[2014] UKUT 0073 (TCC)

Appeal Number: FTC/77/2013

Taxation of profits made on sale or transfer of derivatives under Finance Act 2002. Whether transfer disregarded between subsidiaries where one of the companies is not subject to the regime under the 2002 Act. Closure Notice – whether effective when sent by mistake known to the tax payer company.
Held: The transfer was not to be disregarded for the purposes of the 2002 Act but the Closure Notice was effective and prevented HMRC from seeking to claim tax in that tax year arising out of the transfer between the two companies. Appeal allowed.

BEFORE THE UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

B E T W E E N:

BRISTOL & WEST PLC

Appellant

and

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondent

TRIBUNAL: Mr Justice Peter Smith

Sitting in public in London on 5th & 6th February 2014

Graham Aaronson QC & James Henderson, instructed by Herbert Smith Freehills LLP, for the Appellants

Kevin Prosser QC & James Rivett, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondent

INTRODUCTION

1 The Appellant Bristol & West Plc ("B&W") appeals against the decision of the First-tier Tax (Judge Nowlan and Mrs Lousada) ("the FTT") dated 8th April 2013.

2 B&W sought permission to appeal two of the three issues decided by the FTT and it was granted permission to appeal in respect of those issues by Notice dated 19th June 2013.

3 The first of the two issues is a procedural one. In outline HMRC in error produced and sent out a document headed ***"Notice of completion of Enquiry"*** in respect of B&W's accounting period ending 31st March 2004. A subsequent letter then confirmed to B&W that the enquiry stage was at an end. This occurred without including the additional profits and tax previously said by HMRC to be due as a result of the novation of certain interest rate swaps from the Appellant to another group company, Bank of Ireland Business Finance Ltd ("BIBF"), on 29th August 2003. The issue is whether HMRC can now say that the enquiry stage actually continued and rely on a much later closure letter and consequent amendment to B&W's 2004 return which did include adjustments in respect of the novation ("the Closure Notice Issue"). If HMRC cannot do that no additional tax is due from B&W for the year ending 31st March 2004.

4 The second issue ("the Disregard Issue") only arises if B&W is unsuccessful on the Closure Notice Issue. However the Disregard Issue is relevant also to accounting periods subsequent to the period ending 31st March 2004. B&W contended that it was subject to a new regime for taxation of derivative contracts enacted by the Finance Act 2002 ("FA 2002") even if BIBF was not.

DECISION OF FTT

5 The FTT decided on the procedural issue that the purported notice of 31st October 2007 was not a Closure Notice so that HMRC could make later adjustments to the return occasioned by HMRC's contentions concerning the taxation of the derivatives.

6 In respect of the Disregard Issue the FTT decided that B&W could not rely upon the disregard of a transaction provided by paragraph 28 of Schedule 26 FA 2002 because that only applied if ***both*** the transferor and the transferee companies were under the regime set up in FA 2002. At all times BIBF was not in that regime because its accounting period was not covered by the relevant provisions (see below).

7 The third issue before the FTT has not been challenged by B&W.

FACTUAL BACKGROUND

8 B&W entered into interest rate swap contracts in order to hedge fixed rate mortgages and fixed rate savings products. It was accepted by all parties that the entry into these was for entirely commercial hedging reasons.

9 As a result of interest rate movements certain of B&W's swaps were ***"in the money".*** By that it is meant that the present value of the payments to be received by B&W over the remaining life of the swaps exceeded the present value of the payments to be made by B&W to the counterparty to the swaps.

10 On 29th August 2003 B&W novated 220 interest rate swaps to BIBF in consideration of a payment to B&W of approximately £91,000,000. This was accepted as being the market value of the novated swaps as at 29th August 2003.

11 This novation transaction was carried out by B&W purely in the hope of securing a tax advantage. I should explain what that tax advantage was perceived to be.

12 The FA 2002 had replaced the swaps regime of FA 1994 and came into force in relation to companies for the first accounting period to commence ***after*** 1st October 2002. B&W's accounting period had commenced 1st April 2003 and so B&W was in the regime whereas BIBF's accounting period had commenced on 1st September 2002 and so BIBF was not.

13 The attempt was to have that transaction disregarded as regards B&W's trading activities in the year ending 31st March 2004 to take advantage of the disregard provisions in schedule 26 FA 2002 (paragraph 28). By contrast BIBF was not within the regime in that tax year and therefore would not be treated as the transferor company for the purposes of FA 2002. Thus the transaction would be entered in BIBF's books with an acquisition price of £91,000,000 which would be the base for any taxation it might incur on a subsequent disposal of those novated contracts. The difference therefore was that the £91,000,000 ***"disappeared"*** from B&W's accounts but did not ***"reappear"*** in BIBF's accounts. There would therefore be a tax saving on the part of B&W if the scheme was successful.

14 HMRC's contention in relation to the novation was that the roll over provision set out in paragraph 28 did not apply and B&W should be taxed on the entire £91,000,000.

15 A more detailed analysis factually is set out in the FTT decision. For the purpose of this decision no further facts are required to be set out.

THE CLOSURE ISSUE

16 On 22nd November 2005 HMRC gave notice of enquiry into B&W's tax return for the period ending 31st March 2004. Once HMRC have decided that their enquiry is concluded it serves a Closure Notice on the taxpayer.

17 The service of a Closure Notice is governed by paragraph 32 schedule 18 to the FA 1998 which provides as follows:-

> ***"32 (1) An enquiry is completed when [HMRC] by notice ("a Closure Notice") inform the company that they have completed their enquiry and state their conclusions. The notice takes effect when issued."***

18 There is no statutory form for the issue of Closure Notices.

19 At the material time, under paragraph 34 the Company had 30 days beginning with the day on which the enquiry was completed in which (inter alia) to amend the return that was the subject of the enquiry (inter alia) to accord with the conclusions stated in the Closure Notice.

20 If at the end of that period HMRC were not satisfied that the return that was the subject of the enquiry was correct and complete or that any necessary amendments had been made to any other return delivered by the company it may within the following period of 30 days by notice to the company make such amendments to that return or those returns as they considered necessary.

21 An appeal would be brought by the Company against HMRC's amendment provided it was made in writing within 30 days after the amendment was notified and given to the officer of the Board by whom the notice was given.

WHAT HAPPENED

22 The investigation was being conducted on behalf of HMRC by Gavin Howard Tax Specialist Direct Tax. His counterpart acting for B&W was Mr Liam Boyd Head of UK Tax Bank of Ireland.

23 They had a friendly relationship in that they communicated with in each other on first name terms unless it was in a formal document in which case they were both spoken of as Mr respectively.

24 It is clear that HMRC were still not satisfied in respect of the taxation treatment of the derivatives. For example on 14th September 2007 Mr Howard had written to Mr Boyd seeking clarification on various points. Mr Boyd acknowledged in his evidence before the FTT that he was aware that the question of the interest rate swaps was still outstanding (T1.73). He also acknowledged that he would have been surprised to have received any Closure Notices from Mr Howard at that time.

25 Unfortunately that is precisely what he received. On 30th October 2007 or possibly the day before Mr Howard put a document on the desk of his colleague a Mr Gill who was responsible for arranging for the issue of Closure Notices and amendment to returns. Those instructions the FTT determined were clear (there is no issue in respect of them). Mr Gill input instructions in to the computer system to issue Closure Notices in relation to other group companies where that was intended and in relation to the two periods of B&W. That was a mistake. The FTT were told that this resulted in a creation of some file in HMRC's COTAX system. That started in train

the issue of Closure Notices and the insertion of them in one of the large number of envelopes which HMRC issue each day.

26 On the same day Mr Howard realised an error had been made and sought to rectify the wrong instruction. He was unable to change that for some reason and tried (somewhat desperately) to change the taxpayer's address to HMRC's address so that the Closure Notices would come back to HMRC. He was unable to satisfy himself whether his "rerouting" expedient worked. He arrived at his office at 7.00am on 31st October and then ascertained that the address had not been changed. HMRC entrusts its printing and the arrangement for posting to Fujitsu and the FTT were told that the print run for printing off countless Closure Notices would have commenced at 6.00am on 31st October. Nobody knew when the Closure Notices in relation to B&W's two enquiries would have been printed and then later inserted into the envelope but the FTT was asked to assume that it might have been before 7.44am on 31st October. However the Closure Notices would not have been collected for posting by Royal Mail until 1st November. As they were sent second class it was assumed they would not have been received by B&W until Saturday 3rd November or possibly the following Monday or Tuesday.

27 It was theoretically possible for Mr Howard to go and rummage through all the Closure Notices in their envelopes that were still in HMRC's clutches on 31st October 2007 but I assume that task was so large it was not considered worth doing. As my decision will show had they stopped that Closure Notice being sent out none of the problems would have ensued.

28 The form of the Closure Notice is dated 31st October 2007 and it says:-

> ***"I have completed my enquiries into the company tax return and show my conclusions in the following figures and computation of tax payable.***
>
> ***You may amend the return to agree the figures I have shown and include any further amendments the company can still make. Any amendment you propose must be made within 30 days of the date of issue shown on this notice.***
>
> ***If I have not received your amendment by that date or if I do not agree with it I will amend your return figures including tax payable to show those I think are correct. The law allows me a further 30 days to make such an amendment. You are entitled to appeal against any amendment I make….."***

Attached were amendments of the return of B&W for the period ending 31st March 2004. They did not show any tax charge in respect of the derivatives.

29 If this notice was effective the following ensues. First B&W would not make any amendments because it is in its favour as it does not include any adjustment in respect of the derivatives. Second it is not capable of being

revisited by HMRC after it has been issued. Third HMRC itself cannot appeal to challenge its own figures. Fourth HMRC cannot withdraw a Closure Notice at a later date and substitute a fresh one.

30 It is fair to say that whilst that is the agreed position before the FTT and myself the ensuing correspondence will show that was not always perceived to be the position by HMRC.

31 At 7.44 am on 31st October Mr Howard being alert to the problems sent an email to Mr Boyd as follows:-

> ***"Morning Liam, I wanted to pre-warn you that 2 Closure Notices were issued today in error in relation to B&W Plc for periods ended 31/3/03 and 31/03/04. We will be taking action to correct the position in due course. I'll confirm the position in writing within the next few days.***
>
> ***Best regards***
>
> ***Gavin"***

32 Mr Boyd who was at that time off work at home and ill nevertheless responded. I suspect he never really addressed his mind to Mr Howard's email beyond acknowledging it. Hence his response ***"Ok Gavin. Thanks"***.

33 Thus in my view HMRC through Mr Howard are telling Mr Boyd that he is going to get some Closure Notices which were issued in error on 31st October 2007.

34 As I have set out above once a Closure Notice has been issued HMRC can neither re-open it nor withdraw it. The provision provides that "the Closure Notice takes effect when it is issued". It does not assist as to when a Closure Notice is issued.

35 There are 3 possibilities. The first is that it is issued when it is printed and put in the envelope. Nobody contends for that and they are right. The second is when it is posted and the third is when it is received.

36 It is not necessary for reasons which will appear in this decision below to decide whether it is the date of posting or the date of receipt. For my part I would be of the opinion that it would be the date of posting. The time for amending would run from that date but the question of receipt by the recipient would be governed by the Interpretation Act 1978. I would adopt the quotation from Horace "Ars Poetica" given by Lord Justice Scarman in ***Wallersteiner v Moir [1974] 1 WLR 991*** at page 1030 F.

37 It is probable that Mr Boyd thought that the mistake about the issue of the Closure Notices was the issue of the notice at all. However he could not be sure about that and there could be any number of reasons why the Closure Notice had a problem. I do not think that his short response in the morning when he was ill at home has any significance beyond the fact that he acknowledged Mr Howard's email and was simply waiting to receive the clarification.

38 By the time he received that clarification he had received the Closure Notices.

39 HMRC had power to recall the Closure Notices before they were issued. Thus it would have been possible in my view for Mr Howard to have recalled the Closure Notices by his email of 31st October 2007 because the earliest day on which it can be said that the notices were issued was 1st November 2007. However it is quite clear that his email does not purport to withdraw the Closure Notices. That to my mind is obvious on the face of the email and any argument to the contrary is not sustainable. What the email does is to put the effect (possibly) of the Closure Notices on hold until his definitive communication is received.

40 Mr Boyd could have challenged that decision but his ***"fine ok"*** falls in line with the attempt by Mr Howard to put matters on hold. If Mr Boyd did not agree with that then Mr Howard would have had to commence a search and stop the notices going out. Otherwise they would have become issued and not capable of challenge if they were valid notices in accordance with the provision above.

LETTER 8TH NOVEMBER 2007

41 This letter in my view is the most important document. It was a carefully written and considered letter sent by Mr Howard after consideration setting out HMRC's position. By the time Mr Boyd received it he had already received the Closure Notices.

42 In my view it would have been open to HMRC by that letter to have withdrawn the Closure Notices having put their effect into suspension by the email with Mr Boyd's agreement.

43 The letter in fact did the opposite as regards the Closure Notices. It said this:-

> ***"I refer to our recent email exchange regarding the closure notices issued in error for B&W Plc for the 2 accounting periods noted above. First of all I apologise for the error on our part in issuing these notices and for any confusion that their issue may have caused. As promised I am now writing to explain the action I propose taking so as to enable us to ensure that the assessments can ultimately be finalised in the correct amounts and that the basis upon which they are ultimately finalised is sound in law.***
>
> ***The present position is that, albeit in error, closure notices were issued on 30 October 2007 and those notices are effective under Paragraph 32(1) Schedule 18 FA1998 marking the completion of the enquiries into the returns made by B&W Plc. The original self assessments however remain in place and have not been amended by the closure notices."***

44 The key paragraph is the second paragraph namely ***"the present position is that albeit in error the Closure Notices are effective marking the completion of the enquiries into the returns."***

45 Nothing in my view could be clearer as to HMRC's stance. That has the effect of lifting the agreed suspension so that the Closure Notices become effective. It would have been equally open to Mr Howard by my analysis to have said the Closure Notices were withdrawn. However he did not do so.

46 The letter then went on to deal with how Mr Howard proposed to address the self assessments concerning the derivatives as follows:-

> ***"In order to ensure that the assessments may ultimately be finalised in the correct figures I therefore propose making amendments to the returns of B&W Plc under the provisions of Paragraph 34 (2). The relevant notices of amendment to the returns will be issued shortly after 30 November 2007, being the expiry of the period referred to in Paragraph 34 (1). Bank of Ireland will no doubt wish to appeal those amendments and we will then be in a position where the assessments can ultimately be finalised in the correct figures by agreement under Section 54 of the Taxes Management Act 1970 in the light of the conclusions reached regarding the ongoing issues. Put shortly, in relation to these accounting periods for B&W Plc the statutory position will be akin to that which generally prevailed for all corporation tax returns and accounting periods for pre CTSA accounting periods.***
>
> ***I trust the above has now clarified for you the legal basis upon which we will be moving forward. Once again I apologise for any confusion and inconvenience this situation has created."***

47 The difficulty with that position is that HMRC now acknowledge that it was not possible to proceed in that way once the enquiry had been closed. It is clear as I have said HMRC were not intending to give up on the assessments and it is also clear as I have said that Mr Boyd knew that. However HMRC were in error in thinking that it could allow the enquiry to be closed in accordance with paragrapg 32 and somehow maintain the right to investigate further the question of the derivatives.

48 It is said by Mr Prosser QC who with Mr Rivett appears for HMRC that the letter does not comply with the requirements of a Closure Notice because it does not state HMRC's conclusions and does not show what its calculation of the tax is. The letter itself does not do that but of course it expressly refers to the Closure Notices. Whilst I accept the Closure Notices have to be in one document and that it is not possible to stitch together a number of disparate documents so as to create a Closure Notice it is perfectly possible for the key document to incorporate other documents expressly by reference. That is precisely what the letter does. It refers back to the Closure Notices and says they are valid. It therefore incorporates in it the contents of the Closure Notices which provide all the information that B&W can require.

49 It would be an interesting point as to when the Closure Notice was issued i.e. on the date it was posted 1st November 2007 or when this letter arrived which in effect lifted the suspension. However that does not matter because B&W would not have any interest in disputing the Closure Notice.

ENSUING CORRESPONDENCE

50 Mr Boyd replied to Mr Howard ultimately via a Mr Valentine who had actually issued notices of amendment on 19th December 2007 as follows:-

> ***"On the assumption (emphasis added) that it was correctly issued within the Taxes Act ….. I wish to appeal against the Notice of Amendment….on the grounds that it is not in accordance with the facts…"***

51 On 23rd April 2008 Mr Howard had another attempt at Closure Notices and asked Mr Boyd ***"[to] take this letter as notice that I am formally withdrawing the Closure Notices issued for both periods…."***

52 This was said to be done having received legal advice that the Closure Notices could be withdrawn.

53 Two points arise out of this. First it is evident again that HMRC ***at that time*** still thought that the Closure Notices were valid (and not void). Second they received advice apparently that they could withdraw the earlier Closure Notices. HMRC accepts that if the earlier Closure Notices were valid it has no power to withdraw them.

54 On 4th February 2010 (2.5 years after the Closure Notices) Mr Howard had another go. After setting out that the notices were issued as an administrative error he reiterated that it was his view that in the circumstances of this case it was open to HMRC to withdraw the Closure Notices expressly or impliedly. He reiterated that ***"his opinion on the above remained unaltered."***

55 However he had apparently received further advice which suggested that the Closure Notices never took effect. Although he does not expressly refer to the basis for that it is clearly on the basis that the 7.44 email stopped the Closure Notices and the letter of 8th November 2007 was not a valid Closure Notice.

56 Accordingly he decided that further Closure Notices should be issued and that was done.

HMRC'S SUBMISSIONS

57 First HMRC submitted B&W's reliance on the 8th November letter 2007 was misplaced. The letter does not constitute a Closure Notice because it does not have HMRC's conclusions. I have already dealt with that above. Second the letter and the Closure Notice cannot be construed together. I do not accept that either.

58 Third the Closure Notice cannot be construed in the light of the letter as a Closure Notice.

59 Next HMRC submit that B&W's reliance on Mr Howard's evidence given at the FTT that he did not intend his email to nullify the notice is also misplaced. This is on the basis that the construction of the Closure Notice must be approached objectively. The issue is whether a reasonable recipient would have understood it as informing him that HMRC had completed their enquiry and reached a particular conclusion. Thus Mr Howard's own subjective intentions are irrelevant.

60 Finally HMRC contends that it does not matter that the email does not purport to nullify the Closure Notice because taking into account the relevant objective contextual scene a reasonable recipient would certainly not have understood the Closure Notice as informing that HMRC had completed their enquiry and concluded the profits from the swaps were not taxable.

61 In my view none of these submissions is correct. What HMRC fails to do is to distinguish its approach to the Closure Notice from its continued desire to seek to challenge the derivatives. The Closure Notice was apparently sent erroneously. There is nothing to suggest otherwise. The 07.44 email in my view can only have one construction namely that it was designed to suspend the operation of the Closure Notices. It cannot be construed as withdrawing the Closure Notices as Mr Howard clearly never intended to do so. Indeed his correspondence going to April 2010 affirmed his continued belief in the validity of the Closure Notices. The only other possibility is that the Closure Notices were not put in abeyance in which case the 07.44 email is of no effect and the Closure Notices became valid.

62 This has to be distinguished from HMRC's attitude as regards the derivatives. I accept it still wished to challenge the derivatives. However it believed erroneously it could do so by the procedure set out in the letter of 8th November 2007. That stance was maintained until 2010 as set out above when HMRC via Mr Howard stated that there were two possibilities; either the amendment procedure which he had persisted in, or alternatively the power to withdraw the Closure Notices 2.5 years later and substitute new ones.

63 It is clear that when one looks at the 8th November 2007 letter that HMRC via Mr Howard considered that the Closure Notices were valid in the sense that it intended for them to operate. I do not see how the letter can be given any other construction.

64 That is to be distinguished from its desire to pursue the derivatives. HMRC made a number of mistakes. First Mr Howard as early as 8th November 2007 thought he could pursue the derivatives by amending the self assessment return. Second he decided in April 2008 that he could withdraw the earlier Closure Notices and in February 2010 submitted new ones. B&W challenged both of those possibilities in their letter of 9th April 2010 and ultimately HMRC has accepted that.

65 The issue here in reality is what is the effect of HMRC's mistaken belief that it could allow the Closure Notices to go ahead but still investigate the derivatives.

66 Mr Prosser QC submitted that the two were inextricably linked so that if HMRC was unable to pursue the derivatives in the way it proposed then that invalidated its embracing of the Closure Notices. I cannot see that at all. There is no basis so far as I am aware of enabling HMRC to have relief in some form or another from the consequences of a mistake.

67 B&W by the 07.44 email were told that it was a mistake and that they would receive further communication. By that communication by the letter of 8th November 2007 it was told that HMRC had made a mistake in issuing the Closure Notices but they were still valid. That stance was maintained for several years.

68 As between HMRC and B&W it seems to me that HMRC must be held to what it says in its plain actions. By the letter of 8th November 2007 it plainly accepted that the Closure Notices were valid. That stance was clear and unambiguous and it is not affected in my view by reason of HMRC's mistaken belief that it could nevertheless still pursue the derivatives. It would be quite wrong to allow HMRC to resile from such a clear and unambiguous stance. It must bear the consequence of that absent any power to relieve from the consequences of the mistake and none is said to exist.

69 It follows therefore for the reasons that I have set out above my view is that the Closure Notices are valid.

FTT'S DECISION

70 Its decision on the Closure Notices is to be found in paragraphs 30-36 having set out the circumstances and the law.

71 The FTT correctly stated that paragraph 32 requires a Closure Notice to inform the tax payer that HMRC has completed their enquiries and stating their conclusions. The Closure Notice in fact does both.

72 The FTT then considered the question of issue and what constitutes an issue which for the reason I have set out above is not significant. It then concluded that on 1st November 2007 B&W were aware that a letter had been sent in error and that the substance of the information was that HMRC had not completed their enquiries. Thus it concluded nothing that performed the function of notifying the tax payer that the enquiries had been completed had been issued and so no Closure Notice had been issued. With respect to the FTT in my view that flies in the face of the actual correspondence for the reasons I have set out above. It is quite clear that HMRC intended the Closure Notice to be operated and it is quite clear that objectively looking at the Closure Notices in the context of the 07.44 email and the letter of 8th November 2007 together that the Closure Notices operated and all the correct material was provided to B&W. The FTT have simply failed to address the

effect of the crucial letter of 8th November 2007 and its effect as set out above.

73 Accordingly the FTT in my view fell into error on the procedural point.

74 In all the circumstances for the reasons I have set out above the Closure Notices were effective with the result that it is not open to HMRC to investigate further the derivative issues in respect of the year ending 31st March 2004.

75 Any other decision in my view would be chaotic. To take HMRC's argument to the logical conclusion, when Mr Boyd received the letter of 8th November 2007 which stated that the Closure Notices were valid and HMRC accepted that and intended to proceed on that basis he should have written back and said ***"No no. Your Closure Notices cannot be valid because there are things that are still open".*** It is not necessary in my view for recipients of notices like this in effect to write to the sender of the notices and invite them to consider whether or not their notice is valid. It might be otherwise if the recipient embraces the procedure so that he might be estopped or waived any right to challenge it. It is not suggested that is open to HMRC nor is it argued on the facts. The position is analogous to a notice served to terminate a lease. See for example ***PC Investors Ltd v Cancer Research UK [2012] EWHC 884 (Ch).***

76 I accept that the surrounding circumstances must also be considered in the light of the decision in ***Mannai Investment Co Ltd v Eagle Star Life Insurance [1997] AC 749*** where the wrong date of termination of the lease was put in the notice. Nevertheless it was held to be valid because a reasonable recipient in those circumstances would have understood its bearing in the context that the purpose was to determine the lease and could have been left in no doubt that the tenant wished to determine the lease on the correct date but had given the wrong date.

77 It is important to distinguish between the two propositions. B&W did not understand that the purpose of the Closure Notices was to close the enquiry ***and*** close the investigation in respect of the derivatives. It could not do so because of Mr Boyd's knowledge and because of the content for example of the letter of 8th November 2007. However that is not the correct matter for consideration.

78 B&W knew in the light of the material I have set out above that HMRC ***intended*** the Closure Notices to operate. The letter of 8th November 2007 affirmed that in the light of HMRC's knowledge of the error and its desire to keep the investigation of the derivatives open. The error was entirely self made and there is no basis for linking that error to the separate decision that was deliberately made to adopt the Closure Notices by that letter or to allow the suspension of their effect to be lifted.

SECOND ISSUE "THE DISREGARD ISSUE"

79 This issue does not arise in relation to the period ending 31st March 2004 for the reasons that I have set out in relation to the Closure Notice Issue. However it is relevant in relation to later years.

80 It arises because B&W received advice that if a transaction in respect of the derivatives was entered into between B&W which was subject to the regime created by FA 2002 and a different company namely BIBF which was not subject to that regime (because its accounting period was not caught by the relevant provision) this would have the effect that the sale of the derivatives by B&W to BIBF would not feature in B&W's tax return for that period. However the transaction ***would*** feature in BIBF's books because it was not subject to the FA 2002 Act regime. As I have said above this means that the £91,000,000 disappears from B&W's accounts as a taxable profit but does not correspondingly reappear in BIBF's accounts so that the baseline of its acquisition is £91,000,000. The transaction was deliberately entered into to seek to exploit what was perceived to be this tax advantage.

81 The FTT concluded that the scheme failed because B&W did not have the benefit of the disregard provisions so that the transaction went into its books as a sale of the derivatives for £91,000,000 and would therefore be subject to tax.

THE BACKGROUND

82 Mr Aaronson QC who with Mr Henderson appears for B&W in his attractive oral submissions took me through the gestation of statutory provisions applying expressly to derivatives starting with the Finance Act 1994 going through the Finance Act 1996 and arriving at the FA 2002. Whilst this assisted in the general understanding of the picture I do not see that any of the earlier statutes are relevant in considering the Disregard Issue. The major difference was the introduction of what B&W called a group neutrality rule into the derivatives contract regime for the first time in FA 2002. Mr Aaronson QC submitted that the purpose of these provisions was to ensure that no intra-group transactions were taken into account so that as regards derivatives the taxation would be on the basis of when the derivatives became held by a company in the group and when another company in the group disposed of them but no regard would be had as to what happened in the intervening period. Thus with the full application of the disregard provisions if both of the companies were subject to the 2002 regime in this case B&W would have in its books its acquisition of the derivatives but its disposal of them to BIBF would be disregarded. BIBF's books would not reflect an acquisition at £91,000,000 but at the original base acquisition by B&W and it would be taxed on its disposal on the difference between that base acquisition cost and the price it obtained for it.

83 The regime created by FA 2002 was accounts based namely it was dependant on transactions taking place in particular accounting years. This is where the difficulty occurred and is the potential gap which B&W sought to exploit.

84 It is necessary to set out the statutory provisions in a little detail.

85 First section 83 provides that (inter alia) schedule 26 which makes provision for the taxation of derivative contracts shall have effect with schedule 27 dealing with minor and consequential amendments relating to the taxation of them and schedule 28 which contains transitional provisions shall also have effect.

86 Importantly it is said that the section has effect in relation to the accounting periods ***"beginning on or after 1st October 2002"***. B&W was subject to that regime but BIBF at the time of the transactions was not subject to the regime because its accounting period at that time began before 1st October 2002.

87 The main provision dealing with this aspect is schedule 26 paragraph 28 which provides:-

> ***"(1) This paragraph applies where, as a result of any transaction or series of transactions falling within sub-paragraph (2), one of the companies there referred to ("the transferee company") directly or indirectly replaces the other ("the transferor company") as a party to a derivative contract.***
> ***(2) The transactions or series of transactions referred to in sub-paragraph (1) are—***
> ***(a) a related transaction between two companies that are—***
> ***(i) members of the same group, and***
> ***(ii) within the charge to corporation tax in respect of that transaction;***
> ***(b) a series of transactions having the same effect as a related transaction between two companies each of which—***
> ***(i) has been a member of the same group at any time in the course of that series of transactions, and***
> ***(ii) is within the charge to corporation tax in respect of the related transaction;***
> ***(c) a transfer between two companies of business consisting of the effecting or carrying out of contracts of long-term insurance which has effect under an insurance business transfer scheme; and***
> ***(d) any transfer between two companies which is a qualifying overseas transfer within the meaning of paragraph 4A of Schedule 19AC to the Taxes Act 1988 (transfer of business of overseas life insurance company).***
> ***(3) The credits and debits to be brought into account for the purposes of this Schedule in the case of the two companies shall be determined as follows—***
> ***(a) the transaction, or series of transactions, by virtue of which the replacement takes place shall be disregarded except —***
>
> ***(i) for the purpose of determining the credits and debits to be brought into account in respect of exchange gains or losses and identifying the company which is to bring them into account, or***
>
> ***(ii) for the purpose of identifying the company in whose case any credit or debit not relating to that transaction, or those transactions, is to be brought into account; and***

(b) the transferor company and the transferee company shall be deemed (except for those purposes) to be the same company.

(4) References in this paragraph to one company replacing another as party to a derivative contract shall include references to a company becoming party to any derivative contract which—

(a) confers rights or imposes liabilities, or

(b) both confers rights and imposes liabilities,

where those rights or liabilities, or rights and liabilities, are equivalent to those of the other company under a derivative contract to which that other company has previously ceased to be party.
(5) In this paragraph "insurance business transfer scheme" means a scheme falling within section 105 of the Financial Services and Markets Act 2000 (c. 8), including an excluded scheme falling within Case 2, 3 or 4 of subsection (3) of that section.
(6) In this paragraph references to companies being members of the same group of companies shall be construed in accordance with section 170 of the Taxation of Chargeable Gains Act 1992 (c. 12).
(7) This paragraph has effect subject to paragraphs 29 and 30."

88 Subsection (1) applies the paragraph where as a result of any transaction or series of transactions falling within subparagraph (2) none of the companies directly or indirectly replaces another as a party to the derivative contract.

89 First it applies to a related transaction between two companies that are members of the same group and within the same charge to corporation tax. A related transaction is defined in paragraph 15 (7) to mean any disposal or acquisition (in whole or in part) of rights or liabilities under the derivative contract.

90 Subparagraph (b) applies to a series of transactions having the same effect as the related transaction.

91 The effect of a transaction that falls within those definitions is that it is disregarded and ***"the transferor company and the transferee company shall be deemed (except for those purposes) to be the same company"*** (paragraph 28 (3) (b)).

92 B&W contends that it satisfies all the criteria for the relevant provisions. HMRC (and the FTT) accepted that. Thus B&W contend it is a straightforward issue that once it is established that B&W satisfies the criteria the transaction disposing of the derivatives to BIBF is disregarded.

HMRC'S CONTENTIONS

93 HMRC accepted that the purpose of the legislation was to achieve as regards derivative contracts a neutral way so as far as schedule 26 is concerned that operates by the transferee stepping into the transferor's shoes for the

purposes of that schedule. This it is submitted appears self evident from the paragraphs. For example the opening words of paragraph 28 (3) refer to credits or debits to be taken into account for the purposes of this schedule in the case of two companies. Second there are deeming provisions for the purpose of identifying the company which is to bring debits into account.

94 This is, it is submitted is in accordance with the modern approach to statutory construction as explained by Lord Nichols in ***BMBF v Mawson [2005] 1 AC 648*** paragraph 28 ***"is to have regard to the purpose of a particular provision and interpret its language, so far as possible in a way which best gives effect to that purpose".*** Thus it is submitted that the modern approach requires paragraph 28 to be interpreted as far as possible in a way which best gives effect to the legislative purpose of tax neutrality. Accordingly the provisions can only operate the exception if it applies to both companies. As it cannot apply to BIBF it cannot apply to B&W either.

95 The difficulty is that where two companies are considered and one is not within the 2002 regime for any reason (including in this case the date of its accounting period) the provision does not operate so as to achieve neutrality on either side's case. Thus it is self evident that on B&W's position the transaction that they created to seek to obtain the fiscal advantage does not preserve neutrality because if it is successful £91,000,000 disappears for the purposes of taxing B&W but does not reappear in BIBF's accounts. That can hardly be described as neutrality.

96 Conversely HMRC's contentions are equally non neutral. Whilst one might not be sympathetic to B&W because the transaction in question was deliberately created to achieve a tax advantage it would equally apply where the transaction took place for perfectly bona fide reasons. On HMRC's analysis there would be no tax neutrality in that situation either. The transferor company would pay tax on the disposition and that would not be disregarded. That itself is a negation of the neutrality approach. It might be that the situation can be mitigated as the transferee company's books would reflect an acquisition at £91,000,000. Mr Aaronson QC submitted that would not be fair because the value of the securities might decline and it would not be able necessarily to make a profit on a subsequent disposition. That too is hardly neutrality.

97 Thus both sides' contentions lead to a conclusion which is at variance with the desire to achieve neutrality in respect of dispositions within the group. In the case of B&W's argument it seeks to remove the £91,000,000 completely; in the case of HMRC's it submits to a tax charge on the £91,000,000 in respect of a transaction which was supposed to be neutral.

PRINCIPLES OF CONSTRUCTION

98 I was taken to a number of well known authorities on the question of construction applicable to tax statutes. After some challenging excursions the House of Lords ultimately determined that a taxing statute was to be applied by reference to the ordinary principles of statutory construction by giving the provision a purposive construction in order to identify its

requirements and then deciding whether the actual transaction answered to the statutory description and that before any questions arose as to whether elements of a transaction were to be disregarded as having no commercial purpose the requirements of the particular provision had to be identified (***BMBF*** at paragraphs 26-28 and 32-38). Thus in the present case the transaction between B&W and BIBF whilst it was designed to attempt to take a tax advantage nevertheless had a commercial purpose as well. It was not submitted by HMRC that there was any basis for disallowing the effect of the transaction because it was done to seek to achieve a fiscal advantage. HMRC's case depended entirely on its construction of paragraph 28.

99 In my view applying those principles it is plain that the draftsman overlooked the situation where one of the parties to a transaction was not subject to the FA 2002 regime. He clearly had in mind the possibility of changing accounting periods. Thus in schedule 28 paragraph 1 there are anti avoidance provisions where a company seeks to change its accounting date. Thus it is submitted by Mr Aaronson QC the draftsman of the legislation being aware of the change of accounting periods was alive to the fact that there was a possibility that a company with an accounting period that was not subject to FA 2002 might be a party to a transaction under paragraph 28. It then follows that the draftsman was aware of the fact that where one company's accounting period was outside the regime the result could be that which B&W contended for. However the draftsman was content to challenge only when the accounting period was ***moved***. In the present case there was no move but the draftsman was nevertheless aware that the consequences would be that there would not be symmetry because one of the parties to the transaction would not be subject to the regime.

100 This is ingenious but I do not accept it. I prefer Mr Prosser QC's submission that this anti avoidance provision applies to any company which attempts to create an advantage by moving its accounting period and it is not designed with paragraph 28 in mind.

CONSTRUCTION OF PARAGRAPH 28

101 HMRC repeats before me its successful submissions before the FTT that paragraph 28 assumes or operates on the basis that ***both*** companies are within the statutory regime. Thus B&W can only claim the benefit if BIBF is also within the regime. As it is not it cannot.

102 If group neutrality was to be preserved one would have had the transaction disregarded in both companies's books for tax purposes. Thus B&W would not pay tax on the £91,000,000 transaction but BIBF's books would reflect the acquisition value of the assets when acquired by B&W and not with a base figure of £91,000,000.

103 To achieve group neutrality the B&W base line should be in BIBF's accounts. It is not and I understand it is too late for HMRC to challenge BIBF's tax returns which have been accepted with a £91,000,000 base line. It could be the case that if one way or another the Act was construed so as to

bring BIBF within the regime that HMRC's loss of tax accrues from its failure to keep BIBF's tax returns open until this issue is determined.

104 It is clear (as the FTT determined (paragraph 67)) in my view that BIBF does not inherit any rolled over liability under FA 2002 because that provision does not apply to it because of its accounting date.

105 After analysis of competing arguments the FTT's decision on paragraph 28 is to be found in paragraphs 75-79 as follows:-

> ***75. At a relatively early point in the hearing we indicated to the parties that while we had not reached a decision, it nevertheless seemed to be strongly arguable that even on a literal, let alone a very slightly strained, interpretation, paragraph 28 did not operate in the way in which it had to operate for the Appellant to succeed on the main point in this Appeal.***
>
> ***76. We entirely accept that so far as sub-paragraphs 28(1) and 28(2) are concerned, those sub-paragraphs do aptly refer to the situation of the Appellant and BIBF in relation to the novation. The Appellant's difficulty, however, is that it is sub-paragraph 28(3) that governs what must be done when a transaction is effected by the parties covered by the opening two sub-paragraphs. And on the literal meaning of sub-paragraph 28(3) what must happen is that both the transferor and the transferee must be taxed in the manner provided. Sub-paragraph (3) does not apply disjunctively to the transferor and the transferee. Had it provided that where sub-paragraphs (1) and (2) applied, the transferor was to be treated in a particular way, and the transferee in another way, it is arguable that if one (say the transferor) was capable of being treated in the manner provided for it, whilst the other was not, then the transferor should still be treated as provided. But this is not how the paragraph was worded. It required the two companies to be treated in a clearly matching manner. If we address to the Appellant and BIBF the questions of "Is that how you have presented your respective returns?", and "Would it even have been possible to present your returns on the basis prescribed for the two companies together?", the answers would manifestly have been "No" and "No". It is quite clear to us, without remotely straining the language of paragraph 28 to achieve what was manifestly Parliament's purpose, that paragraph 28 only operates when the parties do what it directs should be done which is to bring into account "for the two companies" the various debits and credits prescribed by the slightly complex rules and the fictitious notions laid down by paragraph 28(3).***
>
> ***77. We then address the follow-on question of what should be done when a transaction has been effected by the parties identified by sub-paragraphs 28(1) and (2) but the direction prescribed by sub-paragraph 28(3) cannot be achieved. The resultant choice is between the following two possibilities. The first is to say that if the operative sub-paragraph cannot be applied and operated, then there is nothing***

to be done. The provision simply does not operate. The alternative is to strain the language of paragraph 28(3) and contend that even if it cannot operate in the manner that is clearly both required, and implicit (from the later notions in the sub-paragraph), it should still be treated as applicable to the one company even though that is not what is envisaged or directed. Since this is manifestly contrary to the obvious intent of Parliament, the conclusion is obvious to us. Our conclusion therefore is that, far from having to stretch the language of paragraph 28 against Mr. Aaronson's contentions, and in his view "to breaking point", such that on appeal our decision would be bound to be held to have been wrong, the reverse is the reality.

78. With Mr. Prosser, we accept that paragraph 28 was badly drafted in that none of this dispute would ever have arisen, had the reference to the two companies both being within the charge to corporation tax been extended to refer to that tax "under this Schedule". However, even without those words, we conclude that, on a literal interpretation of paragraph 28(3), let alone a purposive construction, the direction was to calculate the tax of the two companies together in a manner that was simply not possible on the facts of the novation in this case. Furthermore it would be contrary to the manifest intention of Parliament for us to strain the language to enable it to be relied on by just one party to the transaction when it was clearly inapplicable to the other.

79. Our decision is that paragraph 28 Schedule 26 did not apply at all to the novation effected on 29th August 2003. It follows that in the period ending 31 March 2004 and later periods, the Appellant will be taxable on the £91 million, subject of course to any deduction for any premium initially paid for the swap (we assumed that none was paid, but we were not concerned to look at detailed calculations) and any other deductible costs. We deal in the following paragraphs with the position that we understood to be the agreed position between the parties as to what proportion of the £91 million properly fell to be taxed in the period ending 31 March 2004."

106 I agree with that analysis. I cannot see how paragraph 28 can operate unless both companies fall within the regime. It is clearly contemplated that both companies are under consideration. It could not be made more clear in sub paragraph (3) which refers to the credits and debits to be brought in to account in the case of the two companies. It follows from that inexorably that the two companies were supposed to be the subject matter of the disregard. That means that both companies must be within the FA 2002 regime. This would achieve group neutrality in that the transaction would be disregarded. However it does not work when one company is not within the 2002 regime. The final point which leads to the construction favoured by the FTT is sub paragraph (3) (b) ***"the transferor company and the transferee company shall be deemed …….to be the same company".***

107 This requirement is fatal to B&W's ground of appeal. BIBF cannot be the same company because its accounts are being written up on the basis that its opening figure is £91,000,000; that is the whole purpose of the scheme. If its accounts are opened on the figure which B&W acquired the derivatives for it would then operate in the same way where both companies were under the 2002 FA regime but the purpose of the scheme would fail as the £91,000,000 would not disappear. That provision inevitably leads to the conclusion that both companies must be considered to be operating under the regime.

108 The construction as it appears therefore means that both companies must be operating within the regime.

MISTAKES IN THE LEGISLATION

109 The consequence of the construction above means that neutrality either way is not achieved where one company is not within the FA 2002 regime.

110 I cannot believe that the draftsman intended that to happen but that appears to be what has occurred when one looks at the wording.

CORRECTION OF ERROR?

111 Both sides pray in aid the ability of the Court to imply provisions or exclude provisions on construction of a statutory clause if to do so makes the clause in accordance with the intended object.

112 Thus if I construe paragraph 28 (3) as presently having a requirement that both transferor and transferee be under the 2002 FA regime B&W argue that I can construe the provision so as to enable it to operate where only ***one*** of the companies is so caught.

113 Conversely HMRC argue that if on the present construction I am of the view that prima facie it enables the present arrangement set up by B&W and BIBF to take advantage of the fact that the clause applies although only one of the companies to the transaction is caught in the regime I should impliedly construe paragraph 28 (3) as limiting it to cases where ***both*** companies are caught by the regime.

114 My view above however is firmly that 28 (3) requires both companies to be subject to the 2002 Act regime.

115 That undoubtedly appears to go against the purpose of the provisions which both parties contend was to achieve neutrality as regards internal transactions taking place within a group. Obviously that would require the present challenged disposition to be ignored. If it is ignored and BIBF's books do not ignore the transaction for tax purposes then that secures a fiscal advantage. That is hardly neutrality within the group. Conversely if HMRC's argument is correct the disposition in favour of BIBF is subject to tax when that too is in conflict with the supposed object of neutrality in respect of dispositions within the group.

116 For there to be neutrality in this case BIBF's books should reflect the position that it is deemed to be the transferor company and would have the price paid by B&W inserted as the base figure for its disposition. Assuming the provisions can be construed so as to include a company which does not have an accounting period within the required definitions on the facts of this case it is impossible ironically to achieve that result. The reason for that is that HMRC despite the dispute in respect of B&W's tax returns did not open an enquiry into the tax returns of BIBF showing a base acquisition cost of £91,000,000. There is no power to reopen BIBF's return even if it wished.

117 It is undoubtedly the case that the construction I set out above would have operated unfairly if B&W had entered into the transaction in the belief that it would not be caught. One has less sympathy when the entering into the transaction is to achieve a fiscal advantage; such schemes always carry a risk of them being struck down. However I disregard that for the purpose of this decision as required by the decisions referred to above. Whether the transaction is to achieve a fiscal advantage or not is irrelevant if the transaction falls fairly and squarely within the provisions. I have decided for the reasons I have set out above that it does not.

PRINCIPLES OF IMPLICATION

118 The problem is section 83 (3) FA 2002 which clearly defines the requirement for the accounting period as a basis for a company being subject to the regime of FA 2002. There are consequential amendments arising out of the Act to be found in schedule 27 but none of them has any relevance. There are transitional provisions in schedule 28 and as I have already said paragraph 1 deals with a change of accounting period with the view to vary the amount of tax that would otherwise be payable. As I have said above, paragraph 1 is applicable to single companies and not merely to companies operating within a group. Apart from that there is nothing in schedule 28 which assists me either. The argument for variation requires a provision akin to that found in schedule 28 paragraph 1 (3) to be incorporated somehow in schedule 26 so that BIBF's accounting period is deemed to be within section 83 (3) and treated as if it were a period beginning on or after 1st October 2002. That is of course completely artificial as it is in effect rewriting the statutory provision.

APPLICABLE PRINCIPLES

119 Mr Prosser QC referred me to a number of authorities. First he referred me to the observations of Nourse J in ***IRC v Metrolands [1981] STC 193*** at page 208 as follows:-

> ***"Those were the only authorities to which I was referred to on the extent to which deeming provisions or the like can be carried. From them I deduce these principles. When considering the extent to which a deeming provision should be applied, the court is entitled and bound to ascertain for what purposes and between what persons the statutory fiction is to be resorted to. It will not always be clear what those purposes are. It the application of the provision would lead to an***

unjust, anomalous or absurd result, then unless its application would clearly be within the purposes of the fiction, it should not be applied. If, on the other hand, its application would not lead to any such result then, unless that would clearly be outside the purposes of the fiction, it should be applied."

120 The argument is that there is power to deem provisions to apply to give effect to what the purposes are. In the present case both sides say the purpose was to achieve neutrality as regards internal transactions within a group. I bear very close regard however to the warning observations of Nourse J in the above paragraph.

121 Next I was referred to ***O'Rourke v Binks [1992] STC 703 (CA) per Scott LJ*** at pages 707-710 as follows:-

"So the literal construction of subsection (4) leads to an increased distribution of £1, producing a reduction in the chargeable gain from £332 to £1. This anomaly merits being described as absurd.

The other sections of the 1979 Act which deal with small distributions are sections 21, 83 and 107 to 109. Section 83 (premiums on conversion of securities) is in the same terms mutatis mutandis as section 72. It offers no assistance one way or the other to the problem posed by section 72(4).

Section 21 is concerned with capital sums received by way of compensation for damage or loss or under insurance policies or on certain other accounts. The provision corresponding to section 72(4) is, as Mr Bretten accepted, confined to cases where the amount of the capital sum received is small as compared with the value of the underlying asset.

Sections 107 and 108 deal with the consideration paid on a transfer of land forming part of a larger holding. The provision corresponding to section 72(4) is contained in section 109(2). Mr Bretten accepted that this provision was limited to cases in which the amount of the consideration was small as compared with the value of the holding before the transfer.

A legislative intention that section 72(4), and for that matter section 83(4), would apply to "small" cases only would be consistent with the comparable provisions in sections 21 and 109. A construction of section 72(4) that would treat the provision as applying to all capital distributions would be inconsistent and illogical if the statutory scheme is viewed as a whole.

Finally, I must refer to the antecedent legislation. The predecessor of section 72(1), (2) and (3) is to be found in paragraph 3 of the Seventh Schedule to the Finance Act 1965. Paragraph 3(2) is in the same terms as section 72(2). These provisions produced the anomaly to which I

have earlier referred. The anomaly was remedied by paragraph 9 of the Tenth Schedule to the Finance Act 1966. Sub-paragraph (1) provides:

"Paragraph 3(2) of Schedule 7 to [the 1965 Act]… shall have effect subject to the provisions of this paragraph".

Sub-paragraph (2) provided:

"None of those provisions shall apply, if immediately before the part disposal there is no expenditure attributable to the asset under paragraphs (a) and (b) of paragraph 4(1) of Schedule 6 to the Finance Act 1965 (deductions allowable in computing a gain) or if the consideration for the part disposal exceeds that expenditure but, if there is any such expenditure and the recipient so elects,-

(a) the amount of the consideration for the part disposal shall be reduced by the amount of that expenditure, and
(b) none of that expenditure shall be allowable as a deduction in computing a gain accruing on the occasion of the part disposal or any subsequent occasion".

So sub-paragraph (2) is clearly the predecessor of section 72(4). The language of sub-paragraph (2) makes it impossible, in my opinion, to contend that the part commencing, "but, if there is any such expenditure and the recipient so elects" constitutes a free-standing provision applicable, not only to "small" distributions to which paragraph 3(2) of Schedule 7 to the 1965 Act might otherwise have applied, but also to distributions of any amount.

This is a case in which all the signposts point in the same direction and confirm the first impression that, as I venture to think, any reader would have on reading section 72. The ambiguity produced by the absence of any express limitation of section 72(4) to "small" distributions is, in my judgment, resolved by the aids to construction afforded by the anomalies to which Vinelott J. referred, by the comparable provisions in sections 21 and 109 of the 1979 Act and by the antecedent legislation.

In Luke v. Inland Revenue Commissioners [1963] A.C. 557, Lord Reid said at page 577:

"To apply the words literally is to defeat the obvious intention of the legislation and to produce a wholly unreasonable result."

That, in my judgment, is the case here.

In Mangin v. Inland Revenue Commissioner [1971] A.C. 739, Lord Donovan said at page 746:

"Thirdly, the object of the construction of a statute being to ascertain the will of the legislature it may be presumed that neither injustice nor absurdity was intended. If therefore a literal interpretation would produce such a result, and the language admits of an interpretation which would avoid it, then such an interpretation may be adopted.

Fourthly, the history of an enactment and the reasons which led to its being passed may be used as an aid to its construction".

The approach indicated in these passages justifies, in my judgment, implying into section 72(4) the natural limitation as to its scope that would correspond with the obvious intention of the legislature, namely, that the subsection should apply only to cases where the amount of the distribution was, in comparative terms, small.

Mr Henderson, junior counsel for the Crown, advanced before the judge below two alternative versions of the words that should be implied into section 72(4). Before us Mr McCall, who has led for the Crown, has contended for only one of those alternatives. The learned judge rejected both alternatives on the ground that,

"Although subsection (4) construed as free-standing leads to conclusions which are so anomalous as to justify the description of absurd and which cannot have been present to the minds of the draftsmen or legislature, to give effect to the presumed intention would, in the words of Lord Diplock in Carver v. Duncan 85 Simon's Tax Cases 356 on page 352, involve 'so great a distortion of the actual words the draftsman chose to use and Parliament to approve as to fall beyond the bounds of what it is permissible to achieve by any process of judicial construction.' "

I entirely agree with the learned judge's premise, expressed at the start of the passage I have cited, but I do not agree that effect cannot be given to the legislature's presumed intention. I would, for my part, read subsection (4) as though, after the initial word "where" the following limitation were included:

"…in a case in which the amount distributed is small compared with the value of the shares in respect of which it is distributed".

The addition of these words confines the subsection to the cases to which it was intended by the legislature to be confined. None of the express words of subsection (4) are thereby distorted.

At page 13 of his judgment the learned judge said:

"The case is, I think, one where although the court may be satisfied that the result is not one which the draftsman intended and the legislature approved, effect cannot be given to the apparent intention by any process of interpretation".

In my judgment, it would be a very rare case in which effect could not be given by a permissible process of interpretation to the apparent intention of the legislature. At all events, in the present case I cannot accept that there is any reason why the limitation to which I have referred should not be implied, thereby giving effect to the presumed, the apparent, intention of the legislature."

122 Thus Lord Justice Scott concludes where a literal reading of statutory provision produces an absurd result it would be a very rare case in which effect could not be given by permissible process of interpretation to the apparent intention of legislator. He thus implied a limit to construction to give effect to the presumed and apparent intention of the legislator.

123 I was referred to the decision of ***Inco Europe Ltd & Ors v First Choice Distribution (A Firm) & Ors [2000] 1 WLR 586 (HL).*** This decision concerned provisions of the Arbitration Act 1996 which appeared to have removed the ability of the Court of Appeal to have jurisdiction to entertain an appeal against the grant or refusal of a stay in favour of arbitration. The House of Lords held that the relevant provision was a ***"consequential"*** amendment to substitute the new provisions of the Supreme Court Act 1981 and cannot have intended to remove a long standing right. The key part of the judgment of Lord Nicholls (with whom all the other Lordships agreed) is to be found at page 592 – 593 as follows:-

"I am left in no doubt that, for once, the draftsman slipped up. The sole object of paragraph 37(2) in Schedule 3 was to amend section 18(1)(g) by substituting a new paragraph (g) that would serve the same purpose regarding the Act of 1996 as the original paragraph (g) had served regarding the Act of 1979. The language used was not apt to achieve this result. Given that the intended object of paragraph 37(2) is so plain, the paragraph should be read in a manner which gives effect to the parliamentary intention. Thus the new section 18(1)(g), substituted by paragraph 37(2), should be read as confined to decisions of the High Court under sections of Part I which make provision regarding an appeal from such decisions. In other words, 'from any decision of the High Court under that Part' is to be read as meaning 'from any decision of the High Court under a section in that Part which provides for an appeal from such decision'.

I freely acknowledge that this interpretation of section 18(1)(g) involves reading words into the paragraph. It has long been

established that the role of the courts in construing legislation is not confined to resolving ambiguities in statutory language. The court must be able to correct obvious drafting errors. In suitable cases, in discharging its interpretative function the court will add words, or omit words or substitute words. Some notable instances are given in Professor Sir Rupert Cross' admirable opuscule, Statutory Interpretation, 3rd ed., pp. 93-105. He comments, at page 103:

'In omitting or inserting words the judge is not really engaged in a hypothetical reconstruction of the intentions of the drafter or the legislature, but is simply making as much sense as he can of the text of the statutory provision read in its appropriate context and within the limits of the judicial role.'

This power is confined to plain cases of drafting mistakes. The courts are ever mindful that their constitutional role in this field is interpretative. They must abstain from any course which might have the appearance of judicial legislation. A statute is expressed in language approved and enacted by the legislature. So the courts exercise considerable caution before adding or omitting or substituting words. Before interpreting a statute in this way the court must be abundantly sure of three matters: (1) the intended purpose of the statute or provision in question; (2) that by inadvertence the draftsman and Parliament failed to give effect to that purpose in the provision in question; and (3) the substance of the provision Parliament would have made, although not necessarily the precise words Parliament would have used, had the error in the Bill been noticed. The third of these conditions is of crucial importance. Otherwise any attempt to determine the meaning of the enactment would cross the boundary between construction and legislation: see Lord Diplock in Jones v Wrotham Park Settled Estates [1980] A.C. 74, 105. In the present case these three conditions are fulfilled.

Sometimes, even when these conditions are met, the court may find itself inhibited from interpreting the statutory provision in accordance with what it is satisfied was the underlying intention of Parliament. The alteration in language may be too far-reaching. In Western Bank Ltd. v. Schindler [1977] Ch 1, 18, Scarman L.J. observed that the insertion must not be too big, or too much at variance with the language used by the legislature. Or the subject matter may call for a strict interpretation of the statutory language, as in penal legislation. None of these considerations apply in the present case. Here, the court is able to give effect to a construction of the statute which accords with the intention of the legislature."

DISCUSSION

124 I am of the opinion that the draftsman intended to create provisions whereby dispositions within a group were neutral fiscally. Paragraph 28 for the reasons I have set out above achieves a symmetry as contended by HMRC

but that is not a requirement. There is nothing to suggest there needs to be "symmetry". However neutrality cannot be achieved when the transferee is not within the regime. I do not believe for one minute the draftsman intended to create a situation whereby B&W could secure a fiscal advantage by reason of internal disposition. Equally I do not believe the draftsman intended to create a situation whereby an internal disposition would achieve a charge to tax. The problem occurred because I suspect the draftsman never thought of the possibility of companies in the same group having differing accounting periods.

125 However am I in a position to correct that? I do not think so. The wording of section 83 (3) is plain. I do not see that I am satisfied that I can identify the substantive provision as required by condition (3) set out by Lord Nichols. To do so in my view would cross the boundary between construction and legislation as set out in the observations of Lord Diplock in ***Jones v. Wrotham Park Settled Estates [1980] A.C. 74***. As I have said to achieve fiscal neutrality requires a negation of B&W's scheme. Yet there is no power in this case to give effect to the intention of creating fiscal neutrality as BIBF is not before me, its accounts cannot be revisited and it is not a party to the present enquiry. Accordingly I do not see how I can find a way to deal with this gap which does not involve me acting as a legislator which is a step too far.

CONCLUSION

126 Accordingly I agree with the FTT as to the construction of paragraph 28 and decline to imply any other provisions or to vary the provisions to give effect to the scheme proposed by B&W.

127 I have been greatly assisted by the cogent and compelling submissions both oral and written, of both Counsel in this case.

Mr Justice Peter Smith

Release Date 14 February 2014