computation under this Chapter 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 B account is subsequently shown to the satisfaction of the inspector to be irrecoverable, such adjustment, whether by way of discharge or repayment of tax or otherwise, shall be made as is required in consequence."

Reference must also be made to s 41, to which the marginal note is C "Contingent liabilities". Subsection (1) provides that "In the first instance no allowance shall be made in the computation under this Chapter" for three categories of contingent liability and subs(2) provides that if any such liability is subsequently enforced a similar adjustment shall be made as is provided for in s 40(2).

D In *Randall* v. *Plumb* [1975] 1 WLR 633 a written agreement made between the taxpayer and a gravel working company provided that the company would, on the signing thereof, deposit with the taxpayer the sum of £25,000 and that in consideration thereof the company should have the option at any time during the next twenty years of purchasing at the price of E £100,000 (to include the £25,000) certain freehold land. Later provisions of the agreement gave the company the sole right to apply for planning permission for the extraction of sand, gravel or hoggin, and clause 10(i) and (ii) gave the company certain rights to require repayment of the £25,000, in the first case if it had not obtained planning permission within ten years and in the second if it had not obtained it within twenty years.

F The taxpayer having been assessed to capital gains tax on the £25,000 for the year in which it had been deposited with him, it was held by Walton J. that the consideration for the disposal of the option was not the full £25,000 but the value of what the taxpayer obtained for the grant of the option under the agreement, i.e. "the right to an immediate deposit of G £25,000 with the incident that it may fall to be repaid under the provisions of clause 10(i) or (ii) thereof"; see [1975] 1 WLR 633, 639A.

It is important to understand the reasoning which led Walton J. to that conclusion. Having read the predecessors of s 40(2) and 41 of the 1979 Act, the judge considered a contention advanced on behalf of the Crown to the H effect that, having regard to the structure of those provisions, only those contingencies which were therein referred to were to be given any weight whatsoever, and that if there was any contingency outside the scope of those provisions under which any part of the consideration might fall to be repaid by the person who disposed of the asset, the existence of such contingency must be altogether disregarded for the purposes of capital gains tax. At page I 637D Walton J. said:

"I find this an extraordinary submission. It is not disputed that among the contingencies for which provision is made in [section 41], with consequential provision for adjustment of the tax position if the contingency in fact occurs, are some contingencies which are extremely remote: for example, the breach of a covenant for quiet enjoyment by

the landlord. Yet it is solemnly submitted that a very real contingency such as the contingency for repayment in the present case, if it does not fall within the terms of [section 41(1)], must be disregarded altogether, notwithstanding that, as a result of its actually happening, Mr. Randall would have to repay the whole of the £25,000 and have actually in his hand nothing but notional interest thereon for the period until repayment is effected, and that in those circumstances there is no provision for any adjustment of the tax position whatsoever.

I cannot accept this submission for one moment. I draw precisely the opposite conclusion: namely, that unless the contingency is one which is expressly mentioned in one or other of [sections 40(2) and 41(1)], in which case the contingency is to be disregarded but justice will be done to the taxpayer if the contingency actually turns out the wrong way by an adjustment of tax, 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."

Walton J. also rejected an argument by the Crown to the effect that the contingency in that case fell within what is now s 41(1)(b).

What was decided in *Randall* v. *Plumb* was that, in ascertaining the consideration for the disposal of an option, a contingency upon the happening of which the option money would be repaid, being one which did not fall within what are now ss 40(2) and 41(1), must be taken into account. It not having been suggested by Mr. Henderson Q.C., for the Crown, that that decision was wrong, I proceed on the footing that it was correct. However, it is an inevitable corollary of the decision that if a contingency does fall within one or other of those provisions, it is not to be taken into account, at any rate in the first instance. Indeed, that is precisely what the two subsections provide.

So the first step is to decide whether the taxpayer company's right to receive the £399,750 was subject to a contingency and, if so, whether it was one which fell within ss 40(2) or 41(1). For that purpose it is necessary to return to the option agreement, which, unlike that in *Randall* v. *Plumb*, did not provide for the £399,750 to be paid immediately to the taxpayer company. It was to be held by stakeholders until such time as the covenants were released and the lease granted, at which time it might be paid to the taxpayer company. If, on the other hand, its best endeavours to procure the releases and the grant were unsuccessful, then, if the option was not exercised, the £399,750 was to be refunded to Mowat. If the option was exercised, the £399,750 would be payable to the taxpayer company as part of the purchase price.

In this state of affairs, it can fairly be said, within the terms of s 40(2), both that there was a postponement of the taxpayer company's right to receive the £399,750 and that the right was contingent. The right was postponed while the £399,750 was held by the stakeholders and contingent on a successful outcome of the taxpayer company's best endeavours or the exercise of the option. It follows that the £399,750 was to be brought into account at its full value and that *Randall* v. *Plumb* is distinguishable.

A That, however, is not an end of the suggested application of *Randall* v. *Plumb* to this case. Mr. Justice Carnwath read passages from the judgment of Walton J. and also from the speech of Lord Wilberforce in *Aberdeen Construction Group Ltd.* v. *IRC* [1978] AC 885, 892 and 893. Having referred to submissions by Mr. Ewart, for the taxpayers, that, by analogy with *Randall* v. *Plumb*, the obligation to procure the releases must be taken into B account in computing the consideration and that the best evidence of the value of the obligation was the £90,000 actually paid for it, the judge said (page 562A)[1]:

> "In principle, I agree with that approach. As in the two cases referred to, it is contrary to business reality to have regard only to the C nominal consideration stated in the agreement, without regard to the other incidents of the transaction which materially affect the value of that consideration to the grantor. The value to which the taxpayer company was entitled under the option was not £399,750. That nominal entitlement was qualified in two ways. First, it was dependent on the taxpayer company being able to secure the release of the relevant D covenants. Failing that, it would receive nothing. Secondly, assuming release, the net consideration in its hands would be the nominal amount less whatever was required to secure that release. If the release cost £399,750, in practical terms it would receive nothing. Applying the approach of Walton J. and asking what value the taxpayer company obtained by the grant of the option, the answer would be £399,750 less E whatever was necessary to secure the release of the covenants."

It is clear from those observations that Mr. Justice Carnwath treated *Randall* v. *Plumb* as authority for the proposition that the consideration was not the £399,750 the parties expressed it to be but that sum less the £90,000 paid for the releases of the covenants. That proposition, being one which, if F correct, would have far-reaching consequences in regard to capital gains tax, has understandably caused great consternation to the Inland Revenue.

I have already recounted what was decided in *Randall* v. *Plumb*. It dealt only with contingencies and only with those which do not fall within ss 40(2) or 41(1). Only if you find a contingency in that limited category can you take G it into account in ascertaining the consideration for the disposal of an option. How then can *Randall* v. *Plumb* be treated as authority for the taking into account of an immediate binding obligation on the grantor under the option agreement? There is no answer to that question. A contingency is an event which may or may not happen. An immediate binding obligation on the grantor, such as the taxpayer company's obligation to use its best endeavours H to procure the releases of the covenants, is neither an event nor, if it is, an event which may or may not happen. It is simply an obligation to do something which becomes binding on the grantor immediately the agreement is entered into.

I It appears that the judge regarded the *Aberdeen* case as providing further support for his view that it was contrary to business reality to have regard only to the "nominal" consideration stated in the agreement. Again I must disagree with him. The basis of the decision of the majority in *Aberdeen* was that, on the true construction of the agreement there considered, the

[1] Page 579 *ante*.

purchaser (Westminster) had agreed to pay to the appellant taxpayer (Aberdeen) £250,000, not just for the shares in Rock Fall, but for the waiver of the loans which Aberdeen had made to Rock Fall as well. As Lord Wilberforce put it [1978] AC 885, 893G:

"the contract is that (1) the appellants shall transfer shares and waive the loan (2) Westminster will pay £250,000. The effect of this is that Westminster was paying £250,000 not only for the shares, but for the composite obligation undertaken by the appellants. If this is right, in order to ascertain what Westminster was paying and the appellants receiving for their shares, an apportionment would have to be made of the sum of £250,000 between these two obligations."

In the present case the £399,750 was expressed by the option agreement to be paid only for the grant of the option. It was not expressed to be paid both for the grant of the option and for the taxpayer company's obligation to use its best endeavours to procure the releases of the covenants. The option agreement cannot be so construed and it has never been suggested that it can be. So the *Aberdeen* case does not assist the taxpayer company. On the contrary, I agree with Mr. Henderson that it assists the Crown. Although in a well known passage cited by the judge (page 560B) Lord Wilberforce said that the courts should hesitate before accepting results that are paradoxical and contrary to business sense, the common basis of the decision of both the majority and the minority was that the capital gains tax consequences of the agreement were determined by the terms in which it was expressed. The disagreement between their Lordships arose only out of a difference of opinion as to the true construction of the agreement.

For present purposes, the most pertinent observations are those of Viscount Dilhorne, one of the minority [1978] AC 885, 897D:

"It is not open to us to re-write the bargain made between the parties, and I do not think it is right to hold that part of the £250,000 was paid for the waiver when the letter states that that price was to be paid for the issued share capital and does not state that it was to be paid for anything else."

Similarly in the present case, it is not right to hold that part of the £399,750 was paid for the taxpayer company's obligation to use its best endeavours to procure the releases of the covenants when the option agreement states that that price was to be paid for the grant of the option and does not state that it was to be paid for anything else. I would therefore reject the judge' s view of the first question and decide it in favour of the Crown.

I turn to the second question, which can be dealt with more briefly. At this stage it is assumed that the consideration for the disposal of the option was the full £399,750. The question is whether, as the taxpayer company contends, the £90,000 is allowable as a deduction from the consideration under the second part of s 32(1)(a) of the Act, which provides:

"(1) Except as otherwise expressly provided, the sums allowable as a deduction from the consideration in the computation under this Chapter of the gain accruing to a person on the disposal of an asset shall be restricted to—

A

> (a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly or 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

In regard to that provision Mr. Ewart said, correctly, that this was a case where the asset was provided, not acquired, by the taxpayer company. He then submitted that the £90,000 was expenditure wholly and exclusively incurred by the taxpayer company in providing the asset. As to that submission, Mr. Justice Carnwath said (page 561J)(1):

C

> "The asset was provided long before the expenditure was incurred. The expenditure may have been incurred pursuant to the option, but not in providing it."

I agree with the judge. In my opinion it is impossible to describe the D expenditure of the £90,000 as having been incurred by the taxpayer company in granting the option. The second part of s 32(1)(a) must be read in the context of the provision as a whole. Just as the deductions allowable under the first part are restricted to the consideration given for the acquisition of the asset and the incidental costs of its acquisition, so is the expenditure allowable under the second part restricted to that which is incurred "in E providing the asset", which, at any rate where an option is granted, is the equivalent of "in disposing of the asset". Thus the expenditure contemplated appears to be restricted to the grantor's legal expenses of entering into the option agreement and the like.

Mr. Ewart sought to argue that the asset in this case was an option over F the land free from the covenants and that, in order to provide that asset, the taxpayer company was obliged to incur expenditure in obtaining the necessary releases. That is an incorrect view of the position. The asset provided was an option over the land subject to the covenants. The obligation on the taxpayer company to use its best endeavours to procure their release did not affect the identity of the asset at the date of its disposal. G Moreover, the exercise of the right granted to Mowat was not conditional on the release of the covenants. The option could have been exercised even if there had been no release. Mr. Ewart also sought to rely on *Chaney* v. *Watkis* (1985) 58 TC 707, a decision on s 32(1)(b) of the Act, but I agree with Mr. Henderson that that decision has no bearing on the present case.

H

For these reasons, I would decide the second question, like the first, in favour of the Crown and allow the appeals accordingly.

Waller L.J.: I agree.

I

Sir Iain Glidewell: I also agree.

Appeals allowed, with costs; leave to appeal to the House of Lords refused.

---

(1) Page 579 D *ante*.

The taxpayers appeals were heard in the House of Lords (Lords Slynn of Hadley, Jauncey of Tullichettle, Clyde, Hutton and Millett) on 9 March 2000 when judgment was reserved. On 18 May 2000 judgment was given unanimously in favour of the Crown, with costs.

Launcelot Henderson Q.C. and *Michael Furness* for the Crown.

David Ewart and *Richard Vallat* for the Company and the taxpayer.

The following cases were cited in oral/skeleton argument in addition to the cases referred to in the judgment:—*Spectros International Plc* v. *Madden* 70 TC 349; [1997] STC 114; *E.V. Booth (Holdings) Ltd.* v. *Buckwell* 53 TC 425; [1980] STC 578; *Stanton* v. *Drayton Commercial Investment Co. Ltd.* 55 TC 286; [1983] AC 501; *Oram* v. *Johnson* 53 TC 319; [1980] 1 WLR 558; *Marren* v. *Ingles* 54 TC 76; [1980] 1 WLR 983; *Jenners Princes St. Edinburgh Ltd.* v. *Inland Revenue Commissioners* [1998] STC (SCD) 196.

Lord Slynn of Hadley—

My Lords,

I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Jauncey of Tullichettle. For the reasons he gives I too would dismiss the appeals.

Lord Jauncey of Tullichettle—

My Lords,

These two appeals concern the method of computing for tax purposes the capital gain accruing on the grant of an option to purchase land which was never exercised. Although the taxpayer company has been assessed to corporation tax and the individual taxpayer to capital gains tax the relevant considerations applicable to both taxes are the same and since the two option agreements are for all practical purposes in identical terms I need only refer to the details of the grant by the company.

By agreement dated 9 September 1988 between the company and Mowat Group Plc. ("Mowat") it was stated in clause 1 that:

> "In consideration of the sum of £399,750 paid by [Mowat] to the [company's] solicitors ... the [company] hereby grants to [Mowat] an option to purchase the property subject to the following terms and conditions."

Clause 1.1 provided that the option should be exercisable by Mowat serving on the company's solicitors a purchase notice on any day prior to the expiry of the option period which was later defined, subject to a proviso which is not relevant to the appeal. Clause 1.2 provided that in the event of no purchase notice having been served before the expiry of the option period the agreement should cease to be of any effect whatsoever save that subject to clause 1.3 the sum of £399,750 should not become repayable to Mowat. Clause 1.3 provided that the said sum should be held by the company's

A solicitors as stakeholders until such time as (a) and (b) there had been executed and delivered a deed by each of two coventantees releasing two parts of the land from restrictive covenants and (c) a lease dealing with certain other rights had been granted. The sub-clause further provided:

> "Upon such releases ... and lease ... being delivered to the B [company's] solicitors the sum of £399,750 may be paid to the [company] together with the interest which has accrued thereto [sic]."

The sub-clause then contained an undertaking by the company to use its best endeavours to secure the above releases, and continued:

> C "In the event that the [company] shall not succeed during this option period in procuring either of the releases of such covenants or the said lease then if the option shall not be exercised the said sum of £399,750 shall be refunded to [Mowat] but without interest thereon and such interest will be paid to the [company]."

D Clause 1.4 provided that upon service of a purchase notice there should be constituted an immediately binding contract for the sale of the whole property for the price of £4,490,000 of which the sum of £399,750 should be taken into account as part payment.

On the date of the agreement the sum of £399,750 was paid to the E company's solicitors as stakeholders and in May 1990 the company procured releases of the two restrictive covenants referred to in clause 1.3(a) and (b) on payment of £90,000. It appears that the lease referred to in clause 1.3(c) had also been granted with the result that the sum of £399,750 held by the solicitors was paid over to the company. Notwithstanding the fulfilment of the foregoing conditions Mowat did not exercise the option within the F stipulated period. The Revenue assessed the company to tax on the basis that the consideration for the disposal of the option was £399,750. The company appealed the assessment and has all along maintained that the payment of £90,000 made in order to obtain release of the covenants should be taken into account either in computing the consideration or as an allowable deduction therefrom. That is the issue between the parties.

G

The General Commissioners for Portsmouth determined the appeal in the company's favour concluding that the sum of £90,000 was to be allowed as a deduction from the consideration of £399,750 pursuant to s 32 of the Capital Gains Tax Act 1979. On appeal by the Revenue Carnwath J. rejected the company's contention that the £90,000 was a deduction from the H consideration allowable by virtue of s 32 but upheld its contention that the £90,000 being the value of the obligation must be taken into account in computing the consideration. The Revenue appealed to the Court of Appeal who rejected both arguments advanced by the company and allowed the Revenue's appeal. The company now appeals to this House.

I

The relevant statutory provisions are all to be found in the Act of 1979 and the following matters are not in dispute. A gain accruing on the disposal of an asset is chargeable to tax. An option is an asset (s 19(1)(a)) and a grant of an option is the disposal of an asset, namely the option, unless it is exercised in which event the grant and the subsequent sale by the grantor in pursuance thereof are to be treated as a single transaction (s 137(1) and (2)).

In the present case there being no exercise of the option the date of its disposal was the date of the agreement namely 9 September 1988 (s 27(1)). A

Before examining the arguments advanced to your Lordships I propose to make some general observations about the terms of the agreement. The opening words of clause 1 refer specifically to the sum of £399,750 as consideration for the grant of the "option to purchase the property subject to the following terms and conditions." However, none of those conditions refer specifically to any actual or contingent alteration to the foregoing sum. Furthermore the sum was not necessarily repayable by the company if it failed to procure the release of the covenants since Mowat still had a discretion to exercise the option in that event. Conversely Mowat was not obliged to exercise the option even if the releases had been procured. In the latter event they would, as indeed happened, lose the sum of £399,750 but would incur no further liability. B C

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 ss 40(2) and 41 of the Act of 1979 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. Section 40(2) to which the sidenote reads "Consideration due after time of disposal" provides: D E

"(2) In the computation under this Chapter 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 is subsequently shown to the satisfaction of the inspector to be irrecoverable, such adjustment, whether by way of discharge or repayment of tax or otherwise, shall be made as is required in consequence." F G

This subsection directs that the whole of the consideration must be brought into account at the date of disposal without any discount for deferment and without regard to the risk of any part of it being irrecoverable or of the right to receive any part being contingent. The final sentence of the subsection demonstrates, however, that the initial computation may in certain circumstances be provisional and subject to adjustment: *Goodbrand* v. *Loffland Bros. North Sea Inc.* 71 TC 57; [1998] STC 930, 933F–934A per Millett L.J. It will be seen that this subsection has no relevance to computation at the date of disposal of the consideration subsequently received by the company. Section 41 to which the sidenote reads "Contingent liabilities" provides that in the first instance no allowance shall be made in the computation for certain specified contingent liabilities but provides for adjustment of tax in the event of such contingent liabilities becoming enforceable. None of the specified contingencies are relevant to these appeals. H I

Mr. Ewart relied strongly on the decision of Walton J. in *Randall* v. *Plumb* [1975] 1 WLR 633; 50 TC 392, in which the taxpayer granted for the sum of £25,000 an option to a company to purchase land for the sum of

A £100,000 if the company obtained planning permission, in which event the sum of £25,000 would be treated as part-payment of the purchase price. It was agreed that the company could demand repayment of the sum of £25,000 after the expiration of 10 years if it had not by then obtained planning permission. During the currency of the 10-year period and before planning permission had been obtained the taxpayer was assessed to capital gains tax B in the sum of £25,000. The Special Commissioners upheld the assessment but on appeal Walton J. held that the consideration for the disposal of the option should be valued after taking the contingency of repayment into account. The legislation applicable at the time was the Finance Act 1965 and para 15 of Sch 6 thereto was in identical terms to s 41 of the Act of 1979.

C Walton J. rejected, at [1975] 1 WLR 633, at page 637, a submission by the Revenue that since the contingency of repayment did not fall within [s 40(1)] it must be disregarded altogether notwithstanding that the taxpayer might have to repay the whole £25,000 and have no relief in respect of the tax paid. He continued:

D "I cannot accept this submission for one moment. I draw precisely the opposite conclusion. Namely, that unless the contingency is one which is expressly mentioned in one or other of these sub-paragraphs, in which case the contingency is to be disregarded but justice will be done to the taxpayer if the contingency actually turns out the wrong way by an adjustment of tax, it must (if it can as a matter of valuation) be taken E 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."

It has not been suggested either in the Court of Appeal or in this House F that *Randall* v. *Plumb* was wrongly decided and indeed on its facts I consider that it was a correct decision. However, it is distinguishable. The consideration there was not £25,000 absolute but £25,000 subject to repayment of the whole on the happening of a certain event. Thus, the contingency went directly to the value of the consideration. To have ignored it in valuing the consideration would have produced what Walton J. G described, at p. 638, as "monstrous and unnecessary injustice to the taxpayer." 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 H 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 Mowat. How can the value of a specific sum of cash paid by Mowat 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 Mowat in terms of I the agreement as a consideration for the disposal, i.e. the grant of the option.

Mr. Ewart also referred to *Aberdeen Construction Group Ltd.* v. *Inland Revenue Commissioners* [1978] AC 885; 52 TC 281 at page 296F and to the well known passage in the speech of Lord Wilberforce, [1978] AC 885, at page 893, to the effect that in the taxation of capital gains "the courts should

hesitate before accepting results which are paradoxical and contrary to business sense." A

In that case this House reached the conclusion that a sum paid to acquire the whole share capital of a company X on condition that the vendor of the shares waived a loan to X was in fact paid in consideration not only for the transfer of the shares but also the waiver of the loan. No such B apportionment between the grant of the option and the obligation to obtain releases of the covenants has been here suggested so the case is relevant only to the above general observations of Lord Wilberforce. However important as commercial reality may be, it cannot be invoked to alter the unambiguous terms of an agreement negotiated at arms length. It follows that Mr. Ewart's first argument fails. C

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] 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 D 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.

Mr. Ewart's second proposition was that the sum of £90,000 was E expenditure which was either wholly and exclusively incurred by the company in providing the option or expenditure similarly incurred in enhancing the value of the option, and as such deductible from the consideration for the disposal in accordance with the provisions of s 32(1)(a) and (b) of the Act of 1979. That subsection is, so far as relevant, in the terms: F

> "(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, G
>
> (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 ..."

Parties were agreed that on the authority of *Chaney* v. *Watkis* (1985) H 58 TC 707; [1986] STC 89, the incurring of an obligation which is capable of being valued in money could constitute expenditure for the purposes of s 32. However, they disagreed as to what was the asset which was disposed of. Mr. Ewart maintained that the option was the asset and the obligation was expenditure in relation thereto, whereas Mr. Henderson for the Revenue I submitted that the obligation was an inseparable part of the asset which was disposed of and was not undertaken to provide the option as a separate asset.

Assuming that the asset disposed of consisted of the option alone it was not an option to purchase land only when freed from the restrictive covenants but one to purchase land within a specified period subject to

A certain conditions one of which was the obligation above mentioned. However, what is important is that the implementation of the obligation was not a prerequisite of the option being exercised. If such implementation was not essential then I do not consider that the obligation could be said to be "wholly and exclusively incurred by [the company] in providing the [option]" for the purposes of s 32(1)(a).

B

So far as s 32(1)(b) is concerned the time of disposal of the option was, as I have stated, the date of the agreement and once again neither the obligation nor the subsequent payment of £90,000 could be said to be reflected in the state or nature of the option at that date, which was an option to purchase land at a specified price within a specified period. If the C obligation was fulfilled within the period and Mowat had exercised the option the expenditure would no doubt have enhanced the value of the land which they had acquired but it would not have been reflected in the state or nature of the option itself.

Paragraphs (a) and (b) of s 32(1) are intended to deal with two different D situations. Paragraph (a) relates to the acquisition cost to the taxpayer of the asset being disposed of. When there is no acquisition cost expenditure incurred in providing the asset is deductible. Since an option is created and hence provided by making a grant thereof it is the expenses of the grant which are prima facie deductible under para (a): see [1999] STC 19, at page 28A Nourse L.J.

E

Paragraph (b) applies to expenditure incurred on the asset to enhance its value and reflected in its state or nature at the time of the disposal. It presupposes that the asset is in existence when the expenditure is incurred. This would cover the situation where after acquisition an asset is transformed or improved with the result that it fetches a higher price on subsequent F disposal. Thus the acquisition cost is deductible under para (a) and the subsequent cost of improvement under para (b).

Since the option only came into existence at the date of the agreement I do not see how a contemporaneous obligation could be said to qualify as expenditure to which para (b) applies.

G

Mr. Henderson's argument was short and simple. Since the obligation was not undertaken to provide the option but was an integral part of the asset provided by the company under the agreement it could not be both part of the asset and expenditure in relation thereto at one and the same time. The expenditure referred to in the subsection must be expenditure which was H extraneous to the asset. There is a good deal to be said for the view that the obligation was part of the asset disposed of by the company and not a right independent of the option but in light of my conclusions in relation to the company's arguments I do not find it necessary to reach a conclusion thereon. I agree, however, with Mr. Henderson's contention that the expenditure referred to in s 32(1) must be expenditure which is extraneous to I the asset rather than part of it.

Mr. Henderson suggested that there appeared to be no reason in principle why failure of these appeals should necessarily produce a black hole of £90,000 for the taxpayer company. I consider there to be force in this suggestion. The fact that the payment of £90,000 does not qualify as

expenditure deductible from the consideration received for the option does not inevitably mean that in no circumstances can any part of the sum be taken into account in computing the consideration for a disposal. If Mowat had exercised the option and paid to the company the balance of the purchase price the company would have had strong grounds for claiming that the £90,000 was deductible in whole or in part from the consideration received for the sale of the land. The fact that the land may in fact be sold to a buyer other than Mowat should not alter the position. In either event it is the land not the option which is the asset being disposed of for the purposes of s 32(1), and it is the land whose value will have been enhanced by removal of the restrictive covenants.

For the foregoing reasons I would agree with the conclusions of the Court of Appeal and would dismiss these appeals.

Lord Clyde —

My Lords,

I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Jauncey of Tullichettle. I agree with it, and for the reasons he gives I too would dismiss the appeals.

Lord Hutton —

My Lords,

I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Jauncey of Tullichettle. I agree with it, and for the reasons he gives I also would dismiss these appeals.

Lord Millett —

My Lords,

I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Jauncey of Tullichettle. I agree with it, and for the reasons he gives I too would dismiss the appeals.

Appeals dismissed, with costs.

[Solicitors:—Solicitor of Inland Revenue; Messrs. Warner Goodman & Streat.]