Appeal number: FTC/80/2010
[2011] UKUT 306 (TCC)

CAPITAL GAINS TAX – ALLOWABLE LOSS – ***Tax scheme involving options – the Options entered into were interlinked – no separate commercial existence – part of an indivisible process – planned as a single continuous operation – disputed loss construed against the whole transaction involving the four Options – no allowable loss -– Appeal dismissed by Tax Chamber on substantive dispute – Appeal dismissed***

CAPITAL GAINS TAX – OPTIONS OVER GILTS – ***whether exempt under s 115 TCGA - No***

UPPER TRIBUNAL

TAX AND CHANCERY CHAMBER

HOWARD PETER SCHOFIELD **Appellant**

- and -

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

TRIBUNAL: MR JUSTICE WARREN (PRESIDENT)
JOHN CLARK (TRIBUNAL JUDGE)

Sitting in public at the Royal Courts of Justice, London WC1 on 21 and 22 March 2011

David Goldberg QC, instructed by PricewaterhouseCoopers Legal, for the Appellant

Julian Ghosh QC and Raymond Hill of Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. The Appellant, Mr Schofield, appeals against a decision released on 30 April 2010 ("the Decision") of the First-tier Tribunal (Judge Michael Tildesley OBE and Mr Richard Thomas – "the Tribunal") dismissing his appeal against a decision by the respondents, HMRC, amending his self-assessment return for the year ended 5 April 2003. The amendment refused his claim for relief in respect of a loss for capital gains tax purposes of £11,305,017.

2. Two issues were raised in Mr Schofield's appeal to the Tribunal, and also in his further appeal to us. The first was whether the loss claimed by Mr Schofield in his 2002-03 return was an allowable loss within the meaning of the Taxation of Chargeable Gains Act 1992 ("TCGA 1992"). The second, which arose only if the claimed loss was held to be an allowable loss, was whether two of the options described below fell within the exemption under s 115 TCGA 1992 for options to acquire or dispose of gilts.

The facts

3. From 6 April 2002 until 29 March 2003 Mr Schofield was resident and ordinarily resident in the UK. On the latter date he became resident in Spain. He was not resident or ordinarily resident in the UK in the year of assessment 2003-04, nor has he been resident or ordinarily resident in the UK for any subsequent year of assessment.

4. He realised a chargeable gain in the year 2002-03, as a result of disposing of certain loan notes on 31 December 2002 for a total of £10,904,528. His total chargeable gain on the disposal of the loan notes amounted to £10,726,438.

5. He was aware that there would be a substantial liability to tax on this chargeable gain. On 9 January 2003, at a meeting with PricewaterhouseCoopers ("PWC"), he was advised of a tax planning scheme involving the sale and purchase of options from Kleinwort Benson Private Bank ("KBPB"). He expressed interest in the scheme, and was introduced to a Mr Adrian Jones at KBPB.

6. In order to carry out the proposed scheme, Mr Schofield entered into various agreements with KBPB. These included a Security Agreement and an International Swap Dealers Association Master Agreement, both dated 17 January 2003.

7. On 7 February 2003 Mr Schofield and KBPB entered into four option agreements under the International Swap Dealers Association Master Agreement. The closing level of the FTSE 100 Index on that date was 3599.2.

8. The first option ("Option 1") was a FTSE 100 Index European-style cash-settled put option acquired by Mr Schofield from KBPB. The notional value of the assets subject to the option was £333,000,000. The premium payable by Mr Schofield to KBPB was 3.6149 per cent of the notional amount, ie £12,037,617. The strike price was 3389.91. The expiry date of the option was 7 April 2003.

9. The second option ("Option 2") was a FTSE 100 Index European-style cash settled call option acquired by Mr Schofield from KBPB. The Notional Amount was £333,000,000. The premium payable by Mr Schofield to KBPB was 3.6462 per cent of the latter amount, ie £12,141,846. The strike price was 3725.17. The expiry date of the option was 7 April 2003. Options 1 and 2 are referred to as cash-settled FTSE Options.

10. The third option ("Option 3") was a European-style physically settled put option acquired by KBPB from Mr Schofield. The Notional Amount was £333,000,000. The premium paid was 3.4698 per cent of that amount, ie £12,153,834. The strike price of the option was to be calculated by means of a formula related to the FTSE 100 Index such that the option would be in the money were the FTSE 100 Index to fall below 3390.4. The expiry date of the option was 7 April 2003.

11. The fourth option ("Option 4") was a European-style physically settled call option acquired by KBPB from Mr Schofield. The underlying subject matter was expressed to be 8.25% Treasury Stock 2007. The Notional Amount was £333,000,000. The premium paid was 3.5781 per cent of that amount, ie £11,915,073. As with Option 3, the strike price was to be calculated by means of a formula related to the FTSE 100 Index. This option would be in the money were the FTSE 100 Index to rise above 3725.71. The expiry date of the option was 7 April 2003.

12. The effect of all the options being European-style was that, once they had been entered into, they could only be exercised on expiry; any other action in respect of any or all of the options could only be taken with the agreement of both Mr Schofield and KBPB.

13. It can be seen from the above that the premiums paid by Mr Schofield to KBPB for Option 1 and Option 2 were financed by the two premiums paid by KBPB to Mr Schofield (as noted by the Tribunal at paragraph 14 of the Decision) for the grant of Option 3 and Option 4. Mr Schofield paid KBPB a total of £24,179,463 (being the premium of £12,037,617 for Option 1 and £12,141,846 for Option 2) to KBPB. KBPB paid Mr Schofield £24,068,907 (being the premium of £12,153,834 for Option 3 and £11,915,073 for Option 4). Thus Mr Schofield, on the premiums alone, made a loss of £110,556, representing KBPB's fees. In addition, PWC charged fees for selling the arrangement to Mr Schofield. The fee was £118,000 (although it is not clear whether this included VAT) of which £59,000 plus VAT was payable "up front".

14. Option 1 (the FTSE put option) would only become valuable in Mr Schofield's hands if the FTSE 100 Index was below 3389.91. Option 2 (the FTSE call option) would only become valuable if FTSE rose above 3725.17. Option 3 (the gilts put option) would only become valuable in KBPB's hands if FTSE fell below 3390.4, whereas Option 4 (the gilts call option) would only become valuable in KBPB's hands if FTSE rose above 3725.71.

15. The Tribunal found the incorporation of a potential actual small profit or loss within the structure of the scheme by allocating marginally different strike prices between the set of cash-settled FTSE Options and the set of gilts Options was contrived to give the scheme an illusory aura of commerciality. They held that the scheme served no commercial purpose. The contrived profit and loss only occurred when the FTSE 100 Index moved outside the collar, and fixed at a modest upper limit either a £49,961 profit or a £45,335 loss which did not vary on subsequent movements in the Index. The pursuit of this relatively small profit made no commercial sense having regard to the size of the fees for the scheme which amounted to £218,000.

16. On 13 February 2003 Brian Leyland of PWC's Manchester office wrote to Mr Schofield. (As this is set out almost in full at paragraph 16 of the Decision, we do not repeat it here, but refer to it below). This letter described the planning arrangements which Mr Schofield had recently undertaken. Paragraphs 17 to 24 of the Decision identify and describe a generic scheme from which the arrangements actually entered into by Mr Schofield were derived. We do not need to set out the details of the generic scheme again in this decision.

17. Paragraphs 25 to 27 describe the arrangements or scheme particular to Mr Schofield in the light of his intention to become non-resident in the 2003/04. As the Tribunal noted in paragraph 25 of the Decision, it was crucial that Mr Schofield realised the requisite allowable loss in the year of assessment 2002/03 to deduct from the chargeable gain made in that year, as allowable losses could not be carried back from 2003/04 to 2002/03. As the Options were only exercisable on 7 April 2003 in the year of assessment 2003/04, it required the agreement of both parties to close out selected Options before the end of 2002/03 (*ie* before 6 April). In the situation where the FTSE 100 Index did not move outside the digital collar, the four Options would all be closed out before the 6 April 2003 realising an allowable loss of about £24 million subject to any payments on close out on both cash-settled FTSE Options, the corresponding gains on the Gilt Options being exempt. If the FTSE 100 Index was outside the digital collar (3389.91 - 3725.17), the out-of-the-money options would be closed out before 6 April, whilst the in-the-money options would be exercised on the agreed date of 7 April 2003. This would produce an allowable loss of about £12 million in 2002/03 (subject to any payments on close out) on one of the cash-settled FTSE Options, the gain on the corresponding gilts Option being exempt, with Mr Schofield incurring no capital gains tax consequences from the expiry of the Options in the subsequent tax year because of his non-resident status.

18. It is important to note that the scheme had three possible pre-tax outcomes. These are identified in the letter from PWC dated 13 February 2003 and described in paragraph 27 of the Decision. They are in essence as follows:

> (1) The FTSE 100 Index remains within the digital collar. In that case, all four Options would be closed out on 4 April 2003 giving Mr Schofield a capital loss of an amount equal to double the amount of the chargeable gain which Mr Schofield realised on the loan notes (for the two premiums paid for Options 1 and 2).

(2) The FTSE Index falls below 3389.91. In that case, the put options, Options 1 and 3, become valuable and exercisable but the call options, Option 2 and Option 4, are not exercisable. Option 2 and Option 4 would be closed out on 4 April 2003 to give Mr Schofield a capital loss Mr Schofield's chargeable gain on the loan notes, for 2002/2003. Option 1 and 3 would then expire, giving rise to a capital gain, on 7 April 2003 in the next tax year for which Mr Schofield would be non-UK resident. In this case, PWC said that it was likely that Mr Schofield would realise a commercial loss of about £45,000.

(3) The FTSE 100 Index moves above 3725.17. In that case, the call options, Option 2 and Option 4, become valuable and exercisable but the put options, Option 1 and Option 3, are not exercisable. The put options are closed out on 4 April 2003 giving Mr Schofield a capital loss for the premium paid for Option 1 (£12 million). The call options then expire, giving rise to a capital gain, on 7 April 2003 in the next tax year for which Mr Schofield would be non-UK resident. In this case, PWC said that it was likely that Mr Schofield would realise a commercial profit of about £50,000.

19. PWC noted, in that letter, that the possibility of commercial profit or loss in cases (2) and (3) "arises because for the planning to be effective it is important to demonstrate that there is some commercial risk being taken". They also record the importance of Mr Schofield being non-resident for the tax year 2003/04 and the risk of his not being so saying that "you are comfortable with the requirement to become non-resident before the end of this tax year".

20. The Scheme was duly implemented in the context of the market as it existed at the end of the tax year. On 4 April 2003 (a Friday, and thus the final business day of the 2002-03 year of assessment) Option 1 was closed out by mutual agreement between the parties. On that date the FTSE 100 Index closed at 3814.40. KBPB paid Mr Schofield £732,600.

21. Also on that date, Option 3 was closed out by mutual agreement. Mr Schofield paid KBPB £737,595.

22. On 7 April 2003 Mr Schofield sent a fax to Adrian Jones, of KBPB, in which he said:

> "Dear Adrian, Further to our telephone conversation today. Assuming the options are in the money on expiry, I wish to exercise the cash settled call option of the FTSE 100 index. As you will exercise the gilt option please purchase on my behalf the appropriate gilts in settlement of that option."

23. Option 2 expired on Monday 7 April 2003 (the first business day of the 2003-04 year of assessment) when the FTSE 100 Index stood at 3935.8. The exercise resulted in KBPB paying to Mr Schofield a cash sum of £19,487,605.58, producing a net gain of £7,354,759.58 for him.

24. Option 4 also expired on 7 April 2003, the FTSE 100 Index having closed at 3935.80. With a view to satisfying Option 4, Mr Schofield acted as follows. In a fax to Adrian Jones dated 7 April 2003 (mentioning a telephone conversation that day) and sent from Marbella at 11.45, Mr Schofield referred to the gilts Option, and said that as KBPB would be exercising it, he requested them to purchase on his behalf the appropriate gilts in settlement of that Option. KBPB issued a contract note showing the purchase of £333,000,000 Treasury 8.5% Treasury Stock 2007 for a price of £389,610,000 plus 84 days' interest. They also issued a contract note showing the sale of the same amount of Treasury Stock for £370,172,357.10 plus 84 days' interest.

25. The movements of funds resulting from all the above transactions were recorded in an account statement in the name of "HP Schofield Esq Option Account" covering the period from 1 February 2003 to 25 April 2003. The net effect of the cash flow movements on 7 April 2003 was that Mr Schofield received £49,962 as stated in paragraph 35 of the Decision by reference to the table at paragraph 38. The Tribunal recorded at paragraph 39 that the only resources committed by Mr Schofield to the scheme were the respective fees of £110,556 and £118,000 for KBPB and PWC. The maximum profit that could be secured from the scheme was £49,962.

26. In his tax return for the year ended 5 April 2003, Mr Schofield showed a quantifiable allowable loss of £11,305,017, which he deducted from a gain of £10,726,438. HMRC amended his self assessment return to disallow the loss.

The allowable loss issue

Findings of the Tribunal on the allowable loss issue

27. The Tribunal set out their detailed findings of fact at paragraph 53 of the Decision. We set out the whole of that paragraph in the Appendix to this decision.

28. Mr Goldberg is critical of some of the findings in paragraph 53. He suggests that, contrary to paragraphs 53(6) and (7), Mr Schofield did risk his assets in the implementation of the Scheme. He points to bank statements which show the flow of funds demonstrating that Mr Schofield undertook large liabilities and was therefore at risk. He suggests that Mr Schofield was at risk were KBPB to default on its obligations. Those observations do not, it seems to us, reflect reality and certainly do not undermine the Tribunal's finding. The Tribunal explained in paragraph 53(6) the basis for their finding, an explanation which seems to us compelling. The prospect of KPB defaulting in its obligations seems to us to be one which is so remote that it is to be ignored in assessing the practical likelihood of the scheme running its full course. We reject Mr Goldberg's challenge to this finding of fact by the Tribunal.

29. In paragraph 53(8), the Tribunal expressed the view that the fact that the Options were acquired at market value was irrelevant. Mr Goldberg says that that fact is fundamental and relevant. If that view is a finding of fact at all, it is an uncontroversial one to the effect that the Options were acquired at market value. However, the findings of the Tribunal go further than that. The Tribunal also found

that the notional value of the assets to be acquired or disposed of under the cash-settled FTSE Options and the nominal value of the gilts under the gilts Options had nothing to do with market considerations or Mr Schofield's risk appetite and his ability to pay for the assets concerned: the notional value was a theoretical exercise determined by the size of the premium necessary to deliver the capital losses. Those findings are probably not findings of fact rather than interpretation of the wording of the Options. But either way – findings of fact or interpretation of the documents – we do not consider that they are open to challenge.

30. Whilst not, as we understand him, disagreeing with the findings set out in paragraph 53(9). Mr Goldberg submits that the findings in that paragraph sweep away the foundation of HMRC's argument. He also has one comment on the Tribunal's statement that "any potential profit or loss on the cash-settled FTSE 100 Index outside the collar was matched by an equal and opposite profit or loss on the gilt-edged securities": he observes that there is not a profit and a loss at the same time. It is a correct, and obvious, point; he nonetheless makes it because it supports, he submits, his argument that there is no certainty about the outcome of the scheme and thus that there is no preordained transaction or series of transactions of any sort.

31. Mr Goldberg also challenges the finding of the Tribunal at paragraph 53(11) of the Decision that "The insertion of a collar provided an 85 to 90 per cent probability that movements in the FTSE 100 Index would have no effect on potential gains or losses." He referred to paragraphs 15 and 20 of Mr Hamilton-Ely's witness statement, in which the probability that one or other of the call or the put options would be in the money at expiry was stated to be approximately 45 per cent. Mr Ghosh resisted this, on the basis that the higher probability figure had been stated in a letter from PWC to HMRC: the Tribunal had been entitled to refer to this. We agree with Mr Ghosh; the Tribunal specifically referred to Mr Hamilton-Ely's evidence on this point both at footnote 2 to paragraph 21 and at paragraph 42 of its decision, and yet arrived at the conclusion that the probability was at the higher level. There is nothing to justify interference with the Tribunal's finding of fact. In any case, the Tribunal went on to point out that the effects of movements in the FTSE 100 Index outside the collar were negated by the strategy of early close out and exercise of the relevant Options when Mr Schofield was non-resident. We do not think that the actual percentage attributable to the probability referred to above matters much.

32. There is one further criticism which Mr Goldberg makes of the Tribunal in relation to the facts, although we do not think anything actually turns on it. At paragraph 25 of the Decision the Tribunal were considering aspects of the scheme and stated that if the FTSE 100 Index were to move outside the collar, Mr Schofield would achieve an allowable loss of about £12 million. We think that that is correct; but a footnote states that the loss was less than this because the close out of Option 1 on 4 April 2003 enabled Mr Schofield to receive about £700,000 as consideration although even after this, the loss was still larger that the gain sought to be eliminated. The Tribunal then said that they "had no evidence about how this receipt was calculated" and assumed that "the likely amount of the payment would have been known from the outset". Mr Goldberg says that there is no basis for this at all and that the consideration depended on the level of the Index. Although Mr Goldberg

made this point, it was not developed at all and it was not submitted that this fact would have been enough to bring HMRC's arguments crashing to the ground. We do not in any case understand how this point would be critical if, apart from it, HMRC would succeed. We say no more about it.

33. At paragraph 54 they then set out their conclusions on the facts found:

> "54. The Tribunal is satisfied on the facts found that the Appellant's arrangements consisted of a series of interdependent and linked transactions with a guaranteed outcome of a capital loss at least equivalent to the chargeable gain arising from the redemption of loan notes. The structure of the Options and their interrelationship were such that it provided the funding for the scheme, determined the size of the loss and eliminated the risks associated with movements in FTSE 100 Index with the result that there were only three possible scenarios all favourable to the Appellant. The transactions followed a pre-ordained path which involved the Appellant becoming non-resident and implementing the necessary steps required by whichever of the three known scenarios existed on 4 April 2003. All three scenarios guaranteed a loss of at least around £12 million which the Appellant would claim by deducting it from his chargeable gain. There was no prospect of a party departing from the pre-ordained path. The sole aim of the transactions was to avoid tax. The transactions were bereft of a commercial purpose. The implementation of the scheme achieved the desired result."

34. The Tribunal plainly had in mind that the question of which Options would be closed out or exercised and when would depend on where the FTSE 100 Index stood at the end of the 2002/03 tax year. In using the word "preordained" in paragraph 54, it is clear that they did not mean that, when the scheme was entered into, it was known which actual steps would be taken. But what was known, and in that sense was preordained, was that there would be one, and only one, course adopted at the end of the tax year when the level of the FTSE 100 Index would be known. Moreover, the pre-ordained steps would result in a capital loss of at least an amount equal to the gain on the loan notes. Take a simple analogy. Mr A goes from his home to work by bus; there are two bus routes which can take him on his journey and he always takes the first bus to arrive. It is pre-ordained (and as certain as a bus timetable can be) when he leaves his front door that he will catch the first bus to arrive and that he will arrive at work. The fact that it is not pre-ordained <u>which</u> bus he will catch does not detract from that conclusion.

35. Further, just as it was pre-ordained that the Options would be granted and either closed out or exercised, so too, according to the Tribunal, it was a pre-ordained step that Mr Schofield would become non-resident. That is how we, at least, read paragraph 54 of the Decision ("The transactions followed a pre-ordained path which involved the Appellant becoming non-resident and implementing the necessary steps required by whichever of the three known scenarios existed on 4 April 2003.") especially read with paragraph 53(13) which refers to the "other step" – that is to say, step in the pre-ordained plan – as Mr Schofield becoming non-resident. Mr Goldberg says that it is an essential part of the Tribunal's reasoning that Mr Schofield's non-

residence in 2003/04 was pre-ordained on 7 February 2003 when the options were entered into. But, he says, the Tribunal has made no finding to that effect, the finding at paragraph 53(13) being of an intention to become non-resident, not that non-residence was preordained; in any case, there would be no basis for such a finding since a matter of putative residence can only be determined after 2003/04 is finished and cannot be pre-ordained.

36. Mr Ghosh criticises Mr Goldberg for saying that it was an essential part of the Tribunal's analysis that Mr Schofield's non-residence status was pre-ordained. He makes clear, in any case, that it is not HMRC's case that it was part of the scheme for Mr Schofield to become non-resident. The scheme was predicated on the fact that he would in fact become non-resident and that was in fact what happened but that is different. We do not need to decide whether it was part of the Tribunal's reasoning in reaching the conclusion which they did that it was pre-ordained that Mr Schofield should become non-resident. This is because, consistently with HMRC's approach, it is not necessary to show that becoming non-resident was a pre-ordained (whatever meaning one likes to give to that word in the light of the current state of the authorities) step in the overall scheme. For the scheme actually to work (and indeed to avoid unpleasant tax consequences for him if he entered into the Options but did not become non-resident), it was necessary for Mr Schofield to become non-resident; the expectation and likelihood was that he would do so and he actually did so. The real question, however, is whether each Option and the action taken in respect of it is to be treated separately as Mr Goldberg contends, or whether there is a wider transaction under which the Options and the different actions taken in respect of them are to be treated as a single composite transaction under which there is no gain and no loss. The answer to that question does not depend on whether it was pre-ordained that Mr Schofield would become non-resident. What does depend on whether he in fact became non-resident is the actual tax consequences of the grant of the Options and of the subsequent action taken in respect of them. In that context, on HMRC's approach, there is no gain and no loss so that Mr Schofield's residence is an irrelevance; in contrast, on Mr Schofield's approach, there is no composite transaction and the option are to be viewed separately in which case his non-residence is critical to the success of the scheme. That is not to say that Mr Schofield's intention to become non-resident is irrelevant even on HMRC's approach. It is an important factor in understanding how it was expected that he would avoid capital gains tax on the substantial gain he had made in the tax year 2002/03 and in establishing that the scheme was entirely tax-driven.

37. In any case, even if the Tribunal are to be read as making a finding that Mr Schofield's non-residence was pre-ordained, we do not see why, in spite of Mr Goldberg's protestations to the contrary, that was impermissible. It is of course true that Mr Schofield might not have become non-resident: he might have fallen ill or been injured in an accident and been unable to move to Spain or unforeseen family or business circumstances might have compelled him to spend such an amount of time in the UK as would preclude his becoming non-resident. But subject to matters of that sort, he had, without any doubt on the findings of fact made by the Tribunal, a clear intention to become non-resident and had determined to take the necessary steps to do so. PWC recorded him as being "comfortable" with the need to become non-resident.

The Tribunal was, we consider, entitled to conclude that it was preordained that Mr Schofield would become non-resident using that word in the sense that the step had the necessary element of predictability to be capable of forming an element of scheme to which the *Ramsay* principle is capable of application. Indeed, if the contrary were the case, it is not easy to see why the possibility of an accident causing serious brain damage should be ignored, in which case none of the Options could be exercised or closed out (unless and until the Court of Protection intervened). But it would be fanciful to think that that possibility would, by itself, be sufficient to defeat a challenge by HMRC to the scheme which would otherwise succeed.

The Law –TCGA 1992

38. The provisions of TCGA which are relevant to the present case are discussed briefly in paragraphs 55 to 58 of the Decision. There is no dispute about how the provisions operate if the scheme is effective. Whether it is effective turns on whether the loss which, viewing Option 1 in isolation, was occasioned when Option 1 was closed out on 4 April 2003 is an allowable loss, in the context of the scheme as a whole, within the meaning of s 2(2)(a) TCGA. Section 2 is in the following terms:

> "(1) Subject to any exceptions provided by this Act, and without prejudice to Sections 120 and 276, a person shall be chargeable to capital gains tax in respect of chargeable gains accruing to him in a year of assessment during any part of which he is resident in the United Kingdom, or during which he is ordinarily resident in the United Kingdom.
>
> (2) Capital gains tax shall be charged on the total amount of chargeable gains accruing to the person chargeable in the year of assessment, after deducting -
>
> (a) any allowable losses accruing to that person in that year of assessment, and
>
> (b) so far as they have not been allowed as a deduction from chargeable gains accruing in any previous year of assessment, any allowable losses accruing to that person in any previous year of assessment (not earlier than the year 1965-66).
>
> (3) Except as provided by Section 62, an allowable loss accruing in a year of assessment shall not be allowable as a deduction from chargeable gains accruing in any earlier year of assessment, and relief shall not be given under this Act more than once in respect of any loss or part of a loss, and shall not be given under this Act if and so far as relief has been or may be given in respect of it under the Income Tax Acts."

39. The other relevant provisions of CGTA are found in s 115 (concerning gilt-edged securities and qualifying corporate bonds) and ss 143 to 148 (which contain a special

code in relation to options and of which only ss 144 and 144A are relevant to the present appeal). For completeness, we set out ss 144 and 144A:

"144 (1) Without prejudice to Section 21, the grant of an option, and in particular –

(a) the grant of an option in a case where the grantor binds himself to sell what he does not own, and because the option is abandoned, never has occasion to own, and

(b) the grant of an option in a case where the grantor binds himself to buy what, because the option is abandoned, he does not acquire,

is the disposal of an asset (namely of the option), but subject to the following provisions of this section as to treating the grant of an option as part of a larger transaction.

(2) If an option is exercised, the grant of the option and the transaction entered into by the grantor in fulfilment of his obligations under the option shall be treated as a single transaction and accordingly –

(a) if the option binds the grantor to sell, the consideration for the option is part of the consideration for the sale, and

(b) if the option binds the grantor to buy, the consideration for the option shall be deducted from the cost of acquisition incurred by the grantor in buying in pursuance of his obligations under the option.

(3) The exercise of an option by the person for the time being entitled to exercise it shall not constitute the disposal of an asset by that person, but, if an option is exercised then the acquisition of the option (whether directly from the grantor or not) and the transaction entered into by the person exercising the option in exercise of his rights under the option shall be treated as a single transaction and accordingly –

(a) if the option binds the grantor to sell, the cost of acquiring the option shall be part of the cost of acquiring what is sold, and

(b) if the option binds the grantor to buy, the cost of the option shall be treated as a cost incidental to the disposal of what is bought by the grantor of the option.

(4) The abandonment of –

(a) a quoted option to subscribe for shares in a company, or

(b) a traded option or financial option, or

(c) an option to acquire assets exercisable by a person intending to use them, if acquired, for the purpose of a trade carried on by him,

shall constitute the disposal of an asset (namely of the option); but the abandonment of any other option by the person for the time being entitled to exercise it shall not constitute the disposal of an asset by that person.

144A(1) In any case where

(a) an option is exercised; and

(b) the nature of the option (or its exercise) is such that the grantor of the option is liable to make, and the person exercising it is entitled to receive, a payment in full settlement of all obligations under the option,

subsections (2) and (3) below shall apply in place of subsections (2) and (3) of s 144.

(2) As regards the grantor of the option –

(a) he shall be treated as having disposed of an asset (namely, his liability to make the payment) and the payment made by him shall be treated as incidental costs to him of making the disposal; and

(b) the grant of the option and the disposal shall be treated as a single transaction and the consideration for the option shall be treated as the consideration for the disposal.

(3) As regards the person exercising the option –

(a) he shall be treated as having disposed of an asset (namely, his entitlement to receive the payment) and the payment received by him shall be treated as the consideration for the disposal;

(b) the acquisition of the option (whether directly from the grantor or not) and the disposal shall be treated as a single transaction and the cost of acquiring the option shall be treated as expenditure allowable as a deduction under s 38(1)(a) from the consideration for the disposal; and

(c) for the purpose of computing the indexation allowance (if any) on the disposal, the cost of the option shall be treated (notwithstanding paragraph (b) above) as incurred when the option was acquired.

(4) In any case where subsections (2) and (3) above would apply as mentioned in subsection (1) above if the reference in that subsection to full settlement included a reference to partial settlement, those subsections and subsections (2) and (3) of s 144 shall both apply but with the following modifications –

(a) for any reference to the grant or acquisition of the option there shall be substituted a reference to the grant or acquisition of so much of the option as relates to the making and receipt of the payment or, as the case may be, the sale or purchase by the grantor; and

(b) for any reference to the consideration for, or the cost of or of acquiring, the option there shall be substituted a reference to the appropriate proportion of that consideration or cost.

(5) In this section "appropriate proportion" means such proportion as may be just and reasonable in all the circumstances."

40. In the case of cash-settled options, such as Options 1 and 2, s 144A(3) rather than s 144(3) applies and provides that where a person exercises a cash-settled option he shall be treated as having disposed of an asset, and the payment received by him shall be treated as the consideration for the disposal. The acquisition of the option and the disposal shall be treated as a single transaction and the cost of acquiring the option shall be treated as expenditure allowable as a deduction under s 38 of the 1992 Act from the consideration for the disposal.

41. Section 144(4) provides that the abandonment of, amongst others, a "financial option" is the disposal of the option. "Financial option" includes an option which relates to shares which are dealt with on a recognised stock exchange which is granted by a member of such an exchange. It seems to be agreed that Options 1 and 2 are "financial options". Even if they are not, a disposal under s 22(3)(c) would override the rule in s 144(4) that the abandonment of an option which is not a traded or financial option is not a disposal.

The Law – the authorities

42. HMRC's case is that the *Ramsay* principle (see *Ramsay (WT) Ltd v Inland Revenue Commissioners* [1982] AC 300) applies to treat the scheme, in effect, as a fiscal nullity. A considerable number for cases have come before the courts since the seminal decision in that case. Mr Goldberg submits that following the decisions in *MacNiven v Westmoreland Investments Ltd* [2003] 1 AC 311 and *Barclays Mercantile Business Finance Limited v Mawson* [2005] 1 AC 684 (it has been variously referred to as "*BMBF*" and "*Mawson*" – we will adopt the former), there is nothing which can be called the *Ramsay* principle. Everything is now just a matter of ordinary statutory construction.

43. We will consider *MacNiven* and *BMBF* along with *IRC v Scottish Provident Institution* [2005] STC 15 ("*SPI*") in a moment. They were relied on by both sides in the hearing before us. It might be thought that those decisions make it unnecessary ever to refer again to earlier cases in the light of the extensive review of those cases which they contain, and in that context we have very much in mind the remark of Mummery LJ in *HMRC v Mayes* [2011] EWCA Civ 407 ("*Mayes*") at [71] and [72] decided since the hearing before us. Unfortunately for us, things are not quite that straightforward since some of the earlier cases at least have received express or implicit approval and are still reliable indicators of how the correct approach (which

is easier to state than to apply) is to be applied in practice. Moreover, since the hearing before us, as well as *Mayes*, there has also been the decision of the Supreme Court in *HMRC v Tower MCashback LLP 1* [2011] UKSC 19 ("*Tower MCashback*"). We have received further written submissions from the parties to deal with the impact, if any, of those decisions on Mr Schofield's appeal.

44. In *BMBF*, Lord Nicholls delivered the unanimous opinion of the committee. He started the discussion of the *Ramsay* principle at [26]. After quoting two passages from the speech of Lord Wilberforce in *Ramsay* concerning the general approach to construction and the application of a statutory provision to a composite transaction, he went on to record the decision in that case this way at [31]:

> "31 The application of these two principles led to the conclusion, as a matter of construction, that the statutory provision with which the court was concerned, namely that imposing capital gains tax on chargeable gains less allowable losses was referring to gains and losses having a commercial reality ("The capital gains tax was created to operate in the real world, not that of make-belief") and that therefore:
>
> > "To say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, there is not such a loss (or gain) as the legislation is dealing with, is in my opinion well and indeed essentially within the judicial function." (p 326)"

45. The essence of the new approach appears from [32] and [33]:

> "32 The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of the statute, upon its true construction, applies to the facts as found. As Lord Nicholls of Birkenhead said in *MacNiven v Westmoreland Investments Ltd* [2003] 1 AC 311, 320, para 8: "The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case."
>
> 33 The simplicity of this question, however difficult it might be to answer on the facts of a particular case, shows that the *Ramsay* case did not introduce a new doctrine operating within the special field of revenue statutes. On the

contrary, as Lord Steyn observed in *McGuckian* [1997] 1 WLR 991, 999 it rescued tax law from being "some island of literal interpretation" and brought it within generally applicable principles."

46. At [35], Lord Nicholls observed that there had been a number of cases in which it has been decided that elements which have been inserted into a transaction without any business or commercial purpose did or did not prevent the composite transaction from falling with the charge to tax or bring it within an exemption from tax, referring in that context to *IRC v Burmah Oil Co Ltd* 1982 SC (HL) 114, and *Carreras Group Ltd v Stamp Comr* [2004] STC 1377. In each case, the court looked at the overall effect of the composite transactions; if, on the true construction of the relevant provisions of the statutes, elements were inserted into the transactions without any commercial purpose, those elements were treated as having no significance. Then came this important passage at [36]:

> "36 Cases such as these gave rise to a view that, in the application of *any* taxing statute, transactions or elements of transactions which had no commercial purpose were to be disregarded. But that is going too far. It elides the two steps which are necessary in the application of any statutory provision: first, to decide, on a purposive construction, exactly what transaction will answer to the statutory description and secondly, to decide whether the transaction in question does so. As Ribeiro PJ said in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46, para 35:
>
> > "….the driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.""

47. Lord Nicholls (at [37] and [38]) then turned to *MacNiven* which he saw as demonstrating the needs (i) to avoid sweeping generalisations about disregarding transactions undertaken for the purpose of tax avoidance and (ii) to focus carefully upon the particular statutory provision and to identify its requirements before deciding whether circular payments or elements should be disregarded or treated as irrelevant. Those needs are perhaps emphasised by reference to the decisions in *CIR v HIT Finance Ltd* [2007] FACV Nos 8 and 16, *Mayes* and *Tower MCashback*. In particular, in *HIT Finance* the statutory question concentrated on the purpose of the borrower in taking the loan in question. In that context, Lord Hoffmann (at [16]) observed that the circularity of the payments was therefore irrelevant, adding this:

> "There is, I think, a tendency to assume that if there is circularity of payments, all the transactions in the circle may be treated as never having happened. But that is a fallacy. The question is whether the particular transaction answers to the statutory description – in this case, a borrowing for the purpose of producing profits – and a transaction may do so even though it forms part of a circular of payments."

48. It is also worth noting one paragraph of Lord Hoffmann's speech in *MacNiven* in which he examined the "characteristically compressed reasoning" of Lord Wilberforce in this well-known passage from *Ramsay*:

> "A tax on gains (or I might have added gains less losses), it is not a tax on arithmetical differences. To say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, there is not such a loss (or gain) as the legislation is dealing with, is in my opinion well and indeed essentially within the judicial function."

49. In relation to that, one finds Lord Hoffmann saying this in [32]:

> "......... A loss which arises at one stage of an indivisible process and cancelled out at a later stage of the same process is "not such a loss as the legislation is dealing with". The tax was not imposed "on arithmetical differences". In that case, what kind of loss was the legislation dealing with? The contrast being made throughout Lord Wilberforce's speech is between juristic or arithmetical realities on the one hand and commercial realities on the other. He is construing the words "disposal" and "loss" to refer to commercial concepts which are not necessarily confined by the categories of juristic analysis. In [*Ramsay*], a director, or an accountant concerned to present a true and fair view of the taxpayer's dealings, would not have said that the company had entered into a transaction giving rise to a loss which happened to have been offset by a corresponding gain. There had never been any commercial possibility that the transactions would not have cancelled each other out. Therefore, notwithstanding the juristic independence of each of the stages of the circular transaction, the commercial view would have been to lump them all together, as the parties themselves intended, and describe them as a composite transaction which had no financial consequences. The innovation in the *Ramsay* case was to give the statutory concepts of "disposal" and "loss" a commercial meaning. The new principle of construction was a recognition that the statutory language was intended to refer to commercial concepts, so that in the case of a concept such as a "disposal", the court was required to take a view of the facts which transcended the juristic individuality of the various parts of a preplanned series of transactions."

50. *MacNiven* has, of course, generated some controversy when it comes to what some have seen as a rigid classification by Lord Hoffmann of all relevant concepts as either "commercial" or "legal"; but that particular difficulty has been laid to rest by Lord Nicholls in *BMBF* at [38] (referring to Ribeiro J in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 and to the decision of Mr Theodore Wallace and Mr Ghosh (as Special Commissioners) in *Campbell v IRC* [2004] STC (SCD) 396). In any case, there is no reason to take Lord Hoffmann other than at face value in the context of what are to be seen as "losses" for the purposes of TCGA 1992. See also the remarks of Lord Walker in *Tower MCashback* at [49].

51. Further, whatever reservations there may be about the speech of Lord Brightman in *Furniss v Dawson* [1984] AC 474 (as to which see Lord Hoffmann in *MacNiven* at [49] and Lord Walker in *Tower MCashback* at [42]), in a case which concerns a concept (such as disposal or loss) which can be given "a commercial meaning capable of transcending the juristic individuality of its component parts" (see again Lord Hoffmann in *MacNiven* at [49]), the consequences of adopting a *Ramsay* construction spelled out by Lord Brightman remain apposite: as to that, see the passage from his speech in *Furniss v Dawson* [1984] AC 474 at 527 (quoted many times (including by Lord Hoffmann in *MacNiven* at [47]) The position can be summarised in this way: First, there must be a pre-ordained series of transactions (or, to use different language which has emerged from the case, there must be a composite transaction). Secondly, there must be steps inserted which have no commercial (business) *purpose* apart from the avoidance of liability to tax – not "no business effect". The inserted steps are then disregarded for fiscal purposes meaning, as interpreted by Lord Hoffmann, disregarded for the purposes of applying the relevant fiscal concept.

52. At this stage, we turn to *SPI*. That case, as Lord Nicholls explained at [2], concerned an artificial scheme devised in 1995 to take advantage of a prospective change in the system of taxing gains on options to buy or sell bonds and government securities ('gilts'). Under the legislation then in force, the Scottish Provident Institution ('SPI'), as a mutual life office, was not liable to corporation tax on any gain realised on the grant or disposal of such an option. Under the system proposed in an Inland Revenue consultation document published in May 1995, all returns on such options would be treated as income and losses made on disposals would be allowable as income losses.

53. We do not propose to set out the scheme as implemented in detail: it is described in [7] to [15] of Lord Nicholls' speech. However, a summary is useful because there are parallels between the scheme in that case and the scheme in the present case. We can do no better than set out Lord Nicholls' own outline in [3] to [6]:

> "**[3]** The central element of the scheme devised by Citibank International plc ('Citibank') to enable SPI to take advantage of the change-over was extremely simple. During the old regime, SPI would grant Citibank an option ('the Citibank option') to buy short-dated gilts, at a price representing a heavy discount from market price, in return for a correspondingly large premium. The premium received on the grant of the option would not be taxable. After the new regime came into force, Citibank would exercise the option. SPI would have to sell the gilts at well below market price and would suffer an allowable loss.
>
> **[4]** If that was all there was to the transaction, there would also have been a risk that SPI or Citibank would have made a real commercial profit or loss. The premium would have been fixed by reference to the current market price, but the possibility of a rise or fall in interest rates during the currency of the option created a commercial risk for one side or the other. Neither side wanted to incur such a risk. The purpose of the transaction was to

create a tax loss, not a real loss or profit. The scheme therefore provided for Citibank's option to be matched by an option to buy the same amount of gilts ('the SPI option') granted by Citibank to SPI. Premium and option price were calculated to ensure that movements of money between Citibank and SPI added up to the same amount, less a relatively small sum for Citibank to retain as a fee. In addition, SPI agreed to pay Citibank a success fee if the scheme worked, calculated as a percentage of the tax saving.

[5] The calculation of the SPI option price obviously needed careful thought. In one sense, of course, it did not matter. Whatever price was selected would be reflected in the corresponding premium and subsequent movements in the market price would cancel each other out. But the option price for SPI had to be higher than the option price for Citibank, otherwise the 'profit' realised by SPI on the exercise of its option would cancel out the 'loss' which it suffered on the exercise of the Citibank option and the whole exercise would be futile. Indeed, the greater the difference between the Citibank price and the SPI price, the greater would be the net tax loss created by the scheme. The difference did give rise to a potential cash flow problem because, if Citibank paid the premium for its option, it would be out of pocket in respect of the difference between the two premiums between the date on which the options were granted and the date on which they were exercised. But this was covered by a collateral agreement under which SPI agreed to deposit the difference with Citibank, free of interest, until its option had been exercised or lapsed. This enabled the payment of both premiums to take the form of book entries.

[6] On the other hand, the purpose of the SPI option was to reduce or eliminate the possibility that the outcome of the transaction would be affected by events in the real world such as movements in interest rates. So the SPI option price had to be sufficiently below market price as to be, for practical purposes, out of the possible range of such movements. There was also a third consideration. Plainly it was inconceivable that Citibank, having parted with a large premium for its option, would not exercise it. Equally, if the SPI price had been very low, it would have been inconceivable that SPI would not have countered by the exercise of its own option. That might have given rise to a doubt about whether in truth there was any transaction in gilts at all. It would have been inevitable that the obligations of Citibank and SPI to deliver gilts would cancel each other out and that none would change hands. So the SPI option price had to be close enough to the market price to allow for some possibility that this would not happen."

54. The question at issue was whether the Citibank option gave it an entitlement to gilts (as explained at [18]). That depended on what was meant by "entitlement" within the meaning of the relevant statutory provision. Looking at the Citibank option in isolation, it gave Citibank an entitlement to delivery of gilts by exercise of the option. But, as Lord Nicholls stated it "if the option formed part of a larger scheme

by which Citibank's right to the gilts was bound to be cancelled by SPI's right to the same gilts, then it could be said that in a practical sense Citibank had no entitlement to gilts". If the scheme amounted in practice to a single transaction, the court should look at the scheme as a whole. In that context, it was conceded – and Lord Nicholls clearly thought that the concession was correct – that if there was "no genuine commercial possibility" of the two options not being exercised together, then the scheme must fail.

55. After considering *Craven (HMIT) v White* [1989] AC 398 at 514 and the "no practical likelihood" test derived from that decision, Lord Nicholls went on at [23] to conclude that it would destroy the value of the *Ramsay* principle if the composite effect of a composite transaction had to be disregarded simply because the parties had deliberately included a commercially irrelevant contingency, creating an acceptable risk that the scheme might not work as planned. The composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned. This has a resonance in the present case where the commercial risk to each party – a profit or loss of less than £50,000 – was trivial in the context of the sums involved. As the Tribunal saw it, the difference in the strike prices (which gave rise to the possibility of profit and loss) was contrived to give the scheme an illusory aura of commerciality.

56. We have already mentioned *Burmah Oil*. There, a series of circular payments left the taxpayer in exactly the same financial position as before and this was not regarded as giving rise to a "loss" within the meaning of FA 1965. But circularity is not always enough as Lord Hoffmann reminds us in *HIT Finance Ltd*. And as he said in *MacNiven* at [64], what *Burmah Oil* decided was that the statutory concept of loss accruing upon a disposal has a business meaning and that the "loss" suffered by Burmah did not fall within that meaning.

57. In *Carreras Group Ltd v Stamp Commissioners* [2004] UKPC 16, [2004] STC 1377, a transfer of shares in exchange for a debenture with a view to its redemption a fortnight later was not regarded as an exempt transfer in exchange for the debenture but as an exchange for money. The vendors received cash as a result of the overall transaction. Encapsulating the *Ramsay* principle, Lord Hoffmann (delivering the opinion of the Privy Council) repeated that the courts, since *Ramsay*, have tended to assume that revenue statutes in particular are concerned with the characterisation of the entirety of transactions which have a commercial unity rather than the individual steps into which such transactions are divided, albeit that "This approach does not deny the existence or legality of the individual steps but may deprive them of significance of the purpose of the characterisation required by the statute".

58. We do not think that it is necessary to go into the fact of *Mayes* other than to say this. It concerned a marketed tax-saving scheme called SHIPS 2. A central feature of SHIPS 2 was the purchase by a non-resident company of non-qualifying life assurance policies called AIG Bonds followed, very soon after, by their partial surrender and a withdrawal of funds. The principal point in the appeal was whether, as a matter of law, two pre-ordained, composite, artificial and tax-motivated events in

SHIPS 2 (Steps 3 and 4 identified in the judgment of Mummery LJ) were to be disregarded for fiscal purposes. In dismissing HMRC's appeal and upholding the decision of Proudman J, the Court of Appeal set out the by now well-established approach to construction: see [73] to [78] of the judgment of Mummery LJ. In particular, in [78], he said this:

> "…….it would be an error, which the judge did not fall into, to disregard the payment of a premium at Step 3 and the partial surrender at Step 4 simply because they were self-cancelling steps inserted for tax advantage purposes. It was right to look at the overall effect of the composite Step 3 and Step 4 in the seven step transaction in the terms of ICTA to determine whether it answered to the legislative description of the transaction or fitted the requirements of the legislation for corresponding deficiency relief. So viewed, Step 3 and Step 4 answer the description of premium and partial surrender. On the true construction of the ICTA provisions, which do not readily lend themselves to a purposive commercial construction, Step 3 was in its legal nature a premium paid to secure benefits under the Bonds and Step 4 was in its nature a withdrawal of funds in the form of a partial surrender within the meaning of those provisions. They were genuine legal events with real legal effects. The court cannot, as a matter of construction, deprive those events of their fiscal effects under ICTA because they were self-cancelling events that were commercially unreal and were inserted for a tax avoidance purpose in the pre-ordained programme that constitutes SHIPS 2. It follows that a corresponding deficiency relief is available to Mr Mayes."

59. We now need to refer to *Tower MCashback*. It does not, we think, say anything <u>new</u> about the principles to be applied. And it is, of course, concerned with very different facts in relation to very different legislation. Mr Goldberg submits that the conclusion that the expenditure there in issue was not incurred on an asset which was eligible for capital allowances was dependent entirely on the fact that the software purchased had a market value less than the price supposedly paid for it. In contrast, in the present case, there is a finding that the Options were granted for market value.

60. That is certainly a point of distinction between that case and the present case. But in agreement with Mr Ghosh, we do not consider that the decision has any significant impact on the primary argument which he presented on behalf of HMRC (effectively that all four Options and the subsequent closing out of Option 1 and Option 3 and the exercise of Option 2 and Option 4 were to be ignored entirely). In that context, *Tower MCashback* simply confirms that the commercial and economic reality of a series of transactions determines their reality for tax purposes also, where the relevant terms in the particular tax provisions in question ("expenditure on…" in *Tower MCashback* and, as Mr Ghosh would have it "loss" in the present case) look to the commercial and economic reality of the relevant transactions.

61. In this context Mr Ghosh makes an observation in relation to *Mayes*: that case, he says, decides that where a transaction is effected, even for purely tax avoidance purposes, the legal and commercial reality dictates that transaction's tax treatment.

So if an insurance bond is acquired and then partially surrendered, even for purely tax purposes, the application of the relevant tax provisions must recognise the legal and commercial existence of the insurance bond which was acquired and still remains in existence, even after the partial surrender. He then compares and contrasts a circumstance where assets are acquired and transferred or destroyed in their entirety (as in *Ramsay* and as he would have it in the present case) where the taxpayer starts and ends with nothing and is correctly taxed on the basis that nothing has happened concluding that *Mayes* does not affect this appeal.

62. There is, however, another aspect of *Tower MCashback* which we mention briefly only to put it aside. Mr Ghosh analyses the decision in this way:

> (1) expenditure incurred by the LLP members, to the extent that it was borrowed merely to "*put into a loop in order to enable the LLPs to indulge in a tax avoidance scheme*" [that is to generate capital allowances for the LLP members] is not expenditure "*... on the acquisition of software rights*" for the purposes of CAA 2001, Section 11: see Lord Walker at [75], [76] and [78].;
>
> (2) the conclusion that the disputed expenditure was not expenditure "on" the acquisition of software rights was inferred from a number of factual observations: the observation that the borrowed money "*... did not go to MCashback, even temporarily; it passed ... straight to R&D where it produced no economic activity ... until clearing fees began to flow from MCashback to the LLPs ...*" (see [77]); the absence of any economic or commercial reality to the expenditure was in turn inferred from the fact that the software which was purportedly acquired, as part of the scheme, was acquired "*in bits*" by means of a licence which was "*far short of absolute ownership*", which was commercially unintelligible (see [69], [70] and [71]);
>
> (3) an express observation that the purported purchase price was negotiated at arm's length between wholly unconnected parties (see [58]) was immaterial to the Supreme Court's conclusion.

63. Focusing on the concept of "expenditure" which is "put into the loop" and which did not amount to expenditure "on" the software, so he says it can be argued that the premiums paid for Option 1 and Option 2 are not "expenditure" incurred wholly and exclusively for the acquisition of an asset (each of the two Options). This is on the footing that the premiums have no commercial significance being immediately reimbursed by the premiums paid for Option 3 and Option 4 in circumstances where any movement in the value of Option 1 or Option 2 is immediately cancelled out by an equal and opposite movement in the value of Option or Option 4. The conclusion which could, arguably, be drawn from this is that Mr Schofield is deprived of any base cost for Option 1 and Option 2. In that case, there would be no capital loss in respect of the premiums paid for either Option 1 or Option 2.

64. This argument was identified only following the decision of the Supreme Court in *Tower MCashback*. Mr Ghosh acknowledges that it is a new point and, furthermore, that the approach behind the argument was rejected by the Court of Appeal in the

context of s 38 TCGA 1992 in *Drummond v HMRC* [2009] STC 2206 at [31]*ff*. The point is not, therefore, raised before us for decision. But Mr Ghosh raises it so that it may be addressed should this matter go further. No further evidence is required since it is common ground that neither Option had any commercial purpose and the absence of any real commercial effect of the combined closing out and exercise of all four Options is not, he says, controversial.

65. There are two other cases which we must mention, not because they add anything of significance to the discussion, but because they have been referred to a relied on by the parties. They are *Whittles v Uniholdings Ltd* 68 TC 528 and *Griffin v Citibank Investments Ltd* [2000] STC 1010. We shall deal with them so far as necessary when considering the parties' submissions about them.

The parties' positions and general discussion

66. Mr Goldberg argues, of course, that there is simply no room for the application of the *Ramsay* principle on the facts of the present case. Indeed, he questions whether there is anything left which can properly be called the *Ramsay* principle. Everything is simply a matter of statutory construction. But, whatever there may be left of the principle, he says that it is not permissible to ignore what has actually happened. An analysis of the present case which concludes that nothing happened is, he says, "just wrong". The Tribunal has improperly searched for, and found, some supposed underlying substance which he contends, as a matter of ordinary legal analysis, they did not possess.

67. We are not absolutely clear whether it remained part of Mr Goldberg's case by the end of the hearing that there were steps in the scheme which were insufficiently certain to enable any challenge to be mounted on the basis of the *Ramsay* principle even if, contrary to his main submissions, this would otherwise be possible. In this context there were two relevant possible uncertainties: first in relation to Mr Schofield becoming non-resident, secondly in relation to the actual outcome. We have addressed these in some detail already: see paragraphs 33-37 above. We do not need to say more about them other than to state our conclusions that neither suggested uncertainty is enough to prevent the *Ramsay* principle from applying to the composite transaction.

68. On Mr Goldberg's approach, each step in the overall transaction in the present case is to be viewed in isolation. In that case, there is no dispute about the correct outcome in principle. The result is as follows:

> (1) Mr Schofield realised a loss on Option 1 in 2003/04 of £11,305,017. This is an allowable loss which may be set against chargeable gains accruing to him in that year or later years. The disposal of the option occurred when it was closed out on 4 April 2003 by reference to ss 22 and 144(4)(b) TCGA 1992.
>
> (2) Mr Schofield made a gain on the exercise of Option 2 in 2003/04 of £7,354,959 (applying s 144A TCGA 1992). In principles, this was a

chargeable gain but as it arose in a year in which he was non-resident, no charge arose.

(3) Mr Schofield made a gain in 2002/02 on the grant of Option 3 equal to the price for which he granted it. The Option was an option to acquire gilts so that the grant was exempt from capital gains tax. Since the Option was not exercised but was closed out, nothing material, for tax purposes, occurred after the grant of the option.

(4) Mr Schofield is treated as having made a gain in 2002/03 on the grant of Option 4. The subsequent exercise of Option 4 requires the grant of the option and what happened on its exercise to be treated as a single transaction (see s 144 CGTA) producing a loss of £7,522,570). The single transaction is treated as occurring in 2003/04 and is not chargeable because (i) Mr Schofield was non-resident in that tax year and (ii) because it arose on the purchase and sale of gilts.

69. If that treatment is not correct, it can only be because the statutory provisions do not apply in that way, on their true construction, to the facts as found by the Tribunal. We turn then to why Mr Ghosh submits, on the facts and in the light of the law discussed at length above, why that treatment is not correct. And in doing so, we address the arguments which Mr Goldberg has raised.

70. At the outset of this discussion, we wish to say a little about the way in which the parties have used the words and phrases "loss" and "real and commercial loss". It makes sense to draw a distinction between "loss" and "real and commercial loss" where there is a composite transaction but it does not make (much) sense to draw that distinction in relation to a single transaction. In the latter case, the transaction may generate a gain or a loss in the sense that, applying the computational rules in CGTA (essentially and oversimplifying, proceeds of disposal less base cost), the result is gain or loss. If the statutory conditions for deducting the loss from a gain are satisfied, the loss can be called an allowable loss. A gain or loss in such a case will often reflect a real or commercial gain or loss.

71. In contrast, a composite transaction, ignoring tax altogether, may have an overall economic result in terms of gain or loss of a capital nature. This can be referred to as giving rise to a "real and commercial" gain or loss. In the case of interlocking and interdependent transactions forming a composite whole, the question is whether the overall transaction answers to the statutory description of the sort of transactions to which the statute was intended to apply. If the overall transaction does fall within that description then it is appropriate to apply the statute to it rather than to individual steps having no commercial purpose (other than tax avoidance). And in answering the question just identified, it is helpful, if not essential, to take account of the "real and commercial" gain or loss. The gains or losses viewing each step in isolation are not the "real and commercial" gains and losses and are to be ignored.

72. It is no part of HMRC's case that any of the steps in the scheme was sham. It is accepted that each of the Options was a genuine transaction and was actually granted, albeit as part of a composite scheme. Mr Ghosh also told us in his oral submissions that (subject to the *Tower MCashback* point identified at paragraphs 62-64 above) it

was not any part of HMRC's case that the base value of Option 1 had any part to play and says that the case has nothing to do with base cost.

73. Instead, HMRC's case is that Mr Schofield started with nothing and ended with nothing. The Options it is said are, on the facts, a fiscal nullity and there is no "loss" within s 2 CGTA (as amplified by reference to s 16). Accordingly, when it comes to applying the *Ramsay* principle to the present case, the grants of the Options are ignored for tax purposes just as making the loans in *Ramsay* itself was ignored. As he succinctly put it "Of course, if you respect the options, you get a base cost; but here you start with nil, you end with nil and so there is no loss". [In fact, Mr Schofield did not end up in a precisely neutral position as a result of the transaction as a whole: he made a (modest in the circumstances) profit of about £50,000 (ignoring fees) but even that profit was, on the findings of fact, the result of an engineered exposure to avoid an application of the *Ramsay* principle. For the purposes of the discussion, we put that point aside and address the matter as one of principle.]

74. In making that submission, Mr Ghosh said in his skeleton argument that where one finds transactions with a commercial unity, they are to be taxed by reference to their combined effect, relying particularly on *BMBF* at [32] and *SFI* at [19] and on what Mr Goldberg had said in his skeleton argument ("….it is necessary….to consider the overall effect of a number of transactions intended to operate together"). That submission is correct on one reading; but on another it goes too far. Of course it is the case that where one finds a series of transactions with a commercial unity, they must be considered as a whole to see how a particular taxing provision operates in relation to them. But the mere fact that there is a commercial unity does not automatically lead to the conclusion that the composite transaction must be taxed by reference to the end result as compared with the starting point. It all depends on the statutory provisions and the composite transaction concerned. Thus in *BMBF*, Lord Nicholls (at [37] and [38] – see paragraph 47 above) emphasises the need to focus on the relevant statutory provisions and expressly recognises that even circular payments may not fall to be disregarded. Similarly, we do not think that it can be said *a priori* that self-cancelling transactions fall to be disregarded for fiscal purposes: it all depends on how the self-cancelling operates and on the statutory provision concerned.

75. We need to be careful to recognise what can and cannot be disregarded and for what purposes. There is no doubt that everything which actually happened in the real world is to be taken account of; it may, or may not, as the case may be, have an impact on the end tax result but that is a question of interpretation of the relevant statutory provision. To say that something which actually happened can be "ignored" for tax purposes may be an apposite use of the word in many cases. Thus in *Furniss v Dawson* the intervening steps inserted for nothing but tax avoidance reasons were to be disregarded in identifying the tax consequences of the entire transaction. Since they were disregarded, those did not, of course, of themselves give rise to any tax consequence.

76. And, going back to *Ramsay* itself, the scheme (see the speech of Lord Wilberforce at p 327) involved the creation of two loans L1 and L2 the terms of which we do not need to repeat by which can be found at p 327 D-F. A change was effected to the

interest payable under each loan which resulted, according to the taxpayer, in the realisation of a (non-taxable) gain on the sale of L2 and an allowable loss on the later sale of Caithmead. The taxpayer provided no finance. The loans were not shams; all of the steps in the scheme were real and had legal effect. Nonetheless, the overall transaction resulted in no real gain and no real loss. The relevant legislation was concerned with gains and losses; the transaction in question was the composite transactions which produced no gain and no loss; it was not right "to pick out, and stop at, the one step in the combination which produced the loss": see Lord Wilberforce at p 328F.

77. In contrast, we see *Mayes* as a case where the relevant legislation (which we note did not admit at all let alone easily of a purposive construction) operated on Steps 3 and 4 of the scheme and those Steps could not be ignored simply because they formed part of an overall scheme designed to avoid tax and which, taken as a whole, was not a transaction to which that legislation was applicable. In that context, we refer again to the passage from the judgment of Mummery LJ set out at paragraph 58 above and to his finding (at [77]) that "the statutory requirements as to the transactions to which the provisions were intended to apply were far removed from the kind of case in which the focus is on an end result, such as a loss", *Ramsay*, we add, being an example of such focus.

78. In the present case, the question whether there is a gain or loss can, at a high level, be considered in relation to the scheme as a whole. It must be accepted, as we do, that the precise outcome of the scheme could not be known in advance. But, as we have explained, there were only three possible outcomes if the scheme was to run its course as intended. It was possible that there would be a modest profit or a modest gain for Mr Schofield and it was certain that he would have to bear the fees of the exercise. But, again for reasons already discussed, there was no real risk to him. He was not required himself to fund the scheme; and the prospect of his being able to fund out of his own assets the purchase of the gilts which, in the events which happened, he had to acquire is fanciful. It was a racing certainty that he would become non-resident prior to and for the tax year 2003-04. And Mr Goldberg accepts, as he must, that the scheme was entered into in the hope of mitigating Mr Schofield's tax liability. Indeed, the findings of the Tribunal went rather further: the sole aim of the transactions was to avoid tax and the transactions were bereft of a commercial purpose.

79. Viewing the scheme at this high level, Mr Schofield suffered no real commercial loss. On that approach, HMRC should succeed in defeating Mr Schofield's claim to the allowable loss which he originally included in his self-assessment. Further, on that approach, it is no more difficult to ignore the Options in the present case than it was to ignore the two loans in *Ramsay*. The fact that actual assets are created in the real world – the Options and the obligations under the loan contracts – is not of itself sufficient to defeat HMRC's case.

80. In contrast, if the statutory code in relation to options has to be applied (as Mr Goldberg submits it must be), notwithstanding that it falls to be applied in relation to options created pursuant to an avoidance scheme and having no commercial basis,

then the Options have to be recognised for tax purposes and Mr Schofield succeeds. On this approach, the statutory code concerning options is to be applied according to its terms just as the statutory code concerning insurance contracts and premiums was applied according to its terms in *Mayes*.

81. The statutory code in relation to options is all part and parcel of a wider statutory scheme concerning disposals, gains and losses. That code is necessary to deal with the unique nature and attributes of an option as an asset and the consequences of its grant, disposal, exercise and lapse. But it is a code which is concerned ultimately with establishing real gains and losses and not with arithmetical difference just as much as the main provisions of the legislation are concerned with real gains and losses. Accordingly, the unique nature of options, and the existence of a special code dealing with them in the context of capital gains tax, does not, in our judgment, require, or permit, a court or tribunal to conclude that the grant, exercise, surrender or lapse of options cannot, as a matter of principle, be disregarded in the context of the capital gains tax consequences of a composite transaction; it would be wrong to conclude that options must always be recognised and fall to be dealt with according to the special code.

82. On the facts of the present case, it is our view that the options code is to be ignored in deciding whether there was a loss within the meaning of s 2 TCGA 1992 when Option 1 was closed out on 4 April 2003. We conclude that the composite transaction – the grant of all four Options and, in the events which happened, their exercise or closing out – is to be seen as the relevant transaction. That is the transaction in relation to which it is appropriate to ask whether it satisfied the requirements of the statute (to adopt the more "convenient" analysis formulated by Lord Nicholls in *BMBF* at [32] p327H). But even if one analyses the case by reference to the first formulation (determine the nature of the transaction to which the statutory provision was intended to apply and then decide whether the actual transactions answered to the statutory description) we reach the same conclusion. The composite transaction in the present case is not, in our view, a transaction having the nature of a transaction to which s 2 CGTA applies so as to generate a loss. And, whichever analysis one chooses to apply, the options code to which we have referred does not fall to be applied to each Option separately as if each Option existed as a discrete entity on its own apart from the overall scheme to which it owed its existence in the first place.

83. We do not see this conclusion as open to effective challenge simply because the first step in the composite transaction was the creation of the Options. If it is possible to ignore for fiscal purposes steps inserted into a wider transaction which have an actual effect (*eg* as in *Furniss v Dawson* where, as helpfully stated by Lord Nicholls in *BMBF* at [35], "the transfer of shares to a subsidiary as part of a planned scheme immediately to transfer them to an outside purchaser was regarded as giving rise to a taxable disposition to the outside purchaser rather than an exempt transfer to a group company") we see no reason why it should not be possible to ignore even the first step in a composite transaction and to determine that that composite transaction is not of a nature contemplated by the statutory provision on which the taxpayer seeks to rely to obtain a relief of some sort.

84. We find support for that in *Ramsay* itself. The composite transaction in that case did not generate a loss within the meaning of the statute. This entailed ignoring the loans, or at least L2, for fiscal purposes in the same way in which we are invited by Mr Ghosh to ignore the Options. If it had been right to "respect" L2, to use the word which both Mr Ghosh and Mr Goldberg have used in relation to the Options, then it would follow that the existence of L2 would have had to be recognised with the result that its disposal would have given rise, as the taxpayer claimed, to an allowable loss. Contrary to Mr Goldberg's submission, we do not think that the result of the decision of the House of Lords can be explained away as being nothing to do with disregarding or ignoring the loans (or L2) but everything to do with the base cost of L2. Rather, Lord Wilberforce considered the tax effects of the composite transaction; he concluded that there was no "loss" and can, we think, only have been because he looked at the starting point and the end point and could perceive no way in which it could be said that there was a real loss at all. L2 was a fiscal nullity in the sense that it was not to be respected for fiscal purposes so that nothing had happed for the purposes of capital gains tax. That has a precise parallel in the present case where the effect of the composite transactions is that Mr Schofield could only ever make a small profit or a small loss; there could never be, and there in fact was not, a loss of the size which he now seeks to have allowed.

85. If, contrary to that view, Mr Goldberg is right to say that *Ramsay* can be explained as a decision turning on the base cost of L2, then we would need to confront the issue identified in paragraphs 62 to 64 above. This would require further argument. We do not consider, in the light of our actual decision, that it is necessary to receive further argument and decide the point. But it is one which Mr Ghosh has flagged and is one, we think, which should be open on appeal were this matter to go further.

86. We make clear that it is no part of our reasoning that steps are to be ignored for no other reason than that they are steps in a tax avoidance scheme. They are to be ignored in the present case, as we think that they were ignored in *Ramsay*, because the composite transaction in the present case is not one to which sections 2 and 16 TCGA 1992 apply so as to give rise to the loss claimed by Mr Schofield; and Mr Schofield fails to establish that the options code must be applied independently of the composite transaction.

87. We do not perceive any inconsistency in this decision with anything which was said in *Whittles v Uniholdings Ltd* or *Griffin v Citibank Investments Ltd* to which Mr Goldberg referred us. In the first of those cases, the loan contract and the forward contract were each entered into for genuine commercial purposes. In the second, there was a practical possibility that the pre-planned events would not take place. Patten J rejected the argument of the Crown that the *Ramsay* principle could be applied to the fiscal analysis of transactions in which no artificial steps had been inserted at all which was the way in which he saw the case before him. That is not the position in the present case. The Tribunal considered *Citibank Investments Ltd* at paragraphs 73 to 77 of the Decision. We agree with the distinctions which they drew between that case and the present case, especially in the light if their findings of fact and the contrasts to be drawn with the facts in *Citibank Investments Ltd*. And we agree with what the Tribunal said in paragraph 77 where they (i) noted that in that

case, HMRC were arguing that, because the profit to Citibank was economically equivalent to interest on the company's investment, the *Ramsay* approach meant that it should be so treated for tax purposes and then (ii) identified that as a radically different proposition from that put forward by HMRC in the present case.

Conclusion

88. On the allowable loss issue, we dismiss Mr Schofield's appeal.

The gilt option exemption issue

89. As we have upheld the decision of the Tribunal on the allowable loss issue, it is not strictly necessary for us to deal with this alternative issue, namely whether Option 3 was an option within s 115(1)(b) TCGA 1992. Section 115(1)(b) provides relevantly that a "gain which accrues on the disposal by any person of … any option or contract to acquire or dispose of gilt-edged securities … shall not be a chargeable gain". It is common ground that the gilts referred to in each of Option 3 and Option 4 are gilt-edged securities within that provision. The Tribunal found that they were bound by the ordinary meaning of the contract notes which showed that on 7 February 2003 the parties entered into options to acquire or dispose of gilt-edged securities. It held that the gain on Option 3 was exempt pursuant to s 115 TCGA 1992.

Submissions for HMRC on the gilt option exemption issue

90. Mr Ghosh submits that Options 3 and 4 were outside the scope of s 115(1)(b) TCGA 1992, both because of their terms and because of the application of *Ramsay* and *Furniss v Dawson.*

91. As to the first of those arguments, Mr Ghosh starts with the proposition that the formula setting the strike price for each of Option 3 and Option 4 creates an exposure overwhelmingly to the FTSE Index and not to the price of the underlying subject matter, gilts. To demonstrate that result, he made detailed submissions in his skeleton argument on the terms of the Options and the economic exposure to which Mr Schofield was subject. His analysis shows that the possibility of profit or loss had nothing to do with the value of the underlying gilts. This is because the strike price starts with the price of the gilts on 7 April 2003 and then adds or subtracts, as the case may be, a fraction of the nominal value of the holding where the fraction depends solely on the movement in the FTSE 100 Index over the period 7 February to 7 April 2003. Since Mr Schofield could, in theory, have gone into the market and bought the stock on 7 April for its market value, his exposure turned on the fraction contained in the formula, a fraction which reflected only the move in the FTSE and had nothing to do with the value of the gilts. This analysis ignores, of course, the possibility that going into the market to purchase the amount of gilts concerned might have had an impact on the market and the price which would have to be paid. In our view, Mr Ghosh's starting proposition is correct. But where does it take him?

92. He submits, in the light of the level of Mr Schofield's economic exposure, that Options 3 and 4 were not in any meaningful commercial sense options respectively to

sell and buy gilts: for an option to fall within the scope of the sub-section, the underlying subject matter of the option has to be gilts and it is not sufficient for an option to give rise to a cash obligation dependent on a movement of the FTSE Index, which cash obligation was merely satisfied in money's worth in the form of gilts.

93. In considering that submission, we wish to consider two examples which we think throw light on the correct analysis.

> (1) Consider, then, an option on the same terms as Option 4, standing in isolation and concerning a rather more modest amount of gilts, say £100,000 notional amount rather than £333 million. We do not see why such an option should properly be regarded as simply giving rise to a cash obligation on the grantor of the option when the FTSE 100 Index has moved against him and the grantee decides to exercise the option. The grantee's contractual right, when the call option is exercised, is to acquire the gilts at the strike price. He may, having exercised the option, decide to retain the gilts. Indeed, he might have entered into the option in the first place for perfectly valid commercial reasons.
>
> (2) Consider next an option on the same terms as Option 3, again standing in isolation and again concerning a rather more modest amount of gilts, say £100,000 notional amount rather than £333 million. When the put option is exercised, the option holder (seller) can force the counter-party (purchaser) to buy the relevant gilts at the strike price. The terms of the option do not entitle the purchaser to pay to the seller a sum of money representing the difference between the market price and the strike price, although if the purchaser does not want to hold the gilts and if the seller does not already hold gilts that he wishes to dispose of, they may close out the bargain in that way. In any case, the purchaser may actually want to acquire the gilts to hold as an investment.

94. In these two examples, it seems clear to us that there are options to acquire or dispose of gilts both in the real world and for the purposes of s 115(1)(b). If the option is exercised in either case, the contract which arises requires completion according to its terms by transfer of gilts and payment for them. It is beside the point that the parties may subsequently decide to close out the contract by dispensing with any transfer of gilts and by making a payment in one direction or the other. It is not possible, in our view, to recategorise the options as giving rise to cash obligations dependent on movements in the FTSE 100 Index simply because the parties might choose to close out the bargains by way of cash payment; still less is it possible to see the options as giving rise to a cash obligation equal to the difference between the strike price and the market value.

95. Why should the position be any different in relation to Option 3? In the real world, Option 3 (along with Options 1, 2 and 4) had the legal effect which it purported to have. It is of course the case that all four Options were conceived and entered into as part of a larger plan and that one Option would not have been granted without the others being entered into as well. But there is no suggestion that any of the Options was a sham. Since Option 3 is not a sham, there is, it seems to us, clearly

an option to acquire or dispose of gilts for the purposes of s 115(1)(b) unless the *Ramsay* principle applies to some larger composite transaction of which Option 3 forms part so that there was really no option to acquire or dispose of gilts at all. There is here a close parallel with *SPI* where taking the Citibank option in isolation, it gave Citibank an entitlement to delivery of gilts by exercise of the option: see paragraph 54 above. It was only the application of the *Ramsay* principle which allowed HMRC to succeed in that case. We take the same view in the present case and reject Mr Ghosh's first way of putting his case.

96. As to the second of Mr Ghosh's arguments based on the *Ramsay* principle he submits that it applies so as to exclude Options 3 and 4 from s 115(1)(b), even if all of Options 1 to 4 taken together were not to be treated as a "fiscal nullity". There was no intention in relation to Options 3 and 4 for there to be any physical delivery of gilts, in any meaningful sense, whichever option was exercised. On that footing, there would have been no intention ever to deliver gilts even if one of Options 3 and 4 had been exercised; the contract which arose as a result of the exercise of the relevant Option would not therefore be a contract to acquire or dispose of gilts so that the Options themselves could not be options to acquire or dispose of gilts either.

97. So, what could have happened? First, Mr Ghosh submits that if the FTSE 100 Index remained within the digital collar, Options 3 and 4 would not be exercised at all with the result that there would be no physical delivery of gilts. We consider that the Tribunal must be taken as having decided that as part of the composite transaction which they identified, there would have been no exercise of those Options on this scenario. This is the only conclusion consistent with paragraph 21 of the Decision where the Tribunal record that if, on the expiry date of the Options, the closing price for the FTSE 100 Index was within the digital collar then the Options would expire (which must we think mean expire unexercised) valueless.

98. Secondly, the FTSE 100 Index might go up. This is in fact what happened so that, as planned, Option 3 was closed out (together with Option 1) in 2002/03 and Option 4 was exercised (together with Option 2) in 2003/04. Since the exercise of Option 4 would oblige Mr Schofield to transfer £333,000,000 worth of the relevant gilts to KBPB, he instructed KBPB to acquire the necessary gilts for him, which it did, the provider being KGLG, a gilt market maker in the same group as KBPB (the Dresdner Banking Group). The gilts therefore went round in a circle.

99. Thirdly, the FTSE 100 Index might go down, in which case Option 3 would have been exercised resulting in Mr Schofield being liable to pay for £333,000,000 nominal of gilts at a price above their market value. Mr Ghosh points out that there was no evidence about what Mr Schofield might do with these gilts which represented about 8% of the stock then in issue. As the Tribunal observed:

> "Further there was no reasonable prospect of the Appellant on his own account trading in the gilt options as he would have required funds in the region of £400 million. The Appellant indicated that he would not have been interested in the scheme, if he had known of the extent of his financial exposure."

and

> "At the time he entered into the Option transactions the Appellant had no knowledge of the gilt market. He was completely unaware of his exposure to a potential trade in gilts to the value of £400 million."

100. Moreover, the evidence was that there was never any intention that KBPB would deliver gilts to Mr Schofield to be held beneficially by him. In practice, it is quite impossible to see how this could ever have been done or could ever have been expected to happen given, among other concerns, the exposure of Mr Schofield to substantial risk of market movements and a need for him to find over £396 million of his own to buy the gilts or to borrow the amount (presumably from KBPB). And where, one wonders, was Mr Schofield expected to find a buyer for this stock?

101. The Tribunal, in relation to the main issue, decided that all four Options and each possible outcome (determined by the actual movement in the FTSE 100 Index) comprised a single composite transaction. It must follow logically that, reflecting the events which happened, the grant of Option 4, its exercise, the acquisition of gilts by Mr Schofield and the sale of those same gilts to KBPB in fulfilment of his obligations were themselves part of the composite transaction which the Tribunal had identified. They were interdependent and linked transactions in an overall scheme. Similarly, it must follow logically that, had Option 3 been exercised in the event of a fall in the FTSE 100 Index, the grant of Option 3, its exercise and the linked exercise of Option 1 which would have occurred would under no circumstances have given Mr Schofield beneficial entitlement to gilts at any stage. The gilts which he acquired, if he acquired any at all, would be bound under the preordained arrangements to pass either to KBPB or for example KGCL.

102. Even if we are wrong to say that the conclusions in the preceding two paragraphs follow logically from the Tribunal's express findings, we consider that the evidence in favour of those conclusions is overwhelming and that the Tribunal could not properly have reached different conclusions. And, as the Tribunal recorded at paragraph 41 of the Decision, Mr Hamilton-Ely stated that KBPB would not relinquish control over the dealings in gilt-edged securities.

103. The arrangements were ones under which there was never any commercial possibility of Option 4 being exercised save in circumstances where Mr Schofield had in connection with the exercise of that Option already bound himself to acquire the necessary gilts without having to provide a penny of funding himself. The gilts were always to go round in a circle (assuming that there ever were any actual gilts appropriated to the contract rather than contractual obligations which cancelled each other out) and the money went round in a circle in the sense that book entries appeared in appropriate accounts. In *SPI*, Lord Nicholls stated, in a passage we have already quoted, that "if the option formed part of a larger scheme by which Citibank's right to the gilts was bound to be cancelled by SPI's right to the same gilts, then it could be said that in a practical sense Citibank had no entitlement to gilts". Similarly, in the present case, we consider that Mr Schofield in a practical sense did not, when entering into Option 4, grant an option to dispose of gilts. Instead, there was either no transaction involving gilts at all (because the different legal identities of

KBPB and KGLC are to be disregarded) or (respecting those separate identities) the transaction involved only a disposal of the gilts by KGLC to KBPB.

104. Similarly, the arrangements were ones under which there was never any commercial possibility of Option 3 being exercised save in circumstances where Mr Schofield, in connection with the exercise of that Option had already, or was guaranteed to be able to, dispose of the gilts which he would be acquiring, again without having to provide a penny of funding himself. Even if it could not be said at the inception of the scheme precisely who the ultimate recipient would be, there was no genuine commercial possibility that Mr Schofield would be left with the gilts. As in the case of Option 4, the gilts were always to go round in a circle (assuming that there ever would be any actual gilts appropriated to the contract rather than contractual obligations which would cancel each other out) and the money would go round in a circle in the sense that book entries would appear in appropriate accounts. We consider that Mr Schofield in a practical sense was not subject to a put option to acquire gilts. Instead, there was either no transaction involving gilts at all (because the different legal identities of KBPB and KGLC are to be disregarded) or (respecting those separate identities) the transaction involved only a disposal of the gilts by KBPB to the ultimate recipient in the chain. The relevant transaction therefore is a disposal of gilts by KBPB to itself (*ie* a fiscal nullity) or to the ultimate recipient (just as the taxable disposal in *Furniss v Dawson* was to the outside purchaser) so that Option 3 is to be disregarded.

105. The Tribunal appear to have rejected application of the *Ramsay* principle on the basis that they were, at this stage, operating on the hypothesis that their decision on the main point was wrong. But there was more than one issue facing the Tribunal (and now us) and those issues were different. In relation to the main issue, the question was whether the steps in the composite transaction which the Tribunal had found to exist could be viewed separately so as to give rise to a "loss" within s 2 TCGA 1992. The question on the alternative argument was whether Option 3 was an option or contract to acquire or dispose of gilts. Entirely different questions arise in addressing how, if at all, the *Ramsay* principle applies to these different issues. As we understand them, the Tribunal thought that the assumption that they were wrong on the first point meant that they were compelled to assume that it was impermissible to link Option 3 with any of the other steps of the composite scheme or arrangements in connection with it. We do not agree with that. It seems to us that what they actually did was to proceed on the basis that they were compelled to assume (contrary to their factual determination) that there were no interdependent and linked transactions whereas what they ought to have done, if they were going to address the alternative argument at all, was to assume only that they were wrong in their legal analysis but to maintain their factual findings.

106. We have in the course of the above discussion dealt implicitly with most of Mr Goldberg's submissions. One of his submissions was that there was no evidence for a conclusion that, were the options exercised, gilts would not have been transferred in fulfilment of the obligations then arising (in which context he noted that when Option 4 was exercised, Mr Schofield had fulfilled his obligation by delivering gilts). In relation to that submission, we say this: our conclusion does not turn on whether, in

the real world, there was a delivery of gilts any more than the decision in *Furniss v Dawson* turned on evidence that the shares would not have been transferred to the group company and were in fact so transferred. Rather, our conclusion is based on an analysis of s 115(1)(b) which requires there to be an option to acquire or dispose of gilts and which requires us to ask whether the (composite) transaction identified by the Tribunal entails that that there was such an option.

107. In the light of our approach to the alternative argument and our rejection of Mr Ghosh's first argument, we do not need address certain of Mr Goldberg's other submissions. However, on our approach, Options 3 and 4 are not options to acquire or dispose of gilts within s 115. But if, as we have decided, they are not such options, then it is not easy to see how they can be options within the capital gains tax options code at all. If they are options at all, they must be options over something and if not gilts, then what? We would therefore agree with Mr Goldberg's submission that, if Options 3 and 4 are options at all for the purposes of TCGA 1992, they are options over gilts.

108. Accordingly, it is, as we see it, a necessary consequence of our conclusion that Options 3 and 4 are not options to acquire or dispose of gilts, and in the light of our reasoning in reaching that conclusion, that Options 3 and 4 are not options within the options code of TCGA 1992 at all. They are to be disregarded. In that case, it must follow that Options 3 and 4 were not within the charging provisions of s 144. Whether HMRC can raise any other charge to any tax by reference to Option 3 in these circumstances has not been debated before us.

Conclusion

109. We conclude that Options 3 and 4 were not options to acquire or dispose of gilt-edged securities within s 115(1)(b) TCGA 1992. But nor were they contracts which fell, on their respective grants, within s 144. Accordingly, capital gains tax is not chargeable under s 144 in respect of the effecting of Option 3.

Disposition

110. Mr Schofield's appeal is dismissed.

MR JUSTICE WARREN (PRESIDENT) **JOHN CLARK**

TRIBUNAL JUDGES
RELEASE DATE: 27 July 2011

APPENDIX

Facts Found on Loss Dispute

53. The Tribunal finds the following facts:

(1) The arrangements involving the four Options between the Appellant and KBPB were set up for the sole purpose of eliminating the Appellant's liability to capital gains tax arising from the redemption of loan notes.

(2) The evidence in support of the arrangements being a pure tax avoidance scheme was overwhelming. KBPB's product documentation described it as a strategy for the reduction of a charge to capital gains tax based around option transactions over gilts and the level of FTSE. The PWC letter of 13 February 2003 referred to the arrangements as capital loss planning. The Appellant's sole intention for entering the arrangements was to achieve a capital loss wiping out his gains on the redemption of loan notes. The Tribunal was satisfied that the PWC's letter reflected the parties' understanding of the arrangements before the Options were taken out.

(3) The incorporation of a potential actual small profit or loss within the structure of the scheme by allocating marginally different strike prices between the set of cash-settled FTSE Options and the set of Gilts Options was contrived to give the scheme an illusory aura of commerciality. This was confirmed by the passage in PWC's letter dated 13 February 2003 which stated that *for the planning to be effective it is important to demonstrate that there is some commercial risk being taken* and the limited extent of the contrived risk (see (4) below).

(4) The scheme served no commercial purpose. The contrived profit and loss only occurred when the FTSE 100 Index moved outside the collar, and fixed at a modest upper limit either a £49,961 profit or a £45,335 loss which did not vary on subsequent movements in the Index. The pursuit of this relatively small profit made no commercial sense having regard to the size of the Appellant's fees for the scheme which amounted to £218,000.

(5) Equally the fees charged by PWC and KBPB were directly related to the anticipated tax savings from the scheme. The fees had no connection with commercial profit generated from trading in Options.

(6) The Appellant did not risk his own resources in the implementation of the scheme (beyond the built in fee). KBPB supplied the complete funding for the scheme ranging from the premiums for the cash settled Options, the payment to the Appellant on closing out and the purchase of gilts to the value of £370 million. The funding arrangements consisted of a series of equal and opposite book entries in the Appellant's account with KBPB which all but cancelled each other out. The only actual monies that passed between the Appellant and KBPB were the fees for KBPB's services and the security demanded by KBPB to cover the contrived marginal loss.

(7) The nature of the funding arrangements which did not carry any risks for either KBPB or the Appellant gave KBPB the freedom to configure the

arrangements so that they delivered the desired capital loss for the Appellant. Under the scheme it was the value of the premiums for the cash-settled FTSE Options that determined the size of the capital loss. Thus the figure fixed of £24 million for the two premiums ensured that the scheme either delivered a capital loss of either around £24 million or £12 million.

(8) The fact that the Options were acquired at market value was irrelevant. The notional value of the assets to be acquired or disposed of under the cash-settled FTSE Options and the nominal value of the gilts under the Gilt Options had nothing to do with market considerations or the Appellant's risk appetite and his ability to pay for them. The notional value was a theoretical exercise determined by the size of the premium necessary to deliver the capital losses.

(9) The architecture of the scheme incorporated two particular features which guaranteed the desired capital loss. The first feature took advantage of the exempt status of gains and losses on disposals of gilt edged securities and of options to acquire or dispose of gilts. This enabled the creation of the set of Gilts Options the strike price of which was linked to the FTSE 100 Index matching the cash-settled FTSE Options, which ensured that the corresponding call or put options operated in tandem. Thus any potential profit or loss on the cash-settled FTSE Options arising from movements of the FTSE 100 Index outside the collar was matched by an equal and opposite profit or loss on the gilt-edged securities[1]. Further the matching set of Gilt Options supplied the Appellant with the funding to carry out the necessary steps involved in the arrangements, as the Appellant was the grantor of the Gilts Options, but the grantee/purchaser of the cash-settled FTSE Options.

(10) The second feature utilised the tax saving possibilities arising from the Appellant's intention to change his tax residence from the United Kingdom to Spain, which eliminated the risk inherent in the generic scheme arising from movements in the FTSE 100 Index outside the collar. Thus the expiry date for the four Options was fixed for 7 April 2003 in a new year of assessment when the Appellant would not be resident or ordinarily resident in the United Kingdom. This permitted an early close out of the out-of-the-money cash-settled FTSE Option (Option One) in the preceding year of assessment when the Appellant was resident and ordinarily resident in the United Kingdom. The corresponding in-the-money cash-settled FTSE Option would be exercised in the year of assessment when the Appellant was non-resident, which enabled him to avoid the capital gains tax consequences from the exercise of that Option.

(11) The Appellant's claim that the vagaries of the FTSE 100 Index would render the potential costs required to fund the necessary steps within the scheme and the gains and losses resulting therefrom unpredictable was without foundation. As found in (9) above the question of costs was controlled by the insertion of the matching set of Gilts Options, which ensured the necessary funding for the required steps. The quantum of the desired loss was determined by the size of the premiums paid for the cash- settled FTSE Options not by

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[1] Subject to the marginal difference identified in paragraph 53(3) & (4).

movements in the FTSE 100 Index. The profits and losses delivered by the FTSE 100 Index were regulated strictly and had no impact on the outcomes of the scheme. The insertion of a collar provided an 85 to 90 per cent probability that movements in the FTSE 100 Index would have no effect on potential gains or losses. The effects of movements outside the collar were negated by strategy of an early close out of the out-of-the-money cash-settled FTSE Option and the exercise of in-the-money cash settled FTSE Option when the Appellant was non-resident and not ordinarily resident. Mr Stanton's analysis of the various scenarios of movements in the FTSE 100 index demonstrated that each scenario produced a minimum loss of about £12 million on one of the cash settled Options. The variable gains or losses produced on the other Options were of no effect because of the tax saving strategies built into the scheme.

(12) The scheme was, therefore, guaranteed to deliver a loss of either around £24 million if there was no movement of the FTSE 100 Index outside the collar or around £12 million if the FTSE 100 Index moved in either direction beyond the collar, which the Appellant intended to claim as an allowable loss against the gain from the redemption of the loan notes.

(13) The plan to arrive at the stated destination of a guaranteed loss of either £12 million or £24 million was set out in PWC's letter of 13 February 2003. The plan consisted of a series of pre-ordained steps which involved taking a specific step on 4 April 2003 which was essential to ensure that the claimed loss happened in the same year of assessment as the realisation of the gain from the redemption of the loan notes. The other step was for the Appellant to become non-resident in the subsequent year of assessment, 2003/04, if the FTSE 100 Index moved outside the collar. The pre-ordained step on 4 April 2003 was either to close out all Options if the Index had not by then moved beyond the collar or if it had (as in fact did) to close out the two out-of-the-money Options, in which case the other two Options would be exercised on 7 April 2003. The Appellant asserted that although there was an expectation of an early close out on 4 April 2003, it was not certain because of the unpredictability of the outcomes. The Tribunal finds to the contrary, the outcomes on 4 April 2003 were known, which would be limited to three exhaustive possibilities, all beneficial to Appellant, and requiring either close out of all Options or of the two out-of-the-money Options. The only other variable concerned the non-resident status of the Appellant. The Tribunal decided on the evidence that the Appellant held a firm intention at the time of entering into the Options to live in Spain and to cease to be resident and ordinarily resident in the United Kingdom, an intention which was demonstrated by the fact that he took up residency in Spain on 29 March 2003.

(14) There was no logical reason for KBPB to depart from the script in the 13 February 2003 letter. The Bank in establishing the Appellant's arrangements eliminated any potential risks from the movement of the FTSE 100 Index. KBPB held total control over the arrangements which ensured that the Appellant danced to its tune. The Appellant could not take action under the arrangements unless he had KBPB's consent. The Bank had developed a specific financial product at the behest of PWC. The Tribunal is satisfied that KBPB would not jeopardise its professional and commercial relationship with PWC by departing from the script.

Finally Mr Hamilton-Ely confirmed that KBPB would have closed out the Options on 4 April 2003 provided the amounts payable on the Options were settled. Mr Hamilton-Ely knew that the structure of the scheme guaranteed that the Bank would effectively provide the Appellant with the wherewithal to settle the matching Option held by it.

(15) .The 13 February letter constituted the extent of the Appellant's understanding of the scheme. He did not comprehend the technical infrastructure of the scheme and relied entirely on his professional advisers. The Appellant's sole expectation from the scheme was that it would deliver losses to wipe out the capital gains from the redemption of loan notes. He did not enter the scheme for any commercial reason. The proposition that the Appellant would somehow follow a different course of action from that proposed in the 13 February letter was preposterous.

(16) The ISDA Master Agreement of 17 January 2003 governed the terms of the four Option contracts, and under the ISDA they constituted a single agreement.

(17) Clause 7 of the ISDA Master Agreement prohibited the assignment of the Options by their owner without the consent of the other party. In any event Mr Hamilton Ely accepted that it made no sense for the Appellant to assign his interest in the Options to a third party because of his exposure to the risk of finding gilts to the value of £370 million. The Appellant did not understand the concept of assignment, and completely unaware of the associated risks. The prospect of the Options being marketed or assigned separately to a third party was not a legal or practical proposition. It would not have happened.

(18) The Options were entered into on the same date and shared the same expiry date and all had a short lifespan of two months. They were all European Style Options which meant that no Option could be exercised early by one party without the consent of the other party and the Appellant was effectively locked into the arrangements. The strike price for all four Options was linked to the FTSE 100 Index.

(19) On 4 April 2003 the Appellant and KBPB agreed to close out the out-of-the- money cash-settled FTSE put Option (Option One) and the corresponding Gilt put Option (Option Three), whilst the call Options (options Two and Four) were exercised on 7 April 2003. This was one of the three scenarios contemplated in the PWC letter dated 13 February 2003. As a result the Appellant submitted his tax return for the year ended 5 April 2003 to HMRC in which he showed a quantified loss of £11,305,017 deducted from a gain of £10,726,438.