TC07408

Appeal number: TC/2017/6307 and 7840

COSTS – appeal settled by s 54 agreement on acceptance by HMRC of issue not argued by parties

FIRST-TIER TRIBUNAL
TAX CHAMBER

KS MACMILLAN and G BOARDMAN **Appellants**

- and -

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

TRIBUNAL: JUDGE CHARLES HELLIER

Decision following a hearing and written submissions.

Giles Goodfellow QC and Barbara Belgrano instructed by Barnes Roffe for the Appellants

Richard Jones of HMRC's solicitors office, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Background

1. This is a decision in relation to costs. It relates to an appeal in which the issue was whether capital gains tax Entrepreneurs' Relief was available on a disposal of loan notes by the taxpayers in 2014.

2. These loan notes had been issued to them in 2006 by what I shall call Company 5 as the result of a preplanned series of transactions which all took place on the same day. Those transactions were documented as starting with the disposal of the taxpayers' shares in Company 1 in return, inter alia, for the issue of loan notes in Company 2, their exchange for loan notes in Company 3, their exchange for loan notes in the Company 4 and finally their exchange for loan notes and shares in Company 5.

3. Section 135 TCGA has the effect that, if certain conditions are satisfied, then on an exchange of shares or notes in one company for the issue of those in another, no disposal is to be recognised for CGT purposes but the CGT base cost of the new shares or loan notes is to be taken to be the base cost of the old shares or loan notes. But this is subject to section 116 (see below).

4. As the transactions were documented, section 135 would have applied to the first three exchanges. But it would not have applied to the exchange for the issue of Company 5 loan notes because of section 116.

5. A qualifying corporate bond ("QCB") is a plain vanilla sterling loan note. Section 115 TC GAA provides that no capital gain or loss arises on its disposal but that this is subject to section 116. That section provides that if a QCB is issued in exchange for a non QCB the section 135 treatment does not apply. Instead, on the exchange of a non-QCB or shares in one company for QCBs in another no immediate gain or loss is recognised but the gain which would have arisen on the disposal of the first company's shares or securities is frozen and falls into CGT only when the QCBs are disposed of.

6. It was common ground that the Company 5 loan notes were QCBs, but that the loan notes in Companies 2, 3 and 4 were not. Thus on the basis of the step-by-step picture painted by the documents there would have been no disposal recognised for CGT purposes on the exchange of the Company 1 shares and the Company 2 and Company 3 loan notes, but the base cost of the Company 1 shares would have become the base cost of the Company 4 loan notes. When these were exchanged for the Company 5 loan notes that base cost could be deducted from the value of those loan notes to give the frozen gain which would then accrue on their later disposal.

7. That later disposal took place in 2014 and in their tax returns the taxpayers claimed Entrepreneurs' Relief under Chapter 3 Part V TCGA (sections 169H to 169S) ("Ch 3") in relation to it.

8. Ch 3 was inserted into the TCGA in 2008 and provides for a lower rate of CGT (10%) on qualifying disposals. It is available, subject to a number of conditions, in respect of shares or securities disposed of by a taxpayer in a trading Company which is his or her "personal company". Both Company 1 and Company 5 were accepted as being the appellants' personal companies but Companies 2 to 4 were not.

9. Ch 3 contains provisions which deal with transactions falling within section 135 and 116, but they apply only in relation to such transactions which took place before 2008. But Sch 3 FA 2008 contains transitional provisions.

10. HMRC opened an enquiry into the tax returns and, after some correspondence (to which I shall return later), closed their enquiry setting out their decision that Entrepreneurs' Relief was not available. There followed further correspondence and a review in which HMRC maintained the same stance. The taxpayers appealed and a hearing was held.

11. There was statement of agreed facts which described the issue as whether the appellants were entitled to Entrpreneurs' Relief. But the battleground for the hearing was set out in the parties' skeleton arguments. In their skeleton the appellants argued that the transactions in 2006 should be viewed as a single composite transaction. They described the issue thus:

> "the question for the Tribunal is whether the Taxpayers were issued with [loan notes in Company 5] in exchange for ... the shares in [Company 1] (as the taxpayers argue) or in exchange solely for the loan notes in [Company 4], one of the intermediate companies in the transaction (as HMRC argue).

12. Both parties' skeleton arguments were directed to whether the transitional provisions in paragraph 7 Schedule 3 FA 2008 operated to give Entrepreneurs' Relief on the frozen gain which came into charge on the 2014 disposal (although the Appellants computed that gain by reference to the Company 1 shares and HMRC by reference to the Company 4 loan notes) .

13. The main thrust of the appellants' argument at the hearing was that the four exchange transactions which took place in 2006 should be regarded as a single transaction under which shares in the Company 1 were exchanged for QCBs in Company 5. On this analysis the gain on those shares would be frozen and realised on the disposal of the QCBs in 2014. That gain, they argued, would "by virtue of" the transitional provisions in FA 2008 Schedule 3 paragraph 7 be eligible for a Entrepreneurs' Relief because the gain arose on the disposal of shares in Company 1 which was a personal company.

14. HMRC's argument in their skeleton arguments and at the hearing was that the 2006 transactions should be viewed individually and the provisions of TCGA applied at each stage. On this analysis the frozen gain "was attributable to the hypothetical

disposal of the [Company 4] non-QCBs. As the appellant did not hold any of the shares in this company it could not qualify as their personal company and therefore ER [was] not available" under the transitional rules of para 7 schedule 3 FA 2008.

15. During the course of the hearing (and then afterwards in a more detailed request) the tribunal sought the parties' views on an argument that Entrepreneurs' Relief was available on the 2014 disposal by virtue of Chapter 3 unalloyed by the transitional provisions: that is to say that any frozen gain was to be treated by the legislation as arising on the disposal of the Company 5 loan notes (rather than the Company 1 shares or the Company 4 loan notes) and those loan notes were in the taxpayer's personal company so that Entrepreneurs' Relief applied without recourse to the transitional provisions. I shall call this the "Ch 3 argument".

16. The parties replied to this argument. HMRC agreed that Entrepreneurs' Relief was available and the Appellant agreed the amount of the gains to be charged at the lower rate. The parties formalised the agreement in an exchange of letters which by virtue of section 54 Taxes Management Act 1970 had the same effect as if the tribunal had determined the appeal in that manner. As a result after that determination the tribunal had no further role to play in the determination of the substantive appeal. All that remained was the issue of costs in relation to which I considered, and the parties agreed, that the tribunal retained jurisdiction.

The parties' positions on costs.

17. HMRC submit that each party should bear its own costs because: the appellants' claims were expressly founded on the transitional provisions and their composite view of the 2006 transactions, the parties focused only on that analysis, and neither addressed the argument suggested by the tribunal.

18. The appellants argued that as Entrepreneurs' Relief had been determined to be available the normal costs rule should apply: they had won the appeal and so should be entitled to their costs. They also say that the correspondence between the parties prior to the hearing indicated that HMRC considered that Entrepreneurs' Relief was not available outside the ambit of the transitional provisions and that they have won on that issue (even if not raised by them in correspondence or in argument at the hearing).

19. I must therefore say a little more about that correspondence

Correspondence before the hearing.

20. The appellant's tax returns contained a claim that Entrepreneurs' Relief was available in respect of the amount of the frozen gains. In the "white space" in Mrs Boardman's return she indicated that Entrepreneurs' Relief was claimed under the transitional provision of para 7 Sch3; Mr Macmillan's return did not set out the basis upon which it was claimed.

21. In the initial stages of the dispute different firms advised the two taxpayers and different HMRC officers dealt with their returns.

22. In Mr Macmillan's case, after opening their enquiry into his return it appears that HMRC asked why it was considered that Entrepreneurs' Relief was available. Barnes Roffe replied (paragraph 5 of their letter in 19 December 2016) that the position as regards the Company 5 loan notes was "relatively complex as it arises from a pre-6 April 2008 [transaction]" and referred to paragraph 7 of the transitional provisions.

23. On 13 January 2017 HMRC replied saying:

> "you are claiming ER on the basis that the transitional rules of paragraph 7 (2) Schedule 3 FA 2008 would apply to the QCBs ..."

and setting out their view that those provisions did not apply because Company 4 was not a personal company.

24. On 17 February 2017 Barnes Roffe replied arguing that the 2006 transactions were a single composite transaction properly regarded as the exchange of Company 1 shares for Company 5 QCBs and that the transitional provisions applied to give ER for that transaction.

25. On 27 February 2017 HMRC replied setting out how they regarded the transitional provisions as operating and asking why for the purposes of those provisions the 2006 transactions should be treated as a single composite transaction.

26. Barnes Roffe replied on 8 March 2017 setting out additional reasons why the 2006 transactions could take the benefit of the transitional provisions. HMRC responded on 4 May 2017 saying they could not agree that the conditions for relief were met and explaining that conclusion by reference to transitional provisions and their rejection of the single composite transaction argument.

27. On 8 May 2017 HMRC issued a closure notice saying:

> "the disposal of the [Company 5 loan notes] does not meet the conditions to qualify for Entrepreneurs' Relief or the transitional provisions of paragraph 7 ...".

The appellants note that this statement is not limited to the transitional provisions.

28. Barnes Roffe replied saying that HMRC's analysis was incorrect and requesting a review. HMRC replied, acknowledging that Barnes Roffe's appeal was against the conclusion that the disposal did not:

> "meet the conditions to qualify for Entrepreneurs' Relief or the transitional provisions".

29. I note again that the "or" that appeared in that letter despite Barnes Roffe having put no argument that Entrepreneurs' Relief was available absent the transitional provisions.

30. The review was completed on 21 July 2017. In here letter the review officer summarised the appellant's contention as directed to the operation of the transitional provisions. She said that in her review she had considered whether the disposal met the conditions

> "to qualify for Entrepreneurs' Relief or the transitional provisions".

31. Her letter indicated (page 5c) that she considered that "no chargeable gain arose on the disposal of the QCBs and so that there was no gain against which directly to claim ER". That was in effect a rejection of the argument (which had not been put by the taxpayer) which was accepted by HMRC after the hearing that the frozen gain arose on the disposal of the Company 5 loan notes and qualified for ER on the basis of the status of Company 5 as a personal company. The meat of the letter however dealt with the arguments about the applicability of the transitional provisions and the composite transaction argument.

32. Mrs Boardman's advisers' correspondence with HMRC and HMRC's responses pursued a similar course. Her advisers' arguments were directed solely at the transitional rules.

33. I have recounted earlier how the arguments on the appeals were advertised for, and advanced at, the hearing.

34. My summary of this history is that the Ch 3 point was mentioned by HMRC, but only in passing and was not challenged by the Appellants.

Applicable law

35. Section 29 Tribunals, Courts and Enforcement Act 2007 gives the tribunal discretion to determine by whom what costs should be borne, but is expressed to be subject to a tribunal's rules. Rule 10 of this tribunal's rules limits the power of the tribunal to direct by whom costs should be borne to Complex cases in which the taxpayer had not opted out of cost shifting (and this appeal was classified as Complex and there was no opting out) and also to wasted costs and costs of unreasonable conduct (these latter two are not in my view relevant on this appeal). The only constraint on the exercise of the discretion afforded by section 29 lies in rule 2 of this tribunal's rules which requires it to seek to deal justly and fairly in exercising any power.

36. In *Bastionspark LLP and others v HMRC* [2016] UKUT 425 (TCC) Nugee J considered an application for costs in a case where both parties had been successful in part. He set out the legislative provisions and then said:

> 16. There are no other rules dealing with costs, and hence no guidance in the rules as to the exercise of the FTT's discretion, save for the general provision in rule 2(3) that the FTT must seek to give effect to the overriding objective (which under rule 2(1) is to enable the FTT to deal with cases fairly and justly) when exercising any power under the rules. There is therefore no equivalent of CPR Part 44 which contains general rules about costs, and in particular no

> equivalent of CPR 44.2(2) under which if the court decides to make an order about costs, the general rule is that the unsuccessful party will be ordered to pay the costs of the successful party, although the court may make a different order. But although there is no express provision to this effect, it does not seem surprising that if the FTT is to have a discretion over costs, the starting point will usually be that if any order for costs is made at all, it will be that costs should follow the event, that is that the loser will pay the winner. This is what fairness and justice would seem normally to require.
>
> …19... I accept that *BPP* is illustrative of the general principle that the FTT will look to cases decided under the CPR as helpful guidance, but I would sound a note of caution. Under the CPR the court has to identify the successful party in order to apply (or decide not to apply) the general rule under CPR 44.2, and as appears from the authorities (below) there has been a tendency for courts to seek to identify one or other of the parties as "the successful party" (and the other as "the unsuccessful party"). But it is not obvious, at any rate to me, that the exercise that the FTT is engaged in is necessarily quite the same. No doubt in a case where there is a clear winner and loser, one would normally expect the costs to follow the event in the FTT as in a court. But that is not because any of the rules require this approach but simply because that is likely to be the fair and just outcome and hence in accordance with the overriding objective applicable in the FTT. It by no means follows that in a case where both sides have had some measure of success the FTT has to, or ought to, approach the question of what is fair and just by seeking to identify one or other party as *the* successful party. I would have thought that what the FTT should be doing is seeking to identify a fair and just outcome, and that that is likely to be one that reflects, by one means or another, the fact that the parties have each been successful in part.

37. I conclude that there is no general rule that costs should be borne by the unsuccessful party unless the circumstances dictate otherwise. Rather the rule is to seek just and fair exercise of the discretion, and usually the starting point in considering whether to make an order will be that, if there is a clear winner and a clear loser, an order for the loser to pay is likely to be fair.

Discussion

38. The Appellants rely in particular on two cases.

39. The first is *Bav-Tmw-Globaler-Immobilien-Spezialfonds v HMRC* [2019] UKFTT 233 (TC). In that case Judge Sinfield accepted that the Civil Procedure Rules ("CPR") provided helpful guidance on the principles to be applied in relation to cost shifting. He cited the provisions of CPR 44.2 under which the general rule is stated to be that the unsuccessful party will be ordered to pay the costs of the successful party but that in deciding whether to make a different order the conduct of the parties is relevant and such conduct may include:

> "(3) (b) whether it was reasonable for the party to raise, pursue or contest a particular allegation or issue and
>
> (c) the manner in which a party has pursued or defended its case."

40. He concludes that departure from the general rule should be approached with caution. At [16] he said that the fact that the party had put forward two separate arguments and had been successful only on one did not mean that it was only partially successful for these purposes

> "…On the contrary, BTI only needed to succeed on one of its arguments for the challenge to the closure notices to be upheld and the appeal allowed. In those circumstances, it is not possible to regard HMRC as having been other than wholly unsuccessful in the appeal and, under the general rule, BTI should be entitled to its costs unless there are other features of this particular case which mean that I should exercise my discretion to depart from the general rule."

41. The Appellants suggest that they are in a comparable position. They were successful by reason of a secondary argument. But I do not think that *Bav* provides the support the Appellants seek. First, it does not seem that *Bastionspark* was brought to Judge Sinfield's attention, and in the light of that decision, his decision places perhaps a little too much emphasis on a general rule. Second, Judge Sinfield's decision makes reference to the manner in which a case has been conducted and caveats his conclusion by reference to the particular facts of a case. In this appeal there is the particular fact that the manner in which the appeal was pursued did not include the argument which was eventually accepted by both parties. That suggests that even if it were right to start with a general rule from which departure must be justified, there may be such justification in this appeal.

42. The second case was *BCT Software Solutions Limited v C Brewer & Sols Limited* [2003] EWCA Civ 939 [2004] C.P. Rep.2, In this case the Court of Appeal was dealing with a case which had been settled before judgement. The judge had made a costs order which was appealed. Chadwick LJ noted [24, 25] the difficulties which arise when, because there has been no trial or judgement, the judge may not be in a position to determine whether one party or the other had been successful, or successful on discrete issues. But he said that it did not follow that in all such cases the judge would not be in a position to make a costs order. There would be cases where there was only one issue on which one party had been successful and conduct was not an issue; in such a case it would be obvious who should bear the costs.

43. The appellants say that in their appeal there was only one issue and only one winner and so it was obvious that HMRC should bear their costs.

44. That depends of course on identifying the issue on which there was success. If it was the getting of Entrepreneurs' Relief then the Appellants were the winners; if it was whether or not the transitional provisions applied then there was no clear winner. And the fact that the Ch 3 issue was not argued (by either party) was a matter affecting the conduct of the litigation. So it does not seem to me to be "obvious" that HMRC should bear the costs.

45. The Appellants make three further points

46. First they say that HMRC, in pursuance of its duty to collect the correct amount of tax, should have considered arguments other than those put forward by the taxpayers.

47. My summary of the correspondence shows that HMRC did briefly consider the Ch 3 point, but held a view from which they later withdrew. That does not seem to me to be conduct which should count against them or in the appellants' favour.

48. Second, they say that the point on which the parties now agree was rejected by HMRC in the course of their enquiry.

49. I accept that HMRC's letters to the appellants say, in passing, that Entrepreneurs' Relief was not available absent the transitional rules. But none of the appellants' responses challenged that statement, and in Mrs Boardman's case her claim was made only on the basis of para 7 even though the decision letter is more general.

50. Third, they say that it is understandable that taxpayers should not want to challenge HMRC on a point of general principle (by which I understand them to mean the Ch 3 argument) which might lead to a series of expensive appeals as opposed to challenging HMRC's view of the particular facts of the case.

51. I do not consider that a taxpayer represented by expert counsel would reasonably cavil at the thought of challenging even HMRC's most sacred views, nor was there any evidence that the taxpayers or their advisers had been that pusillanimous. But in any case the challenge on the basis of the Ch 3 argument as an alternative to the transitional provisions argument was open to them and would not necessarily have led to an expensive series of onward appeals if they won on both arguments.

52. In *Bastionspark*, Nugee J summarised his thinking on that case at [58]:

> …58. What then are the implications for the present case? In the first place, I remain unpersuaded that it is always necessary for the FTT, before deciding a question of costs, to identify one or other as *the* successful party. The driver for doing so in the CPR cases appears to me to be the wording of CPR 44.2(2), although the practice is no doubt also influenced by the seminal statement of Sir Thomas Bingham MR in *Roache* that the question is who is really the winner. As I have already pointed out, CPR 44.2(2) does not apply in the FTT, and the only specific requirement under the FTT Rules is the obligation to give effect to the overriding requirement and hence to deal with cases fairly and justly. That does not seem to me to require the FTT in all cases to proceed by characterising either the appellant or the respondent as *the* successful party to the exclusion of the other; I see no reason why the FTT cannot say that both parties have been to some extent successful but the success of one party is more significant than the success of the other, and I see nothing in the authorities which I have referred to which makes this impermissible.

53. This appeal, by contrast, was one where, whilst the taxpayer's arguments might have been correct, the result was not a success for the arguments of the taxpayer nor a success for those of HMRC. It was a success for the taxpayer only in the sense that they obtained the relief sought even though – particularly in Mrs Boardman's case - it was obtained on a different basis from that on which it was claimed. Both sides could be said to have caused expenditure on costs which might have been avoided if the point was considered earlier. It seems to me that a just and fair decision must take these matters into consideration.

54. But it must also take in to account the fact that had the taxpayer not brought the appeal it would not have obtained the relief sought.

55. For these reasons I consider that it would be just and fair to order HMRC to pay a portion of the appellants' costs. I fix that portion at 50%.

56. I direct that such costs be assessed under Rule 10(6)(c) if not agreed.

57. I direct that HMRC make a payment on account of 20% of the costs claimed by the appellants within 14 days of the release of this decision..

Rights of Appeal

58. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

CHARLES HELLIER

TRIBUNAL JUDGE
RELEASE DATE: 16 October 2019