



**Appeal numbers FTC/72/2011  
& FTC/79/2011**

***CORPORATION TAX – scheme to avoid tax on chargeable gains – whether derivative transactions gave rise to chargeable gains and losses – whether loss arising on disposal of shares in group company was an allowable loss – ICTA, s 128, and TCGA, ss 2 and 143 – application of Ramsay principle***

**UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)**

- (1) EXPLAINAWAY LIMITED**
- (2) QUARTFED LIMITED**
- (3) PARASTREAM LIMITED**

**Appellants/Cross-Respondents**

**- and -**

**THE COMMISSIONERS FOR HER MAJESTY'S  
REVENUE AND CUSTOMS**

**Respondents/Cross-Appellants**

**TRIBUNAL: MR JUSTICE NEWEY  
JUDGE GREG SINFIELD**

**Sitting in public in London on 25 and 26 July 2012**

**Mr Julian Ghosh QC and Miss Elizabeth Wilson, instructed by Mayer Brown International LLP, for the Appellants**

**Mr Malcolm Gammie QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

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## DECISION

### Introduction

- 5 1. This case is about the effectiveness of some tax planning that was designed to avoid the corporation tax that would otherwise have arisen on the disposal of certain shares. The First-tier Tribunal (Judge Roger Berner and Mr Tym Marsh) concluded, in effect, that the tax planning had not succeeded in avoiding liability to tax, although it had operated to defer the charge by a year.  
10 Both sides appeal against the decision (“the Decision”). The Appellants argue that the Tribunal (“the FTT”) ought to have held that there was no tax liability at all, HM Revenue and Customs (“HMRC”) that the FTT was wrong to take the view that the tax charge had been deferred.

### 15 Basic facts

2. Before the events at issue, Paul Rackham Limited (“PRL”) was the beneficial owner of four million shares in Waste Recycling Group plc (“WRG”).
- 20 3. In the latter part of 2000, representatives of PRL were asked by its board to address the tax implications of a sale of some of the shares in WRG. To this end, they were given a presentation in January 2001 by Deloitte & Touche (“Deloitte”) on a “Capital gains tax mitigation scheme”. The scheme applied to “companies disposing of assets at a significant profit” and had as its object  
25 “to allow the disposing company to dispose of the gain asset such that the attributed gain can be sold to a capital loss group without triggering the provisions of Schedule 7AA [Taxation of Chargeable Gains Act] 1992”. The scheme involved the company with the asset selling it to a new subsidiary which, in turn, would dispose of it in the open market. The subsidiary was then  
30 to purchase two futures which would “produce corresponding gains losses on a predetermined movement in the FTSE”. The presentation went on to explain:

35 “Before the end of its current accounting period B [i.e. the subsidiary] will close out one of the two contracts which should be standing at a loss equal to the realised gain.

Contemporaneously, B will take out a further future to secure the profit on the original gain contract. B will then be disposed of by A [i.e. B’s parent company] at a price to be agreed to a capital loss group  
40 (‘Lossco’). Subject to [Taxation of Chargeable Gains Act] 1992 Schedule 7AA the gain on the remaining future [that] was held by B will not be pre-entry and will be offset by losses of Lossco”.

4. This scheme (which the FTT termed “Plan A”) was put into effect in relation  
45 to part of PRL’s holding in WRG. In the first place, on 1 March 2001 PRL acquired Explainaway Limited (“Explainaway”), one of the Appellants, from formation agents and sold it two million of its shares in WRG. As this was an

intra-group transfer, no chargeable gain arose to PRL, and Explainaway inherited PRL's base cost for capital gains tax purposes.

5. In the following month, Explainaway sold the WRG shares in the open market for £9.4 million. A net chargeable gain of £8,595,731 accrued to Explainaway on the sale of the shares.
6. On 17 July 2001, Explainaway entered into two derivative contracts with Kleinwort Benson Private Bank ("KBPB"). Each contract had a nominal value of £174,011,400 and a maturity date of 15 March 2002. One contract ("the July Long Contract") involved an "over the counter long position" in FTSE 100 LIFFE Futures, the other ("the July Short Contract") a short position in FTSE 100 LIFFE Futures. The two contracts were broadly equal and opposite in their effect, in that the value of each moved inversely to the value of the other.
7. The derivative contracts were structured in such a way that KBPB would be bound to receive £174,325.50 irrespective of how the FTSE index moved. The contracts were entered into by reference to a "stand alone basis client agreement letter dated 5<sup>th</sup> July 2001". The letter in question was from KBPB and countersigned on behalf of Explainaway.
8. On 6 September 2001, Explainaway closed out the July Long Contract at a loss of £8,717,845.50. It took out a new long position, again with KBPB as the counterparty. This contract ("the September Contract") had a nominal amount of £165,467,880 and, like the July contracts, a maturity date of 15 March 2002. The September Contract had the effect of locking in the profit that was latent in the July Short Contract as at 6 September 2001. It was hoped that this profit would be sheltered by selling Explainaway to a company with capital losses. In the event, no such sale was achieved.
9. Explainaway claims that the closing out of the July Long Contract gave rise to an allowable loss of £8,804,846 in the accounting period ended 31 December 2001, offsetting its gain on the WRG shares.
10. On 26 February 2002, Explainaway closed out the July Short Contract and the September Contract, on the basis of which it claims to have realised a chargeable gain of £8,687,645 in the accounting period ended 31 December 2002.
11. At the same time, three recently-acquired subsidiaries of Explainaway, Quoform Limited ("Quoform"), Quartfed Limited ("Quartfed") and Parastream Limited ("Parastream") (the last two of which are Appellants), entered into further derivative contracts. The contracts were entered into as part of an arrangement designed to avoid the tax that would otherwise be payable on the gain of £8,687,645.

12. The contracts that matter for present purposes are those entered into by Quoform and Quartfed (respectively “the Quoform Contract” and “the Quartfed Contract”). Quoform acquired an over the counter long position in FTSE 100 LIFFE contracts while Quartfed opened a short position. One contract was with KBPB, the other with another Kleinwort Benson entity: Kleinwort Benson (Channel Islands) Bank. Both had a nominal value of £174 million and a maturity date of 21 June 2002, and both were standard International Swaps & Derivatives Association (“ISDA”) contracts. The contracts were broadly equal and opposite in effect.
13. These transactions were entered into pursuant to a scheme that Deloitte had outlined in a letter of 22 October 2001. At that time, it was still hoped that agreement would be reached for the sale of Explainaway to a company with sufficient losses to cover the gain on the July Short Contract. Deloitte, however, proposed to run an “extended scheme in parallel as a fall back position for the time being”. An appendix to the letter explained that Explainaway was to “set up 2 new subsidiary companies, Newco 1 and Newco 2” that were to enter into derivative transactions, referred to as “F3” and “F4”. The appendix continued:
- “(vi) Newco 1 will close out F3 and let us assume a capital loss of £8.7m will arise. Newco 2 will close out F4 and assume a capital gain of £8.7m will arise. Newco 1 and Newco 2 will make a joint election s.171A [Taxation of Capital Gains Act] 1992 such that the capital gain and capital loss arising in each company will be matched.
  - (vii) Explainaway Ltd will then dispose of Newco 1 for £1 to an international bank – this company has a balance sheet of nil and thus a market value of nil. A capital loss of £8.7m will arise in Explainaway Ltd on the disposal of this company. This capital loss of £8.7m will be used to frank the capital gain on the WRG shares in Explainaway Ltd of £8.7m.
  - (viii) Newco 2 will pay a dividend to Explainaway of £8.7m (i.e. pay up the profit realised on the closure of F4) ....
  - (ix) Newco 2 will be liquidated shortly thereafter and the share capital of £8.7m will be repaid to Explainaway on liquidation of Newco 2”.
14. In the event, no sale of Explainaway was concluded and so Deloitte’s “extended scheme” (referred to as “Plan B”) was pursued.
15. On 7 June 2002, the Quoform Contract was novated to Quartfed. At the time, the contract stood at a loss of £8,715,564, and Quoform paid Quartfed that amount for accepting the novation.

16. At this point, Quartfed closed out both the Quoform Contract and the Quartfed Contract. Parastream also closed out its contracts.

5 17. On 20 December 2002, Explainaway sold its shares in Quoform to unconnected third parties (a Mr and Mrs Austin) for £10. Explainaway contends that an allowable capital loss of £8,864,992 arose on the sale and that it is entitled to set that against the gain of £8,687,645 that, on its case, had arisen earlier in the same accounting period.

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### **The legislative framework**

18. Section 2(2) of the Taxation of Chargeable Gains Act 1992 (“TCGA”) provides for capital gains tax to be charged on:

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“the total amount of chargeable gains accruing to the person chargeable in the year of assessment, after deducting—

(a) any allowable losses accruing to that person in that year of assessment, and

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(b) so far as they have not been allowed as a deduction from chargeable gains accruing in any previous year of assessment, any allowable losses accruing to that person in any previous year of assessment (not earlier than the year 1965-66)”.

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19. Section 1 of TCGA states that companies are to pay corporation tax, rather than capital gains tax as such, on chargeable gains.

20. Derivatives are addressed in section 143 of TCGA. So far as relevant, this stated:

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“(1) If, apart from section 128 of the [Income and Corporation Taxes Act 1988], gains arising to any person in the course of dealing in commodity or financial futures or in qualifying options would constitute, for the purposes of the Tax Acts, profits or gains chargeable to tax under Schedule D otherwise than as the profits of a trade, then his outstanding obligations under any futures contract entered into in the course of that dealing and any qualifying option granted or acquired in the course of that dealing shall be regarded as assets to the disposal of which this Act applies.

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...

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(5) For the purposes of this Act, where, in the course of dealing in commodity or financial futures, a person who has entered into a futures contract closes out that contract by entering into another futures contract with obligations which are reciprocal to those of the first-mentioned contract, that transaction shall constitute the disposal of an

asset (namely, his outstanding obligations under the first-mentioned contract) and, accordingly—

- 5 (a) any money or money's worth received by him on that transaction shall constitute consideration for the disposal; and
- (b) any money or money's worth paid or given by him on that transaction shall be treated as incidental costs to him of making the disposal.

10 (6) In any case where, in the course of dealing in commodity or financial futures, a person has entered into a futures contract and—

- 15 (a) he has not closed out the contract (as mentioned in subsection (5) above), and
- (b) he becomes entitled to receive or liable to make a payment, whether under the contract or otherwise, in full or partial settlement of any obligations under the contract,

20 then, for the purposes of this Act, he shall be treated as having disposed of an asset (namely, that entitlement or liability) and the payment received or made by him shall be treated as consideration for the disposal or, as the case may be, as incidental costs to him of making the disposal ...”.

25 21. The opening words of section 143 (“If, apart from section 128 of the [Income and Corporation Taxes Act 1988] ...”) make it necessary to consider section 128 of the Income and Corporation Taxes Act 1988 (“ICTA”). This provided:

30 “Any gain arising to any person in the course of dealing in commodity or financial futures or in qualifying options, which is not chargeable to tax in accordance with Schedule 5AA and apart from this section would constitute profits or gains chargeable to tax under Schedule D otherwise than as the profits of a trade, shall not be chargeable to tax under Schedule D.

35 In this section ‘commodity or financial futures’ and ‘qualifying options’ have the same meaning as in section 143 of the 1992 Act, and the reference to a gain arising in the course of dealing in commodity or financial futures includes any gain which is regarded as arising in the course of such dealing by virtue of subsection (3) of that section”.

40 22. Section 18 of ICTA provided for tax under Schedule D (to which there is reference in section 128 of ICTA) to be charged under the Cases set out in section 18(3). Case VI was:

“tax in respect of any annual profits or gains not falling under any other Case of Schedule D and not charged by virtue of Schedule A or E”.

5    **The Decision**

23.    The issues that the FTT identified as arising before it included these (see paragraph 6 of the Decision):

10                   “(a)    Whether the respective derivative transactions undertaken by Explainaway (in 2001) and by Quoform, Quartfed and Parastream (in 2002), followed by the disposal of Explainaway’s shares in Quoform gave rise to the chargeable gains and losses as claimed by the Appellants; or

15                   (b)    Whether, as HMRC contend, either (i) all of the relevant derivative transactions are outside the scope of ... TCGA altogether, so that chargeable gains and allowable losses do not arise as the Appellants contend, or even if such gains and losses do arise (ii) whether, applying the *Ramsay* principle, the loss arising on the disposal by Explainaway of the Quoform shares was an allowable loss within the meaning of TCGA”.

24.    So far as relevant, the FTT arrived at the following conclusions (see paragraph 107 of the Decision):

25                   “(1)    The respective derivative transactions undertaken by Explainaway (in 2001) and by Quoform, Quartfed and Parastream (in 2002) gave rise to chargeable gains and losses.

30                   (2)    The loss arising on the disposal by Explainaway of the Quoform shares was not an allowable loss within the meaning of TCGA”.

25.    Key elements of the FTT’s reasoning included these:

35                   (a)    The 2001 derivative transactions fell within the scope of section 128 of ICTA and, hence, section 143 of TCGA. Profits and losses on the transactions would, but for section 128 of ICTA, have been within Case VI of Schedule D (paragraph 46 of the Decision);

40                   (b)    The 2002 derivative transactions similarly “gave rise to gains and losses on the disposals of those individual derivatives” (paragraph 89 of the Decision);

(c) The *Ramsay* principle does not apply in relation to either the 2001 derivative transactions or those of 2002 (paragraphs 88 and 89 of the Decision); but

5 (d) The *Ramsay* principle bites on the sale of the Quoform shares, with the result that the loss on the disposal of the shares is not an allowable loss within the meaning of TCGA (paragraph 96 of the Decision). “On a realistic view of the Plan B transactions, taken together, ... the loss on the Quoform shares was not a real loss within the meaning of s 2  
10 TCGA, purposively construed” (paragraph 95).

### **The parties’ positions in summary**

15 26. HMRC appeal against the FTT’s conclusions in relation to the 2001 derivative transactions. Their position is essentially that those transactions did not give rise to any gains, profits or losses for the purposes of the relevant statutory provisions having regard to:

20 (a) The decision of the House of Lords in *F.A. & A.B. Ltd v Lupton* [1972] AC 634 and related cases; and

(b) The *Ramsay* principle.

25 The upshot, according to HMRC, is that Explainaway is liable to tax on the gain realised when it sold the WRG shares in April 2001.

30 27. Explainaway, in contrast, maintains that the FTT was correct in its approach to the 2001 derivative transactions. Where it takes issue with the FTT is in relation to its conclusions as regards the sale of the Quoform shares. According to Explainaway, the *Ramsay* principle is not relevant in that context and an allowable loss accrued when the shares were sold. It therefore appeals against the second of the conclusions set out in paragraph [24] above.

### **The Lupton argument**

35 28. As was pointed out by Mr Malcolm Gammie QC, who appeared for HMRC, his arguments in relation to the 2001 derivative transactions overlap. The ultimate question is whether the transactions gave rise to a loss (and corresponding profits/gain) within the meaning of the relevant legislation, and  
40 the *Lupton* and *Ramsay* points both bear on that issue. However, the FTT addressed the *Lupton* argument separately from the *Ramsay* principle, and it is convenient for us to do so too. We shall therefore consider the *Lupton* argument before turning to the implications of the *Ramsay* principle (as regards both the 2001 derivative transactions and the sale of the Quoform  
45 shares).



29. The *Lupton* argument is on the following lines. The “loss” and “gain” generated by the 2001 derivative transactions will be relevant for corporation tax purposes only if, but for section 128 of ICTA, they would have fallen within Case VI of Schedule D. Case VI is concerned with income profits and losses. If derivatives produce “gains” and “losses” in the course of trading, they are naturally viewed as income profits and losses. Where, on the other hand, “gains” and “losses” do not arise from trading, the context has to be examined to determine whether they represent *income* profits and losses. The “loss” and “gain” from the 2001 derivative transactions were not of that nature.

30. The earliest of the authorities to which we were referred on this aspect of the case was *Cooper v Stubbs* [1925] 2 KB 753. There, the Court of Appeal held, by a majority, that profits made from speculating in cotton futures were “annual profits or gains” assessable under Case VI even though the taxpayer had not been trading in futures. One of the majority, Warrington LJ, explained as follows (at 769):

“The question ... is simply this, were these dealings and transactions entered into with a view to producing, in the result, income or revenue for the person who entered into them? If they were, then in my opinion profits arising from them were annual gains or profits within the meaning of para. 1 (b) of Sch. D. On the findings of the Commissioners themselves they were contracts entered into with a view to making a profit on a rise or fall, as the case might be, in the market price of the contracts. They extended over a considerable number of years. There were large numbers of transactions in each of those years, from which in some years the appellant derived considerable revenue; and for myself I cannot see what there is to exclude that revenue from the tax which is charged under Sch. D. It seems to me, therefore, that, in this case, whatever may be the case under different facts, at all events the profits made by these transactions are annual profits or gains, and must be assessable to income tax”.

Atkin LJ, the other member of the majority, said this (at 775):

“There is no doubt that speculations in commodities of this kind are just like speculations in shares. They may under some circumstances be such that you could not reasonably call the profit made an annual profit or gain. It may very well be that transactions may be so carried out as to be nothing but in the nature of temporary investments repeated several times over, and resulting in something in the nature of capital accretions which could not be brought within the title or meaning of ‘annual profit or gain,’ which to my mind must mean something which is of the nature of revenue or income, although I also think it is plain that it need not be repeated every year so as to be a continuous source

of income. It may come in only as income or revenue in the one year, but still it has to be in the nature of annual profit or gain”.

31. The *Lupton* case itself concerned a company (A) trading as a dealer in stocks and shares which entered into dividend-stripping transactions. It bought the issued shares of another company (B) pursuant to an agreement under which the vendors warranted that B’s profits would be such as to allow a dividend of a specified amount to be declared. The dividend having been paid, the value of B fell, on the strength of which A claimed that to have incurred a trading loss. Lord Morris of Borth-y-Gest said (at 647) that, while the presence of a motive of securing tax recovery may not cause a transaction to be no longer a trading transaction, “some transactions may be so affected or inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction”; the transaction at issue involved “truly strange arrangements” and was “something very different” from “a share dealing transaction coming within the area of trade of a dealer in shares” (650). Lord Guest, agreeing with Lord Morris, said that “[t]he shares were not bought as stock in trade of a dealer in shares but as pieces of machinery with which a dividend-stripping operation might be carried out” (651). Viscount Dilhorne said (at 657):

“if a transaction viewed as whole is one entered into and carried out for the purpose of establishing a claim against the revenue . . . , I for my part would have no hesitation in holding that it does not form part of the trading activities of a dealer in stocks and shares”.

Lord Donovan observed (at 657):

“I say that this is not trading in stocks and shares. If I am asked what it is, I would reply that it is the planning and execution of a raid on the Treasury using the technicalities of revenue law and company law as the necessary weapons”.

Lord Simon of Glaisdale, finally, said (at 660-661):

“[T]his is not share-dealing within the trade of dealing in shares. It is plainly a joint venture of the appellants and the vendors of the shares, by taking advantage of quirks of revenue and company law, to obtain money out of the public purse and share it between them. Even if the transaction were equivocal, its true nature would, in my view, be resolved by investigation of its paramount object: since, on the findings of the special commissioners, the transaction would produce a loss to the appellants unless repayment of income tax were obtained, I conclude that the paramount object of the transaction was to procure such repayment of income tax: it was, in other words, a tax-recovery device”.

32. The specific issue in *Lupton* (viz. whether transactions had been undertaken in the course of the taxpayer company's trade) does not arise in the present case: there is no suggestion that any of the relevant transactions was part of a trade. Mr Gammie, however, argues that an analogy can be drawn between this case and *Lupton*. In *Lupton*, Mr Gammie says, transactions that would otherwise have been common form trading transactions were stripped of their ordinary character as income transactions once they were viewed in their proper context and seen as what they were, namely, "tax planning machinery"; the 2001 derivative transactions should likewise be viewed in their context and recognised as "tax planning machinery". They did not, accordingly, generate *income* profits or losses. The transactions with which *Cooper v Stubbs* was concerned did so because they were entered into with a view to profit, but that was not true of 2001 derivative transactions: there was no possibility of the transactions, taken together, generating any profit at all.
33. The FTT explained its views on this part of the case in paragraphs 45 and 46 of the Decision. It said:

"45. What is made clear in [*Lupton*] is that, following *Griffiths v J P Harrison (Watford) Ltd* [1963] AC 1, trading transactions do not cease to be such merely because they are entered into in the hope of later taking advantage of the revenue law by making a claim for recovery of tax (per Lord Morris of Borth-y-Gest at p 646D). Motive does not alter or transform the essential and factual nature of the transaction; it is the transaction itself and the form and content which must be examined and considered (p 646G). The distinction drawn in [*Lupton*] was that, as in *Finsbury Securities Ltd v IRC* [1966] 1 WLR 1402, certain fiscal arrangements were inherently and structurally part of the transactions sought to be described as trading transactions. In [*Lupton*], the appellant company purchasing the shares gave an undertaking to the vendors that they would make a 'loss'. The vendors were directly and financially interested in the result of the loss claim. These 'truly strange' arrangements were not, it was held, the arrangements of a trading transaction of a dealer in shares (p 650D-F).

46. In relation to this issue we are concerned only with the derivative transactions themselves. Those transactions it seems to us were real transactions of a nature commonly transacted in the market. There were no fiscal arrangements inherently and structurally built into the derivative transactions themselves. Any claim for a loss arose as a consequence of the result of those transactions, and was separate from them. In this connection it is in our view of no consequence that the derivative transactions were all in essence matched, nor that settlement was by way of set-off. We find that there is nothing in [*Lupton*] that could lead to the conclusion that profits and losses on the transactions were not of an income nature. Accordingly, and

subject to the *Ramsay* argument to which we shall now turn, as those transactions were not trading transactions, the profits and losses were, but for s 128 ICTA, within Case VI of Schedule D, and as a result the derivatives fell within the scope of s 143 TCGA”.

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34. Mr Julian Ghosh QC, who appeared with Miss Elizabeth Wilson for Explainaway and the other Appellants, supported the FTT’s conclusions. He argued that Explainaway hoped that there would be a loss on one of the 2001 derivatives and, hence, that there would be a profit on the other. Where a derivative yields a profit, it is income. The fact that Explainaway had a fiscal objective did not (so Mr Ghosh submitted) denature the “form and content” of the derivatives as speculative transactions in the market yielding an income profit.

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15 35. On balance, we are not persuaded by these arguments and take a different view from the FTT on this part of the case. It seems to us that, even if Explainaway can be said to have gained and lost on the 2001 derivative transactions, the “gains” and “losses” did not have the character of income. Our reasons include these:

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(a) Unlike the transactions at issue in *Cooper v Stubbs*, the 2001 derivative transactions were one-offs. *Cooper v Stubbs* concerned “large numbers of transactions” entered into “over a considerable number of years”. In contrast, the 2001 derivative transactions stand alone;

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(b) The 2001 derivative transactions also differ from those at issue in *Cooper v Stubbs* in terms of the reasons for which they were undertaken. The *Cooper v Stubbs* transactions were “speculations” that were “entered into with a view to making a profit on a rise or fall, as the case may be, in the market price of the contracts”. The 2001 derivative transactions, on the other hand, were not undertaken in the hope that they would, of themselves, produce any profit. The immediate objective was to achieve a loss, albeit one balanced by a locked-in gain. There was no question of Explainaway ultimately achieving a profit, nor any prospect of it being out-of-pocket except to the extent of KBPB’s £174,325.50 “fee” (paragraph [7] above). If, as Warrington LJ said in *Cooper v Stubbs*, the question is whether the dealings were “entered into with a view to producing, in the result, income or revenue for the person who entered into them”, the answer appears to us to be “No”;

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(c) An indication of the fiscal motivation behind the 2001 derivative transactions is to be found in the terms of the July Long Contract. Through its definitions of “Futures Price” and “Initial Price”, the July Long Contract provided for KBPB to receive £174,325.50 independently of movements in the market, with an “Upfront Amount” of £174,000 payable by Explainaway to KBPB almost at once. If the

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July Long Contract and July Short Contract are looked at together, it is perfectly plain that they have not been entered into for ordinary commercial purposes. In combination, they were incapable of either generating any profit for Explainaway or protecting the company from risk;

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(d) While the “form and content” of a transaction are of course important, it seems to us that the purpose for which the transaction was entered into is also relevant. The Court of Appeal evidently approached matters on that basis in *Cooper v Stubbs*; as already mentioned, Warrington LJ identified the question as whether the dealings were “entered into with a view to producing, in the result, income or revenue for the person who entered into them”. Further, the *Lupton* case does not seem to us to be authority for the proposition that motive is irrelevant. While passages in Lord Morris’s speech can be read that way (see e.g. 646G, to which the FTT referred), we do not think the majority of the House of Lords endorsed that view. Lord Simon of Glaisdale said that, “if the appearance of the transaction leaves the matter in doubt, an examination of its paramount object will always be relevant and will generally be decisive” (660C-D). Lord Donovan referred to the relevant shares having been bought pursuant to a plan having particular objects (657F) and distinguished cases “where fiscal advantages are incidental” (657H). Viscount Dilhorne accepted that a transaction established to be a trading transaction “does not lose its character in consequence of a fiscal advantage”, but observed that the question at issue was “not did a trading transaction cease to be one, but was it a trading transaction in the first place” (655G-H). Certainly, we do not think *Lupton* requires the Court to consider each of the July contracts only individually, without regard to the matching contract entered into on the same day and between the same parties. If the contracts are looked at together, it becomes, as we have said, perfectly plain that they have not been entered into for ordinary commercial purposes.

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36. It follows that any “loss” or “gain” the 2001 derivative transactions may have generated would not have fallen within Case VI of Schedule D but for section 128 of ICTA and, hence, that section 143 of TCGA does not apply.

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37. This conclusion is enough to dispose of the case. In case, however, we are wrong on the point, we shall go on to consider the impact of the *Ramsay* principle.

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### **The *Ramsay* principle**

38. The *Ramsay* principle takes its name from the decision of the House of Lords in *W. T. Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300.

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39. Lord Nicholls of Birkenhead explained the *Ramsay* case in these terms in *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51, [2005] STC 1:

5                   “29 The *Ramsay* case ... liberated the construction of revenue statutes from being both literal and blinkered. It is worth quoting two passages from the influential speech of Lord Wilberforce. First, at p 323, on the general approach to construction:

10                   ‘What are “clear words” is to be ascertained upon normal principles: these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant Act as a whole, and its purpose may, indeed should, be regarded.’

15                   30 Secondly, at pp 323-324, on the application of a statutory provision so construed to a composite transaction:

20                   ‘It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded.’

25                   31 The application of these two principles led to the conclusion, as a matter of construction, that the statutory provision with which the court was concerned, namely that imposing capital gains tax on chargeable gains less allowable losses was referring to gains and losses having a commercial reality (‘The capital gains tax was created to operate in the real world, not that of make-belief’) and that therefore:

30                   ‘To say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, there is not such a loss (or gain) as the legislation is dealing with, is in my opinion well and indeed essentially within the judicial function.’ (p 326)

35                   32 The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first  
40                   construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether  
45                   they satisfy the requirements of the statute. But however one

approaches the matter, the question is always whether the relevant provision of the statute, upon its true construction, applies to the facts as found. As Lord Nicholls of Birkenhead said in *MacNiven v Westmoreland Investments Ltd* [2003] 1 AC 311, 320, para 8: “The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case.””

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40. In a passage endorsed by the House of Lords in the *Barclays Mercantile* case, Ribeiro PJ said this about the *Ramsay* principle in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46, (2004) 6 ITLR 454 (at paragraph 35):

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

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41. The mere fact that a tax-saving scheme contains a contingency will not necessarily preclude the application of the *Ramsay* principle. That is apparent from the decision of the House of Lords in *IRC v Scottish Provident Institution* [2004] UKHL 52, [2004] 1 WLR 3172, judgment in which was given on the same day as judgment in the *Barclays Mercantile* case. The scheme at issue in that case envisaged the exercise of matching options. The Special Commissioners had held that there was an outside but commercially real possibility that circumstances might occur in which the two options would not be exercised so as to cancel each other out. The question therefore arose “whether, in a case in which they were in fact exercised so as to cancel each other out, the existence of this contingency prevented the commissioners from applying the statute to the scheme as it was intended to operate and as it actually did operate” (paragraph 16). It was held that it did not. Lord Nicholls said this:

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“23 We think that it would destroy the value of the *Ramsay* principle of construing provisions such as section 150A(1) of the [Finance Act 1994] as referring to the effect of composite transactions if their composite effect had to be disregarded simply because the parties had deliberately included a commercially irrelevant contingency, creating an acceptable risk that the scheme might not work as planned. We would be back in the world of artificial tax schemes, now equipped with anti-*Ramsay* devices. The composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned.

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24 It follows that in our opinion the special commissioners erred in law in concluding that their finding that there was a realistic possibility of

the options not being exercised simultaneously meant, without more, that the scheme could not be regarded as a single composite transaction. We think that it was and that, so viewed, it created no entitlement to gilts and that there was therefore no qualifying contract.”

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42. In the *Scottish Provident* case, the House of Lords distinguished its previous decision in *Craven v White* [1989] AC 398. In *Craven v White*, the taxpayers had exchanged their shares in a company for shares in a Manx company in the hope that they would subsequently agree a sale to a third party and that, if they did so, the interposition of the Manx company would be advantageous from a tax point of view. In the event, agreement with a purchaser was achieved quite soon after the share exchange. The House of Lords nonetheless held, by a majority, that the *Ramsay* principle did not apply. Lord Keith of Kinkel, one of the majority, said (at 480-481):

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“Is it enough that the original owners of the shares, being minded to dispose of them, decide to do so through an intermediary company under their control, carry through a share exchange and thereafter seek and successfully find a purchaser? In that situation there is certainly a scheme on the part of the holders of the shares to dispose of them in such a way that any capital gains tax liability is deferred. According to circumstances, there may be varying degrees of interconnection between the disposal to the intermediary company and the disposal to the ultimate purchaser. It may be many months before a possible purchaser is found and many more before a bargain is concluded. Again, the share exchange may be entered into without any immediate intention of selling but so that it may stand in good stead for tax purposes if and when a decision to sell is made. Or it may take place when negotiations with a particular purchaser are under way but the outcome is still open. In all these cases it is clear that the owner of the shares has so arranged matters that if and when a sale of the shares does take place it will not be a direct disposal of the shares by him but a disposal by an intermediary company which he controls. But I do not think that the transaction embodied in the final disposal can be said to be pre-ordained, a matter to be ascertained as at the time of the share exchange, when at that time it is wholly uncertain whether that disposal will take place, or a fortiori when neither the identity of the purchaser nor the price to be paid nor any of the other terms of the contract are known. In my opinion both the transactions in the series can properly be regarded as pre-ordained if, but only if, at the time when the first of them is entered into the taxpayer is in a position for all practical purposes to secure that the second also is entered into”.

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In the course of his judgment, Lord Oliver of Aylmerton, another member of the majority, said this (at 516-517):



5 “Another identifying feature is that all the stages of what is claimed as  
the composite transaction are pre-ordained to take place in an  
orchestrated sequence and, in my opinion, that must mean more than  
simply ‘planned or thought out in advance.’ It involves to my mind a  
degree of certainty and control over the end result at the time when the  
intermediate steps are taken. That does not, I think, mean absolute  
certainty in the sense that every single term of the transaction which  
ultimately takes place must then be finally settled and agreed. But it  
does seem to me to be essential at least that the principal terms should  
10 be agreed to the point at which it can be said that there is no practical  
likelihood that the transaction which actually takes place will not take  
place. Nor is it sufficient, in my opinion, that the ultimate transaction  
which finally takes place, though not envisaged at the intermediate  
stage as a concrete reality, is simply a transaction of the kind that is  
15 then envisaged, for the underlying basis of the *Ramsay* doctrine is that  
it must, on the facts, be possible to analyse the sequence as one single  
identifiable transaction and if, at the completion of the intermediate  
disposition, it is not even known to whom or upon what terms any  
ultimate disposition will be made, I simply do not see how such an  
20 analysis is intellectually possible”.

A little later, Lord Oliver said (at 517):

25 “A third identifying feature, at any rate in the *Furniss v. Dawson*  
[[1984] AC 474] type of transaction, is in my opinion that there should  
be no sensible and genuine interruption between the intermediate  
transaction and the disposal to an ultimate purchaser. If such an  
interruption occurs I cannot for my part see on what possible basis of  
statutory construction the intermediate transaction can, as it were, be  
30 held in limbo once it has been completed”.

43. In the *Scottish Provident* case, Lord Nicholls noted (at paragraph 21) that in  
*Craven v White* “important parts of what was claimed by the Revenue to be a  
single composite scheme did not exist at the relevant date”. In paragraph 22,  
35 he said this:

40 “Thus there was an uncertainty about whether the alleged composite  
transaction would proceed to completion which arose, not from the  
terms of the alleged composite transaction itself, but from the fact that,  
at the relevant date, no composite transaction had yet been put  
together. Here, the uncertainty arises from the fact that the parties have  
carefully chosen to fix the strike price for the SPI [i.e. Scottish  
Provident Institution] option at a level which gives rise to an outside  
chance that the option will not be exercised. There was no commercial  
45 reason for choosing a strike price of 90 .... Thus the contingency upon  
which SPI rely for saying that there was no composite transaction was  
a part of that composite transaction; chosen not for any commercial

reason but solely to enable SPI to claim that there was no composite transaction. It is true that it created a real commercial risk, but the odds were favourable enough to make it a risk which the parties were willing to accept in the interests of the scheme”.

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44. The *Ramsay* principle has recently been applied in the context of a tax avoidance scheme based on the use of options linked in part to the FTSE 100 index: *Schofield v Revenue and Customs Commissioners* [2012] EWCA Civ 927, a decision of the Court of Appeal. The FTT had concluded that the four options used “were parts of an overall preordained scheme designed to produce neither a gain nor a loss” (paragraph 36 of the Court of Appeal decision). That meant, Sir Andrew Morritt C explained, that it was “wrong to adopt the step by step approach for which counsel for Mr Schofield contended and consider only Option 1” (paragraph 36).

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### **The impact of *Ramsay* principle on the present case**

#### *The need for “real” gains and losses*

45. The FTT took the view that section 2 of TCGA and section 128 of ICTA are both “concerned with an end result, namely a profit or gain, or a loss” (paragraph 76 of the Decision). With regard to section 2 of TCGA, the FTT observed that “it is clear from *Ramsay* that, applying a purposive construction, the transaction in question must give rise to a real loss, and not merely an arithmetical difference” (paragraph 76). The same analysis is, the FTT considered, to be applied to section 128 of ICTA, with the result that the “reference in that section to profits and gains chargeable to tax under Schedule D otherwise [than] as the profits of a trade” is “properly construed as referring to real profits and gains”.

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46. As it seems to us, the FTT was plainly correct that the *Ramsay* principle can operate in the context of both section 2 of TCGA and section 128 of ICTA. Mr Ghosh did not suggest otherwise.

#### *The 2001 derivative transactions*

47. As already mentioned, the FTT concluded that the *Ramsay* principle did not apply in relation to the 2001 derivative transactions. It explained its reasoning in these paragraphs of the Decision:

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“[87] In relation to the 2001 transactions, therefore, we are left with those transactions that were planned and actually took place as part of Plan A. We note that it is no part of Mr Gammie's argument that the transactions should be recharacterised as something other than their actual legal nature (such as a loan as was argued unsuccessfully in *[Griffin v Citibank Investments Ltd [2000] STC 1010]*); he simply submitted that the transactions were self-cancelling, gave rise to no

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commercial gain or loss, and that the loss cannot therefore be a loss within Sch D, Case VI or an allowable loss within the TCGA.

5 [88] We do not consider that the fact that two derivative transactions are entered into, one of which gives rise to a loss and the other a gain, even in circumstances where they have no commercial purpose and they are so closely linked as to form a pre-ordained series of transactions, is sufficient to enable the *Ramsay* principle to be applied so as to find that the true effect in law of those transactions is anything other than that they are, and remain,  
10 individual derivative transactions on which gains and losses separately arise. Absent any constituent part of the scheme of Plan A whereby the gain on the 17 July 2001 short contract was somehow eliminated, leaving a tax loss, but no material net commercial loss, we consider that the true effect is that the statutory provisions must be applied to the individual gains and losses on the two derivatives.  
15 Accordingly, the loss on the disposal of the 17 July 2001 long contract is an allowable loss, and the gain on the disposal of the 17 July 2001 short contract is a chargeable gain”.

20 48. We are not ourselves convinced by this reasoning. As the FTT recognised, the relevant statutory provisions are concerned with gains and losses having a commercial reality. We find it hard to see that either the “loss” which the FTT held to have arisen on the disposal of the July Long Contract or the “gain” which the FTT considered to have arisen on the disposal of the July Short  
25 Contract had any commercial reality. As mentioned earlier, there was no question of Explainaway ultimately achieving a profit, nor any prospect of it being left out-of-pocket except to the extent of KBPB’s £174,325.50 “fee”. The “loss” that arose when the July Long Contract was closed out was balanced by the “profit” locked in by the September Contract; and the “profit”  
30 in due course produced by the July Short Contract balanced the previous “loss” on the July Long Contract. The transactions were essentially self-cancelling. The aim was to achieve fiscal consequences. The hope was that one or other contract (in the event, the July Long Contract) would generate an allowable loss to be set against the gain on the WRG shares and a new  
35 chargeable gain which could be negated by a company with capital losses (because, unlike that on the WRG shares, the new gain would not fall foul of the pre-entry rules).

40 49. In the *Ramsay* case, Lord Wilberforce said (at 326):

45 “To say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, there is not such a loss (or gain) as the legislation is dealing with, is in my opinion well and indeed essentially within the judicial function”.

50. These words are, as it seems to us, apt to refer to what was being attempted with the 2001 derivative transactions. What happened with the 2001 derivative transactions represented an indivisible process, and the “loss” which appeared to arise on the July Long Contract was intended to be and was cancelled out by a later stage (viz. on the disposal of the July Short Contract).
51. Seeking to uphold the FTT’s view on this point, Mr Ghosh stressed that the idea had been to sell Explainaway to a company with capital losses and that that had not been achieved. Mr Ghosh was inclined to accept that, had the intention been merely to defer tax (as in fact happened, on the basis of the FTT’s conclusions), the *Ramsay* principle might have been in point. He said, however, that the 2001 derivative transactions did not represent a free-standing scheme but merely part of a larger plan involving the sale of Explainaway. The larger plan had never been a practical certainty and did not ultimately come to fruition. That being so, there can, Mr Ghosh maintained, be no scope for applying the *Ramsay* principle.
52. For our part, however, we cannot see why the fact that it was hoped that the 2001 derivative transactions would lead on to a sale of Explainaway should preclude the application of the *Ramsay* principle to the 2001 derivative transactions. They were of themselves designed to achieve a “loss” and “gain” of fiscal significance without there ever being any prospect of a loss or gain having a commercial reality. We cannot see why, in those circumstances, the transactions should be considered to have produced a “loss”, “gain” or “profits” within the meaning of the relevant provisions.
53. Reference was made to the fact that the “loss” and “gain” arising from the 2001 derivative transactions depended on events (viz. movements in the FTSE index) outside the control of any party. However, the FTT did not think that important, and nor do we. There was, the FTT found, no practical likelihood that no “loss” would arise on either of the July derivatives (paragraph 82 of the Decision), and we agree with the FTT that it is of no consequence that at the outset it could not be said which of the two derivatives the “loss” would be realised on (paragraph 83 of the Decision).
54. Accordingly, we would have allowed HMRC’s appeal even if we had taken a different view on the *Lupton* argument. In our view, the only relevant chargeable gain was that which accrued on Explainaway’s sale of the WRG shares. The “loss” and “gain” on the July Long Contract and the July Short Contract were not, as we see it, a *real* loss or a *real* gain within the scope of the relevant legislation.

#### The sale to Quoform

55. The FTT concluded that the 2002 derivative transactions “gave rise to gains to and losses on the disposals of those individual derivatives” (paragraph 89 of

the Decision). However, it went on to hold that “the loss on the disposal of the Quoform shares is not an allowable loss within the meaning of the TCGA” (paragraph 96). It said:

5            “[94] We have found ... that there was no practical likelihood that  
no loss would be realised. It follows that there was no practical  
likelihood that the shares in one or other of Quoform or Quartfed  
would not be reduced. We also find that there was no practical  
likelihood that the shares in the relevant company, which in the event  
10            turned out to be Quoform, would not be disposed of. No third-party  
purchaser had been identified at the outset of the scheme, nor at the  
time of the reduction in the value of the Quoform shares. However,  
we have found on the evidence that there was no real risk that such a  
disposal would not be effected. This is not, in our view, of the nature  
15            of a commercial contingency, or uncertainty, as arose in *Craven v*  
*White* [[1989] AC 398]. There, in each of the cases, it was the  
commercial end result of a series of linear transactions that was in  
doubt. Here, by contrast, the disposal of Quoform was a planned  
element of a self-cancelling transaction. The ultimate disposition of  
20            Quoform in some manner was in our view certain, and it was  
indivisible from the other transactions carried out as part of Plan B.  
There is no intellectual difficulty, as was encountered in *Craven v*  
*White*, in treating those transactions as a single indivisible whole.

25            [95] In summary therefore we find that the transactions in question  
were part of an overall scheme to avoid corporation tax on chargeable  
gains on a disposal by Explainaway. The scheme envisaged a  
reduction in the value of shares held by Explainaway in one  
company, that in the event was Quoform, through the effect of the  
movement of the FTSE index on a derivative contract, which was as  
30            it turned out the Quoform long contract. This was matched by a  
corresponding (if not exactly equal) increase in the value of another  
company, Quartfed, and a consequential increase in the value of  
Explainaway's shares in Quartfed. This corresponding decrease and  
increase in value of Explainaway's shares in these two companies  
35            was pre-planned, even if the amount of the increase and decrease  
could not be predicted. Precisely the same result would have been  
achieved, in reverse, had the FTSE index moved in the opposite  
direction at the time the various contracts were closed out. The  
increased value of Quartfed was substantially realised by the closure  
40            of the Quartfed short contract, and was extracted in a tax-free manner  
by the distribution of an interim dividend by Quartfed to  
Explainaway. On a realistic view of the Plan B transactions, taken  
together, we find that the loss on the Quoform shares was not a real  
loss within the meaning of s 2 TCGA, purposively construed”.

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56. Mr Ghosh took issue with the views expressed in paragraph 94 of the Decision. He argued that, when Plan B was undertaken, it could not be said with certainty that either Quoform or Quartfed could or would be sold. It was impossible to be sure that a loss would arise on either of the derivatives held by the companies or that, even if it did, a buyer for the company holding the relevant derivative could be found. At the time, no one had even looked for a potential purchaser. There was (Mr Ghosh submitted) a real risk that no sale would be concluded, just as no sale of Explainaway had materialised in the previous year.
57. In substance, Mr Ghosh is seeking to impugn findings of fact. The circumstances in which such findings are susceptible to challenge on appeal were explained by the House of Lords in *Edwards v Bairstow* [1956] AC 14. Viscount Simonds there said (at 29) that a finding of fact should be set aside if it appeared that the finding had been made “without any evidence or upon a view of the facts which could not reasonably be entertained”. Lord Radcliffe referred (at 36) to the facts found being “such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal”.
58. In our view, it cannot be said of the findings of fact that Mr Ghosh attacks that they lacked any evidential basis or were otherwise unreasonable or irrational. Common sense suggests that one or other of the Quoform and Quartfed Contracts was bound to generate at least some “loss”; after all, there is movement on the FTSE index every working day, let alone over a period of months. Further, the nominal value of the Quoform and Quartfed Contracts (viz. £174 million) was evidently thought to be sufficient to produce a “loss” of the order of £8.7 million, as desired; a higher nominal value could have been selected had that been considered necessary to achieve a “loss” on that scale. As for the prospects of finding a purchaser for whichever company proved to have the loss-making derivative, Mr Atterbury, the tax partner at Deloitte who gave evidence before the FTT, said in cross-examination:
- “We didn’t anticipate there would be a major problem with finding a buyer, although ... we knew the market wasn’t going to be large for this type of company”
- and:
- “We would expect to be able to sell it”.
59. The fact that the FTT’s factual findings are not open to challenge is, as it seems to us, fatal to the Appellants’ appeal. On the basis of those findings, there can be no real scope for challenge to the FTT’s conclusion that the *Ramsay* principle was applicable. If, as the FTT found, there was “no practical likelihood” that no loss would be realised or that the shares in the relevant company would not be disposed of, there was “no real risk” that such a

5 disposal would not be effected and the ultimate disposition of Quoform was  
“certain”, this was a very different case from *Craven v White*. On the facts as  
found, we agree with the FTT that there “is no intellectual difficulty ... in  
treating [the Plan B] transactions as a single indivisible whole”. Unlike *Craven*  
6 *v White*, this was not a case in which there was a “sensible and genuine  
interruption between the intermediate transaction and the disposal to an  
ultimate purchaser” (to echo Lord Oliver in *Craven v White*).

10 **Conclusion**

60. HMRC’s appeal is allowed and that of the Appellants dismissed.

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**Mr Justice Newey**

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**Judge Greg Sinfeld**

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**RELEASE DATE: 19 October 2012**