*Meaning of "beneficial entitlement", "Group Relief" "Consortium Relief".*
*Section 403C and sch 18 Taxes Act 1988*

*[2014]UKUT 0262 (TCC)*

**BEFORE THE UPPER TRIBUNAL** **FTC/27/2013**
**(TAX AND CHANCERY CHAMBER)**

**B E T W E E N :**

**BUPA INSURANCE LIMITED**

Appellant

**- and -**

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

Respondents

**TRIBUNAL: The Hon Mrs Justice Asplin and Judge Julian Ghosh QC**

**Sitting in public at Rolls Building, Royal Courts of Justice, Fetter Lane, London EC4A 1NL on 25 and 26 March 2014**

**Jonathan Peacock QC and John Brinsmead-Stockham** (instructed by **Slaughter and May**) for the **Appellant**

**Richard Bramwell QC** (instructed by the **General Counsel and Solicitor to HM Revenue and Customs**) for the **Respondents**

## Introduction

1. This appeal concerns the meaning of "beneficial entitlement". In particular, it concerns whether a corporate shareholder, which receives a distribution on shares it holds in a subsidiary company is deprived of a "beneficial entitlement" to that distribution by reason of a contractual obligation to pay an equivalent sum to another party. We set out the relevant statutory context below.

## The Facts

2. Mr Peacock QC, who appeared for Bupa Insurance Ltd ("Bupa Insurance") and Mr Bramwell QC, who appeared for The Commissioners for Her Majesty's Revenue and Customs ("HMRC") prepared a Statement of Agreed Facts and Issues. We have annexed this to our Decision as a Schedule.

3. The facts which are relevant to the appeal are as follows: at the material times, CX Reinsurance Company Limited ("CX Re") was a UK tax resident and UK incorporated limited company. CX Re carried on a trade of reinsurance. At the material times, CX Re was "*in run-off*", meaning that it had stopped writing new reinsurance contracts, so that its trade consisted of carrying out its reinsurance contracts and managing its portfolio of investments. At all material times CX Re's functional currency was US dollars. And at all material times, CX Re had no profits available for distribution.

4. Prior to 20th March 2006, CX Re was a 100% subsidiary of Tawa UK Limited (now Tawa Plc; "Tawa"). On 20th March 2006, Tawa sold part of its shareholding to two individuals, Mr Paul Jardin and Mr Philip Marcell. On 21st March 2006, Tawa sold a further part of its shareholding to Bupa Finance plc (Bupa Finance") and Nationwide Building Society ("Nationwide"). Under the Share Purchase Agreement of 21st March 2006 ("the SPA"), Bupa Finance acquired 46.18% of the ordinary "A" shares in CX Re (Nationwide acquired 41.17% of ordinary "A" shares and Tawa retained 12.65% of ordinary "A" shares in CX Re). Bupa Finance's "A" shares in CX Re entitled Bupa Finance to receive 46.18% of every distribution made by CX Re on the "A" shares. Bupa Finance and Nationwide also acquired certain "B" shares in CX Re which are not relevant to this appeal. Bupa Finance and Nationwide held the shares they acquired in CX Re as investments and not on trading account.

5. The terms under which Bupa Finance acquired its shares in CX Re, from Tawa, were important. In particular, the consideration clause, at Clause 3, provided as follows:-

> "*3.1 The purchase price shall be the aggregate of:*
>
> *3.1.1 the Initial Consideration, which shall be $1.00 … and*
>
> *3.1.2 the Earn-Out Consideration, which shall be calculated and shall be payable … in accordance with Clause 3.2.*

> 3.2 *This clause sets out how the Earn-Out Consideration shall be calculated and when it is payable.*
>
> 3.2.1 *For the purposes of this Clause 3.2:*
>
> (a) *"**Distribution**" means:*
>
> (i) *the aggregate amount of any lawful distribution of the profits of [CX Re] from time to time; and*
>
> (ii) *the aggregate amount of any lawful distribution of capital of [CX Re] (including the distribution of capital pursuant to a capital reduction which would result in the repayment of capital, the repurchase of shares in [CX Re], the winding up of [CX Re] or any analogous process) from time to time.*
>
> 3.2.2 *At any point in time at which any Distribution is made by [CX Re] to its Shareholders [including Bupa Finance], [CX Re] shall immediately notify [the Seller, Tawa] of the amount of the Distribution... Within ten Business Days of receipt of such notification ... each Purchaser [including Bupa Finance] shall pay an amount to the Seller [Tawa] in respect of the Earn-Out Consideration as is equal to [100% of the Distribution up to $171 million, "the Benchmark Amount" and 95% thereafter].*"

Any corporation tax "*due and paid or estimated ... to be due and payable ... in respect of the Distribution (if any)*" paid to either purchaser, that is, Bupa Finance or Nationwide, reduced, to that extent, the sum payable as Earn-Out Consideration under Clause 3.2.2.

6. Thus Bupa Finance was obliged to pay Tawa an amount equal to any distribution (income or capital) made by CX Re, as "Earn-Out Consideration", within 10 Business Days of the distribution being made. Once the "Benchmark Amount" of $171 million had been reached, the Earn-Out Consideration reduced to 95% of any further distribution.

7. Clause 3.4 further provided that Tawa, as Seller under the SPA, had the right to require the Purchasers, Bupa Finance and Nationwide, "*to meet with [the Seller, Tawa] for the purposes of negotiating and agreeing the terms of an Escrow*

*Agreement for the Distributions (the "Distribution Escrow Agreement").*" The Distribution Escrow Agreement included a term that Bupa "*... irrevocably direct [CX Re] to pay all Distributions which are payable in respect of [the shares acquired by Bupa Finance from Tawa], directly to [a specified] Distribution Escrow Account.*" (Clause 3.4.4). It is common ground that Tawa did not, at any of the material times, exercise its right to require the establishment of any Distribution Escrow Agreement.

8. For its accounting period ended 31st December 2006 (which was a short accounting period which commenced on 21st March 2006), CX Re had trading losses of US $474,876,681, which mainly consisted of carried forward losses. Under the terms of an election made by CX Re under the Finance Act 2000, Section 107(4), the terms of which are not material to this appeal, such losses were treated as losses which arose for the accounting period ended 31st December 2006. The parties agree that these trading losses were available for group (and consortium) relief.

9. Tawa had commissioned a report from the Tawa Group actuaries to determine the projected surplus that would be generated, following the CX Re share sale, by the run-off of CX Re. The report concluded that there was a 52% probability of the surplus from the run-off of CX Re's business exceeding the Benchmark Amount (US $171 million) and that Bupa Finance and Nationwide would receive a return on their Initial Consideration of US $1.

10. No dividends (and therefore no "Distributions", within Clause 3.2 of the SPA) were paid at any of the material times, since CX Re had no profits available for distribution at those times.

11. Finally, Bupa Insurance was, at all material times, a 100% subsidiary of Bupa Finance. Bupa Finance and Bupa Insurance were within the same "group" for the purposes of the Income and Corporation Taxes Act 1988 ("TA 1988"), Section 413(3), the relevance of which we set out below.

**<u>Preliminary Point: Whether Bupa Finance had a sole tax avoidance purpose in acquiring shares in CX Re</u>**

12. During the course of Mr Bramwell's oral submissions, Mr Bramwell advanced a submission that Bupa Finance had a sole "tax avoidance" purpose (we consider what this might mean, in the context of this appeal, below) in acquiring the 46.18% of the ordinary shares in CX Re from Tawa. Mr Peacock maintained that Bupa Finance did have non-tax reasons for its acquisition of shares in CX Re. More fundamentally, Mr Peacock objected to Mr Bramwell taking this point at all.

13. We are satisfied that Mr Bramwell was not entitled to advance this proposition, which would have entailed us making a finding of fact, in this appeal.

14. Firstly, we observe that it is not immediately apparent that at the material times, the acquisition of shares in a loss-making company to take the benefit of its losses was considered by Parliament to be "tax avoidance" in any relevant sense. Furthermore, an invitation to ignore Bupa Finance's acquisition of shares in CX Re is at first sight

contrary to HMRC's acceptance that Bupa Finance did have "beneficial ownership" of its shares in CX Re and that the only issue between the parties was whether Bupa Finance had a "beneficial entitlement" to any distributions made to it by CX Re.

15. Secondly, the determination of Bupa Finance's purpose in acquiring shares in CX Re is a matter of evidence. The documentary evidence (certain Board Minutes of Tawa and the report commissioned by Tawa, to which we refer above) referred to by the parties is not at all adequate to allow us to determine Bupa Finance's purpose in its acquisition of Shares in CX Re, since the Board Minutes and the report commissioned by Tawa refer to both the value of CX Re's losses and the prospect of Bupa Finance achieving an overall (non-tax) commercial benefit on the CX Re shares it was to acquire. We cannot tell whether the prospect of the non-tax commercial benefit formed part of Bupa Finance's purpose in acquiring the CX Re shares or whether this commercial prospect was merely a welcome incidental by-product of the acquisition of the CX Re shares. Even had we wished to, we could not have made a finding of fact that Bupa Finance had a sole tax avoidance purpose in acquiring the shares which would yield a non-tax monetary benefit to Bupa Finance. Thus further (presumably oral) evidence is required for us to make a finding one way or the other as to whether Bupa Finance had a sole tax avoidance purpose in acquiring shares in CX Re. This would, in turn, require either a remitter to the First-tier Tribunal or for the parties to make an application to lead evidence before us in the Upper Tribunal. No such application was made. And in any event either course would be inappropriate.

16. Thirdly, there are formidable procedural obstacles to Mr Bramwell's submission. This appeal was designated a "lead case". Directions to this effect were issued (see Direction 2) on 6 September 2012. Direction 4 clearly specifies that the only issue in dispute was whether or not Bupa Finance was "beneficially entitled" to distributions made by CX Re. This issue, as framed, does not require us to consider any tax avoidance motive or purpose on Bupa Finance's part. It would be highly surprising if it did, since if the issue between the parties turned on a finding of fact, it could not possibly bind all of the other appeals which stand behind this lead case, at least without agreement that the same finding of fact applies to them (which, without evidence, makes no sense at all).

17. Furthermore, this appeal was transferred so as to be heard directly by the Upper Tribunal under Rule 28 of the FTT (Tax Chamber) Rules. Although there is no absolute bar upon fact-sensitive cases to be transferred to the Upper Tribunal, the procedure is generally (but not always) inappropriate for such cases.

18. Fourthly, prejudice arises to the Appellant, if we accept Mr Bramwell's invitation to make a finding of fact as to Bupa Finance's purpose in acquiring shares in CX Re (we remind ourselves that it is Bupa Insurance which is the Appellant and Mr Bramwell's submission relates to bupa Finance, its parent company). We observe that at no stage, either in the joint application which led to the designation of this case as a lead case, or in the joint application for the transfer of this case to the Upper Tribunal, is there any record of HMRC having advanced a proposition that Bupa Finance's acquisition of its shares in CX Re was motivated by a sole tax avoidance purpose. For the reasons given above, any such submission would likely have prevented this case from

being designated as either a lead case or from its transfer from the First-tier to the Upper Tribunal.

19. Indeed, there is absolutely no mention made (at all) in HMRC's Statement of Case as to any allegation of a sole tax avoidance purpose on the part of Bupa Finance in acquiring shares in CX Re. Neither is any such allegation made in HMRC's Skeleton Argument. The first time it was advanced was in the course of Mr Bramwell's oral submissions, in response to Mr Peacock's opening submissions on the second day of the hearing. As Mr Peacock pointed out, the transfer of this case to the Upper Tribunal deprived Bupa Insurance's representatives of the opportunity to lead evidence as to Bupa Finance's purposes in acquiring its shares in CX Re. There is self-evident prejudice in inviting us, sitting as the Upper Tribunal, to make a finding of fact when no notice has been given of the point HMRC wished to advance in HMRC's Statement of Case, or in its Skeleton Argument.

20. It is inappropriate to mount this sort of "ambush" in the Upper Tribunal. For completeness, we also record (we make further reference to this below) that it was unclear to us as to what part the notion of "sole tax avoidance purpose" played in HMRC's submissions in this case.

21. We therefore reject Mr Bramwell's submission that Bupa Finance had a sole tax avoidance purpose in acquiring the shares it did in CX Re. We find that he is not entitled to make this submission.

## The Statutory Context of this Appeal

22. This appeal concerns a claim for "consortium relief" by Bupa Insurance. We set out a broad summary of the nature of such a claim below.

### *The Statutory Framework: "Group Relief" and "Consortium Relief"*

23. TA 1988, Part X, Chapter IV, entitles certain companies to participate in "group relief", whereby one company ("the surrendering company") may surrender losses attributable to a particular accounting period to another company ("the claimant company"), on the making of a claim by the claimant company. The surrendered losses relieve the claimant company's profits from corporation tax. Losses which may be so relieved are specified in TA 1988, Section 403(1) and include trading losses: Section 403(1)(a). It is common ground in this appeal that CX Re's trading losses fall within Section 403(1)(a) and that CX Re had sufficient trading losses to satisfy Bupa Insurance's claim for "consortium relief", which is a form of "group relief" (see below).

24. "Group relief" has two forms. Where a "surrendering company", with trading losses (or other eligible losses), and a "claimant company", with otherwise taxable profits, are within the same "group", that is, one is a "75% subsidiary" of the other, or, alternatively, both companies are 75% subsidiaries of a third company, the claimant company may make a "group claim". A group claim allows the surrendering company to surrender its trading losses (or other amounts eligible for relief) to the

claimant company: TA 1988, Section 402(1), (2), section 413(3). A company, or any body corporate, is a "75%" subsidiary of the other "*if and so long as not less than 75% of its ordinary share capital is owned directly or indirectly by that other body corporate*": TA 1988, Section 838(1)(b).

25. "Consortium relief" (which is the relief which is relevant to this appeal) is a form of "group relief" (see TA 1988, section 402(3), which expressly terms consortium relief as "group relief" which is available for members of a "consortium", as opposed to a "group") where a trading company is "*owned by [a] consortium*" and is not a "75% subsidiary" of any single company: TA 1988, Section 402(3). There are other circumstances in which consortium relief is available which are not relevant to this appeal. A company is "*owned by a consortium*" if "*three-quarters or more of [its] ordinary share capital* [relevantly defined in TA 1988, section 832(1)] ... *is beneficially owned between ... companies of which none beneficially owns less than one-twentieth of that capital*": TA 1988, Section 413(6). The companies which together beneficially own 75% or more of the trading company's ordinary shares are the "*members of the consortium*": TA 1988, Section 413(6).

26. In this appeal, it is common ground that CX Re is a "trading company". It is also common ground that the shares owned by each of Bupa Finance, Nationwide and Tawa are both "*ordinary shares capital*" within TA 1988 section 832 and "*ordinary shares*" within TA 1988, Schedule 18, paragraph 1(2). And it is common ground that those shares are "beneficially owned" by the "members of the consortium", comprising Bupa Finance, Nationwide and Tawa.

*Extension of consortium relief to "group members" of the members of the consortium: Bupa Insurance's right to make a consortium claim*

27. The ability of a "member of a consortium" to make a "consortium claim" is extended by TA 1988, Section 402(3) and 406 to companies which are within the same "group" as a member of the consortium (a "group member"). A "group member" of a member of a consortium may only make a consortium claim to the extent that the member of the consortium is entitled to make a consortium claim: TA 1988, Section 406(1), (2). Where a "group member" of a member of a consortium makes a consortium claim, the member of the consortium whose right to make a claim is extended under section 402(3) is termed a "link company" and the trading company owned by the consortium is termed "a consortium company": see TA 1988, Section 406(1), (2).

28. Here, it is common ground that Bupa Finance is a "link company" and that Bupa Insurance is a "group member", in relation to Bupa Finance. It is also common ground that if (but only if) Bupa Finance is entitled to make a consortium claim, so as to accept a surrender of CX Re's trading losses, Bupa Insurance is also entitled to do so. In fact Bupa Insurance did make such a consortium claim, which is why Bupa Insurance is the Appellant in this appeal, rather than Bupa Finance. But Bupa Insurance's right to make a consortium claim is dependent on Bupa Finance's right to make such a claim. Thus, although Bupa Insurance is the Appellant in this case, it is Bupa Finance's ability to make a consortium claim which we must scrutinise.

*Mechanics and Quantum of a Consortium Claim*

29. In making a consortium claim, one must first identify the "overlapping period", which is common to the claimant company's accounting period ("the claim period") and the surrendering company's accounting period: TA 1988, Section 403A(1)(a) and (8). It is common ground that the "overlapping period" for the purposes of Bupa Insurance's consortium claim is identical to CX Re's accounting period which ran from 21 March 2006 to 31 December 2006. One then ascertains the surrendering company's available losses ("the unused part of the surrenderable amount for the overlapping period") which may be surrendered by way of consortium relief and the profits of the claimant company which may be sheltered ("the unrelieved part of the claimant company's total profits for the overlapping period"): Section 403A(1). The "the unused part of the surrenderable amount" which can relieve the "unrelieved part of the claimant company's total profits for the overlapping period" is defined in Section 403A(2). Section 403A(4) to (6) contain rules which prevent double counting of losses for the purposes of group and consortium relief. Section 403A(7) contains rules which determine the order in which claims are deemed to be made. The attribution of the unused part of a surrenderable amount and the unrelieved part of a claimant company's total profits is made under Section 403A(3) and Section 403B.

*Limitation of Consortium Relief: The "Relevant Fraction"*

30. We now turn to the provisions which are the subject-matter of this appeal. The amount by which a claimant company's profits may be relieved by surrendered losses by consortium relief is limited to the "relevant fraction" of the surrenderable amount. Section 403C(2) provides as follows:-

> "***403C Amount of relief in consortium cases***
>
> *(1) In the case of a consortium claim the amount that may be set off against the total profits of the claimant company is limited by this section.*
>
> *(2) Where the claimant company is a member of the consortium, the amount that may be set off against the total profits of that company for the overlapping period is limited to the relevant fraction of the surrenderable amount.*
>
> *That fraction is whichever is the lowest in that period of the following percentages -*
>
> *(a) the percentage of the ordinary share capital of the surrendering company that is beneficially owned by the claimant company;*
>
> *(b) the percentage to which the claimant company is beneficially entitled of any profits available for distribution to equity holders of the surrendering company; and*

> (c) *the percentage to which the claimant company would be beneficially entitled of any assets of the surrendering company available for distribution to its equity holders on a winding-up.*
>
> *If any of those percentages have fluctuated in that period, the average percentage over the period shall be taken.*
>
> (3) *Where the surrendering company is a member of the consortium, the amount that may be set off against the total profits of the claimant company for the overlapping period is limited to the relevant fraction of the claimant company's total profits for the overlapping period.*
>
> *That fraction is whichever is the lowest in that period of the following percentages –*
>
> (a) *the percentage of the ordinary share capital of the claimant company that is beneficially owned by the surrendering company;*
>
> (b) *the percentage to which the surrendering company is beneficially entitled of any profits available for distribution to equity holders of the claimant company; and*
>
> (c) *the percentage to which the surrendering company would be beneficially entitled of any assets of the claimant company available for distribution to its equity holders on a winding-up.*
>
> *If any of those percentages have fluctuated in that period, the average percentage over the period shall be taken ...*
>
> (6) *Schedule 18 has effect for supplementing this section.*"

31. TA 1988, Schedule 18, which supplements Section 403C (see Section 403C(6)) provides, relevantly, as follows:-

> "***SCHEDULE 18***
>
> ***GROUP RELIEF: EQUITY HOLDERS AND PROFITS OR ASSETS AVAILABLE FOR DISTRIBUTION***

*... **2-** (1)* *Subject to the following provisions of this Schedule, for the purposes of [sections 403C …] the percentage to which one company is beneficially entitled to any profits available for distribution to the equity holders of another company means the percentage to which the first company would be so entitled in the relevant accounting period on a distribution in money to those equity holders of –*

*(a)* *an amount of profits equal to the total profits of the other company which arise in that accounting period (whether or not any of those profits are in fact distributed); or*

*(b)* *if there are no profits of the other company in that accounting period, profits of £100;*

*and in the following provisions of this Schedule that distribution is referred to as "the profit distribution" ...*

***3-*** *(1)* *Subject to the following provisions of this Schedule, for the purposes of [sections 403C …] the percentage to which one company would be beneficially entitled to any assets of another company available for distribution to its equity holders on a winding-up means the percentage to which the first company would be so entitled if the other company were to be wound up and on that winding-up the value of the assets available for distribution to its equity holders (that is to say, after deducting any liabilities to other persons) were equal to –*

*(a)* *the excess, if any, of the total amount of the assets of the company, as shown in the balance sheet relating to its affairs as at the end of the relevant accounting period, over the total amount of those of its liabilities as so shown which are not liabilities to equity holders as such; or*

*(b)* *if there is no such excess or if the company's balance sheet is prepared to a date other than the end of the relevant accounting period, £100.*

*(2) In the following provisions of this Schedule a winding-up on the basis specified in sub-paragraph (1) above is referred to as "the notional winding-up" ...*

...

***6*** *For the purposes of [sections 403C ...] ... above –*

*(a) the percentage to which one company is beneficially entitled of any profits available for distribution to the equity holders of another company, and*

*(b) the percentage to which one company would be beneficially entitled of any assets of another company on a winding-up,*

*means the percentage to which the first company is, or would be, so entitled either directly or through another body corporate or other bodies corporate or partly directly and partly through another body corporate or other bodies corporate.*"

32. So having identified the "members of the consortium" and "the consortium company" whose shares they (together) beneficially own (TA 1988, section 402(3), section 406, section 413(6)), and then extending the prospect of consortium relief to "group members", the draftsman then, in Section 403C, restricts the quantum of consortium relief available (in this case, in relation to Bupa Finance and hence to Bupa Insurance) by the mechanics contained in Section 403C and Schedule 18 to the "relevant fraction", being the lowest percentage of the consortium member's (Bupa Finance):-

"beneficial ownership" of the consortium company's (CX Re) "ordinary share capital" (Section 403C(2)(a));

"beneficial entitlement" to its share of the "profits available for distribution" of the "consortium company's" (CX Re) distributable profits, postulated by TA 1988, Schedule 18, paragraph 2. In fact, Schedule 18, paragraph 2 postulates a notional distribution ("the profit distribution") by calculating the profits available for distribution and ascertaining the "beneficial entitlement" of each "equity holder" (equity holder" is defined as, *inter alia*, the holder of ordinary shares: Schedule 18, paragraph 1; it is common ground that Bupa Finance, as holder of the "A" ordinary shares in CX Re is an "equity holder" for the purposes of Section 403C(2)(b)); if the consortium company, with surrenderable losses, has no profits available for distribution for the "overlapping period", a notional distribution of £100 (this notional distribution appears to be restricted to a cash distribution) is postulated and the "relevant fraction" is calculated by the percentage of that notional £100 to which the "equity holder" (here Bupa Finance) is "beneficially entitled" (section 403C(2)(b)).

> The "beneficial entitlement" of each "equity holder" to the consortium company's assets on a "notional winding-up" postulated by section 403C(2)(c). If the consortium company, with surrenderable losses, has no assets available for distribution for the "overlapping period", a notional (cash) distribution of £100 is postulated and the "relevant fraction" is calculated by the percentage of that notional £100 to which the "equity holder" (here Bupa Finance) is "beneficially entitled" .

33. Fluctuating entitlements within an accounting period are averaged out: see the tailpiece to Section 403C(2).

34. "Beneficial entitlement", for the purposes of the "profit distribution" in Schedule 18, paragraph 2 (which is the term we must construe in this appeal) and the "notional winding-up" in Schedule 18, paragraph 3 is defined in Schedule 18, paragraph 6 as a direct or indirect beneficial entitlement.

35. TA 1988, Schedule 18 contains further provisions which may apply to reduce a company's "beneficial entitlement" to distributions on the notional "profit distribution" governed by paragraph 2 and the "notional winding-up" governed by paragraph 3. Shares or securities which carry rights which are "*limited by reference to a specified amount or amounts"* are ignored (by being treated as if waived)" (paragraph 4); alterations to share rights are anticipated, so they are treated as if share rights which are to change in the future had already occurred (and any "arrangements" for such share rights to change had been already effected): paragraph 5; "option arrangements" which may alter the percentage of profits to which shareholders are entitled on the "profit distribution", or to assets on the "notional winding-up" are treated as having been effected (paragraph 5B). If any of these assumptions have the effect of reducing the percentage of profits to which a shareholder is beneficially entitled under the "profit distribution" under paragraph 2, or the "notional winding-up" under paragraph 3, the reduced "beneficial entitlement" is the relevant percentage for the purposes of Section 403C (which, of course, means, in turn, that the "relevant fraction" is reduced, thus further restricting the quantum of consortium relief available under Section 403C).

36. There is no reference in any of the provisions of Section 403C , or Schedule 18, to the "purpose" of a consortium member (or a group member) in holding ordinary shares of the consortium company, or otherwise, as being relevant to obtaining consortium relief.

**<u>The Parties' Submissions</u>**

37. The parties' submissions concerned whether Bupa Finance's contractual obligation to pay the Earn-Out Consideration to Tawa under Clause 3.2 of the SPA affected Bupa Finance's "beneficial entitlement" to any distribution (actual or notional, as postulated by TA 1988, Schedule 18, paragraph 2) made by CX Re to Bupa Finance. Mr Peacock said that the answer was "no" and so Bupa Finance (and thus Bupa Insurance) was entitled to consortium relief in respect of CX Re's losses. Mr Bramwell said "yes", so that consortium relief was denied.

## **The Appellant's Submissions**

38. Mr Peacock's primary submission was that "beneficial entitlement" in Section 403C(2)(b) was synonymous with a right to acquire an "equitable interest" as a matter of English Private Law. Mr Peacock acknowledged that no distributions had been made at the material times, since CX Re had no profits available for distribution at those times. But, said Mr Peacock, applying the notional distribution of £100 in TA 1988, Schedule 18, paragraph 2, CX Re would have acquired equitable ownership of 46.18 of that £100 and thus a "beneficial entitlement" to that amount for the purposes of Section 403C(2)(b). Mr Peacock submitted that, as a matter of authority, *J Sainsbury plc v O'Connor* [1991] STC 318 ("*Sainsbury*") was, at least on one view, binding authority for the proposition that "beneficial entitlement" was synonymous with "equitable ownership". No other party, according to Mr Peacock, certainly not Tawa (which was entitled to the payment of the Earn-Out Consideration) would acquire any equitable interest in a distribution made by CX Re in relation to shares held by Bupa Finance.

39. Alternatively, Mr Peacock submitted that any proprietary interest which amounted to more than a "mere legal shell" amounted to a "beneficial entitlement" within Section 403C(2)(b). Mr Peacock relied on *Wood Preservation Ltd v Prior* 45 TC 112 ("*Wood Preservation*") and *Sainsbury* for this proposition. Bupa Finance, said Mr Peacock, had more than a "mere legal shell" in respect of any entitlement to distributions made by CX Re. It was open to Bupa Finance to expend the receipts of any such distribution as it wished. Of course, it is true that Bupa Finance had a contractual obligation to pay an equivalent amount (up to the Benchmark Amount and 95% thereafter) to Tawa as Earn-Out Consideration but that could have been funded howsoever Bupa Finance wished. And even if the Earn-Out Consideration had to be funded out of the proceeds of any distribution, said Mr Peacock, since there was a 10 day gap between Bupa Finance receiving any such distribution and the requirement for Bupa Finance to pay the Earn-Out Consideration to Tawa, Bupa Finance would be entitled to any interest yielded by, say, putting the distribution proceeds on deposit. Bupa Finance would also be entitled to the benefits of any foreign exchange fluctuations and be exposed to any foreign exchange loss (bearing in mind that CX Re's functional currency was the US dollar, whereas Bupa Finance's functional currency was sterling). Bupa Finance was entitled to assign its right to distributions (nothing in the SPA, nor in the Memorandum or Articles of CX Re prohibited this; we assume that this right was thought by Tawa not to frustrate Bupa Finance's obligations under Clause 3.2 and we record that Mr Bramwell did not quarrel with Mr Peacock's submission as to Bupa Finance`s right to assign the benefit of any distribution; we therefore take this to be common ground). All this, submitted Mr Peacock, amounted to far more than a "mere legal shell" so far as Bupa Finance's rights, qua owner of shares in CX Re, to any distributions on those shares was concerned. Thus, even on this alternative basis, Mr Peacock maintained that Bupa Finance had the requisite "beneficial entitlement" to any distributions in respect of its shares in CX Re and thus satisfied Section 403C(2)(b).

40. Mr Peacock characterised HMRC's submission, that Bupa Finance's contractual obligation to pay the Earn-Out Consideration to Tawa deprived Bupa Finance, to that extent, of a "beneficial entitlement" to distributions from CX Re as absurd, since this

meant that any contractual obligation to fund liabilities out of distributions would result in a loss of beneficial entitlement to such distribution and hence to a loss, to that extent, of consortium relief (or indeed to group relief as between companies within a 75% "group": see above). Mr Peacock said there was no intelligible policy reason for such a result.

41. Further, Mr Peacock submitted that nothing in the case-law which required tax provisions to be construed purposively, affected his submissions. Mr Peacock accepted that all tax provisions, including Section 403C(2)(b), should be construed purposively. But, said Mr Peacock, such purposive construction required an examination of the relevant text of the provisions under scrutiny (here Section 403C(2)(b)), their legislative context and Parliament's intention in enacting those provisions. None of these considerations suggested that a contractual obligation to pay a sum of money of an amount equal to a distribution should deprive the recipient of that distribution of a "beneficial entitlement" to the distribution.

42. We also record that Mr Peacock identified what is perhaps an anomaly in HMRC's submissions, in that Clause 3.2 of the SPA required Bupa Finance to pay Earn-Out Consideration of an amount equal to any distribution, whether that distribution was an income distribution or a capital distribution. A capital distribution might arise on a purchase of own shares by CX Re, or its liquidation. Thus said Mr Peacock, if HMRC were correct to submit that Bupa Finance's contractual obligation to pay Earn-Out Consideration under Clause 3.2 of the SPA deprived Bupa Finance of a "beneficial entitlement" to any income distribution on the "profit distribution" contained in section 403C(2)(b) (as supplemented by Schedule 18, paragraph 2), the same must also be true of any capital distribution on a winding-up, which ought, in turn, to mean that Bupa Finance had no relevant beneficial entitlement within Section 403C(2)(c) in relation to the notional winding-up. It was, therefore, said Mr Peacock, inherently contradictory for HMRC to identify the sole issue as whether Bupa Finance's contractual obligation to pay Earn-Out Consideration to Tawa infringed Section 403C(2)(b) and yet seemingly accept that Section 403C(2)(c) was not infringed.

43. It is convenient for us to dispose of this last point at this stage. Certainly, to the extent that CX Re's assets comprised cash on a liquidation of CX Re, Mr Peacock seems to be right that it is contradictory for HMRC to complain that Bupa Finance's obligation to pay Earn-Out Consideration under Clause 3.2 of the SPA deprived Bupa Finance of a beneficial entitlement to income distributions for the purposes of section 403C(2)(b) but to accept that Bupa Finance did have a beneficial entitlement to CX Re's assets on the notional distribution for the purposes of Section 403C(2)(c), since any cash receipts on a capital distribution would give rise to an obligation on the part of Bupa Finance to pay an equivalent amount as Earn-Out Consideration to Tawa. Different considerations may apply (we express no concluded view on this) to the extent that a capital distribution of non-cash assets was made by CX Re, whether on a liquidation or otherwise. Be that as it may, all that needs to be said on the matter is that if HMRC's submissions are correct as to Section 403C(2)(b), that is sufficient for this appeal to fail and what is admittedly a contradiction in HMRC's submissions in relation to capital distributions is neither here nor there.

**HMRC's Submissions**

44. Mr Bramwell maintained that Bupa Finance's contractual obligation to pay Earn-Out Consideration to Tawa under Clause 3.2 of the SPA deprived Bupa Finance of any beneficial entitlement to the distribution. As cash was fungible, according to Mr Bramwell, it made no difference whether Bupa Finance's contractual obligation under Clause 3.2 was to pay an amount equal to the distribution received or had been expressed as requiring Bupa Finance to pay on, to Tawa, the very distribution it received. The 10 day period between receipt and any payment of Earn-Out Consideration was neither here nor there, said Mr Bramwell. Bupa Finance could not be said to enjoy the receipt of any distribution from CX Re in any meaningful sense. This demonstrated, said Mr Bramwell, that the consortium was (in Mr Bramwell's words, which we quote, to do his submissions no disservice) "*not the sort of consortium that Parliament wished to be the subject of consortium claims*". It did not matter, according to Mr Bramwell, where (if anywhere) "beneficial entitlement" lay in relation to any distribution made by CX Re: it did not lie with Bupa Finance. Purposively construed, Section 403C(2)(b) excluded rights such as those held by Bupa Finance in respect of distributions from CX Re, which were subject of the contractual obligation to pay Earn-Out Consideration under Clause 3.2 of the SPA, from the notion of "beneficial entitlement". Mr Bramwell relied on *Carreras Group Ltd v Stamp Commissioner* [2004] STC 1377 ("*Carreras*") and *IRC v Scottish Provident Institution* [2005] STC 15 ("*SPI*") for this approach.

45. Furthermore, as a matter of authority Mr Bramwell submitted (Mr Bramwell relied in particular on *Wood Preservation*) that "beneficial entitlement" was not, on any view, a synonym for "equitable ownership".

46. And finally, as we have observed above, Mr Bramwell submitted, in the course of his oral observations, that the purposive construction of tax statutes required any transaction effected for a solely tax avoidance purpose to be ignored (and thus we should ignore Bupa Finance's acquisition of shares in CX Re). Mr Bramwell relied on *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 ("*Arrowtown*"). We have already observed that Mr Bramwell is not entitled to make any submissions as to Bupa Finance's purpose in acquiring its shares in CX Re. But we give our reasons below as to why Mr Bramwell's proposition is also misconceived as a matter of law.

**Discussion and Conclusion**

47. We are in no doubt that Bupa Finance's contractual obligations under Clause 3.2 to pay Earn-Out Consideration to Tawa did not deprive Bupa Finance of "beneficial entitlement" to any distribution (actual or notional) made by CX Re, for the purposes of TA 1988, section 403C(2)(b).

**The purpose and nature of the consortium relief provisions**

48. In order to construe the term "beneficial entitlement" in Section 403C(2)(b), we must identify the nature and purpose of the provisions contained in Section 403C.

49. The purpose of the group relief provisions and thus the consortium relief provisions (since consortium relief is merely a form of group relief: see above) is readily apparent from their terms. These provisions recognise a "*substantial measure of identity*" between surrendering companies with losses on the one hand and claimant companies with profits on the other, which identity is sufficient, so far as the draftsman is concerned, to permit the surrender of losses by the former to the latter. There is, in this statutory context, a "*piercing of the corporate veil* (*Wood Preservation* at 132D-E, per Lord Donovan; *Ayerst v C&K Construction Ltd* [1975] STC 345 ("*Ayerst*") at 347h, per Lord Diplock); these observations were made, in both cases, in the context of other provisions which permitted a transferor to transfer a trade and the benefit of historic trading losses to a subsidiary which the transferor "beneficially owned" but we consider that the draftsman's recognition of the "identity" required to engage the benefit of these provisions applies equally to group/consortium relief; certainly both parties relied on *Wood Preservation*, *Sainsbury* (which was concerned with group relief) and *Ayerst* as authorities which were directly relevant to this appeal.

50. As we have observed above, the draftsman of the consortium relief provisions sets out the conditions to establish the required level of "identity", or connection, for consortium relief to be available, at two levels:-

(i) The trading company ("the consortium company", here CX Re) must have a share capital "beneficially owned" by the "members of the consortium", as to at least 75% (TA 1988, Section 413(6)).

(ii) Then, as regards each consortium member, the quantum of relief available to each member is restricted by Section 403C (as supplemented by Schedule 18) to the lowest "relevant fraction" of the consortium member's "beneficial ownership" of ordinary share capital of the consortium company (Section 403C(2)(a)), its "beneficial entitlement" to income distributions made by the consortium company on the notional "profit distribution", (Section 403C(2)(b)) and its "beneficial entitlement" to the assets of the consortium company on a notional winding-up (Section 403C(2)(c)).

**The features of "beneficial ownership" and "beneficial entitlement"**

51. So far as section 403C is concerned, we consider the term "beneficial", as used by the draftsman in relation to the calculation of the "relevant fraction" under section 403C(2)(a) to (c), to have the same meaning in each of Section 403C(2)(a), (b) and (c). The draftsman of Section 403C(2)(a) to (c) has identified three connecting factors as between the consortium member and the consortium company, being the beneficial ownership of ordinary share capital in the consortium company, a beneficial entitlement to income distributions made by the consortium company and a beneficial entitlement to assets on a winding up of the consortium company. Each of Section 403C(2)(a) to (c) self-evidently has the same purpose, that is, to restrict consortium relief to the lowest proportionate share which the consortium member beneficially owns of each of these three connecting factors. Put another way, the relevant fraction calculated under Section 403C identifies the degree of "identity" between a consortium member and the consortium company by reference to these three

connecting factors and restricts consortium relief to the lowest degree of "identity" between the two companies. Incidentally, we agree with a submission made by Mr Peacock (with which Mr Bramwell did not quarrel) that the reason that the draftsman used the term "entitlement" in relation to a notional profit distribution in Section 403C(2)(b) and to assets of the notional winding up in Section 403C(2)(c) rather than "ownership" is that the draftsman was, in relation to the profit distribution and notional winding-up, referring to (notional) future events rather than to a present state of affairs (the ownership of shares), in relation to which the term "ownership" is more apt. Thus any reference we make to "beneficial ownership" (in the context of construing Section 403C) is also a reference to a "beneficial entitlement" and the authorities we consider below which examine the notion of beneficial ownership in the context of the group relief provisions apply equally to the term "beneficial entitlement".

52. The term "beneficial ownership" (in relation to ownership of the assets of a company) has been described as a "*term of legal art as descriptive of the proprietary interest in its assets of a company*" (Ayerst at 348a-b, per Lord Diplock). We consider that the following propositions as to the meaning of "beneficial entitlement" are good, given the text and purpose of the relevant provisions and the application of judicial authority.

53. Firstly, we consider that "beneficial entitlement" is not synonymous with an "equitable entitlement", as understood as a matter of English Private Law. This is clear from the text of Schedule 18, paragraph 6, which provides that:

> "*For the purposes of sections 403C … and paragraphs 2 to 5F above-*
>
> *(a) the percentage to which one company is beneficially entitled of any profits available for distribution to the equity holders of another company, and*
>
> *(b) the percentage to which one company would be beneficially entitled of any assets of another company on a winding-up,*
>
> *means the percentage to which the first company is, or would be, so entitled either directly or through another body corporate or other bodies corporate or partly directly and partly through another body corporate or other bodies corporate.*"

In other words paragraph 6 contemplates a "beneficial entitlement" for the purposes of Section 403C(2)(b) and (c) which can be held both "directly" or "through another body corporate". This shows, we consider, that "beneficial entitlement" is a wider concept than "equitable ownership" (in this specific respect but not for all purposes; see below). It is trite that one company has no proprietorial interest, as a matter of equity, in the assets of a subsidiary, let alone in the assets of a sub-subsidiary.

54. And since TA 1988, at the material times, applied throughout the United Kingdom (and in particular to Scotland) we consider it impossible that the draftsman intended the notion of "beneficial entitlement" to mean equitable ownership, since that concept is unknown in Scotland.

55. We should also say that judicial authority is clear and consistent that "beneficial ownership" and "equitable ownership" are different concepts in the context of the group/consortium relief provisions (and, contrary to Mr Peacock's submission, *Sainsbury* is not authority for the proposition that the two are the same). That the two concepts are different is clear from *Wood Preservation*, where "beneficial ownership" was construed without reference to equitable ownership at all and was rather equated to any ownership which amounted to more than a "mere legal shell" (see below) and *Sainsbury*, where, although the Court of Appeal preferred to equate "beneficial ownership" to "equitable ownership", (see *Sainsbury* at 325g, per Lloyd LJ and at 331b-d, per Nourse LJ), the Court of Appeal nevertheless (as it was bound to do) applied the "mere legal shell" test adopted in *Wood Preservation* (see *Sainsbury* at 328e-j, per Lloyd LJ and at 331j, per Nourse LJ; Ralph Gibson LJ agreed with both Lloyd LJ and Nourse LJ).

56. Secondly, in ascertaining whether or not a particular party has "beneficial ownership" of an asset (or a "beneficial entitlement" to distributions, or assets on a winding up) one looks at the party claiming beneficial ownership and asks whether it indeed beneficially owns the asset by applying the appropriate tests (see below): "*[O]ne must not look so much at whether beneficial ownership has reached the purchaser; one must examine the situation of the vendor and ask whether the legal ownership...retained the attributes of beneficial ownership...*" (*Wood Preservation* at 133H-134A, per Widgery LJ).

57. Thirdly, beneficial ownership may be in suspense. The most obvious example is property subject to a discretionary trust, where no party (neither the trustees, nor the beneficiaries) has beneficial ownership of the trust property (and see *Ayerst* at 349g to 350d, per Lord Diplock, for further examples of an executor administering an estate and a trustee in bankruptcy, where beneficial ownership is in suspense). However, it has been judicially recognised that a commercial contract for the sale of assets, such as land or shares, will not normally result in any suspension of beneficial ownership (*Sainsbury*, at 326b, per Lloyd LJ and at 331c-d, per Nourse LJ).

58. Fourthly, "beneficial" ownership, in the context of the group/consortium relief provisions, means ownership with "benefit" (*Wood Preservation* at 133, per Harman LJ).

59. Fifthly, at a slightly lower level of abstraction, critically, any incidents of ownership which amount to more than a "mere legal shell" amount, in the context of the group/consortium relief provisions, to "beneficial ownership". In particular, a right to dispose of an asset and enjoy its fruits confers "beneficial ownership" of that asset, whereas a complete absence of both rights "*bereft of the rights of selling or disposing or enjoying the fruits...*" (*Wood Preservation* at 132E, per Lord Donovan) deprives an owner of "beneficial ownership". So the seller of shares under a binding contract conditional only upon the purchaser obtaining the benefit of a commercial contract for

the company which was sold, which condition might only be waived by the purchaser, is deprived of beneficial ownership of the shares sold under the contract, because the seller could not, while waiting to see whether the condition was satisfied or waived, deal with the property; neither could it declare or pay a bonus on the relevant shares: "*the shares...were like a tree which the owner could not sell and could not cut down and of which he could enjoy none of the fruit*" (Wood Preservation at 132B-C, per Lord Donovan; the seller was "tied hand and foot"; at 133F, per Harman LJ). Similarly, a parent company of a subsidiary subject to a liquidation order is deprived of beneficial ownership of the shares in the subsidiary; custody and control of all of the subsidiary's property were, under the order, transferred to the liquidator and all power to deal with the subsidiary's assets passed to the liquidator (*Ayerst* at 348h-349b, per Lord Diplock). Thus the parent company was "[deprived] of all possibility of enjoying the fruits of [the subsidiary's shares] or disposing of it for [its] own benefit." (at 350e).

60. But so long as an owner has "*the right at least to some extent to deal with the property as [its] own*", the owner has "beneficial ownership" of that asset (*Wood Preservation* at 133D, per Harman LJ). Put another way, the legal owner must be bereft of "*all rights which would normally attach to [the asset]*" to be deprived of beneficial ownership of the asset (*Sainsbury* at 328g, per Lloyd LJ, emphasis added). So where a parent company's shares in a subsidiary are subject to a fixed price option, which meant that: (1) the parent company must obtain the option holder's consent before the parent might deal with the subsidiary's shares; (2) any dividend received by the parent company from the subsidiary reduced the price payable under the option; and (3) the parent company is deprived of any increase in value of the subsidiary if the option is exercised, the parent company nevertheless retains beneficial ownership of the shares in the subsidiary despite the existence of the (unexercised) option. The parent company, despite the option, "*retained almost all the rights which normally attach to shares...*" and the option did not deprive the parent company of "*all rights in relation to [the relevant shares]... pending the exercise of the [option]...*" (*Sainsbury* at 329 d-e, per Lloyd LJ). Since the rights of the parent company amounted to more than a "*mere legal shell...the ground on which the Court of Appeal held that the vendors in [Wood Preservation] were not the beneficial owners of the shares in question [did] not apply*" (*Sainsbury* at 329c). Thus any incidents of ownership which permit a dealing (even if the dealing requires the consent of another party) or the receipt of profits, qua owner, amounts to more than a "mere legal shell" and thus amounts to "beneficial ownership".

61. Sixthly (and finally), equitable ownership may be (but will not always) be sufficient to confer "beneficial ownership" on the *Wood Preservation* test, if the incidents of equitable ownership confer more than a "mere shell" of ownership rights to deal with and enjoy the fruits of the asset in question. And an equitable entitlement to call for an asset (or particular receipts) equally may confer a beneficial entitlement if the equitable rights, once exercised, confer a right to deal with and enjoy the fruits of the asset. However, if the equitable entitlement, once exercised, does not confer more than a "mere shell" of ownership rights in the asset, because for example, the owner is contractually bound to on-sell the asset to another party and forbidden to deal with it or to enjoy the fruits of the asset in the meantime, there is no "beneficial entitlement", within Section 403C(2)(b). In other words, it is the "more than a mere legal shell"

test which applies in each and every case to ascertain whether there is a "beneficial" right of ownership or entitlement, which rights in equity may or may not satisfy, depending on whether they confer a right to deal with and enjoy the fruits of the asset.

**The approach to construing tax statutes**

62. Having dealt with the purpose and nature of Section 403C and the authorities construing the notion of "beneficial ownership", we must consider the proper approach to the construction of Section 403C.

63. Of course statutes, including tax statutes, should be construed purposively: "*The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.*": Arrowtown, paragraph 35, per Ribeiro PJ.

64. The technique of the purposive construction of tax statutes, through the surrogate of the "*Ramsay* principle", was articulated as a series of 15 propositions by Lewison J (as he then was) in *Berry v HMRC* [2011] STC 1057 ("*Berry*") at 1067d-1069a. All of the propositions articulated by Lewison J are helpful in providing the mechanics by which purposive construction is to be undertaken. However, certain of the principles have particular relevance in this case and we set them out here (we set out the propositions in a slightly different order to that set out in *Berry* and thus the numbering is our own):-

(i) "*The [Ramsay] principle is twofold; and it applies to the interpretation of any statutory provision:*

*(a) to decide on a purposive construction exactly what transaction will answer to the statutory description; and*

*(b) to decide whether the transaction in question does so ...*".

(ii) "*In approaching the factual question whether the transaction in question answers the statutory description the facts must be viewed realistically ...*".

(iii) "*A realistic view of the facts includes looking at the overall effect of a composite transaction, rather than considering each step individually ...*".

(iv) "*Although the interpreter should assume that a statutory provision has some purpose, the purpose must be found in the words of the statute itself. The Court must not infer a purpose without a proper foundation for doing so. ...*".

(v) "*In seeking the purpose of a statutory provision, the interpreter is not confined to a literal interpretation of the words, but must have regard to the context and scheme of the relevant Act as a whole ...*"

(vi) “*However, the more comprehensively Parliament sets out the scope of a statutory provision or description, the less room there will be for an appeal to a purpose which is not the literal meaning of the words.*”

(vii) “*A provision granting relief from tax is generally (though not universally) to be taken to refer to transactions undertaken for a commercial purpose and not solely for the purpose of complying with the statutory requirements of tax relief ... However, even if a transaction is carried out in order to avoid tax it may still be one that answers the statutory description ... In other words, tax avoidance schemes sometimes work*”.

65. As we have recorded above, Mr Bramwell advanced a submission that any transaction effected solely for tax avoidance purposes was to be ignored and as Bupa Finance had acquired shares in CX Re solely for tax avoidance purposes, the shareholding should be ignored. Mr Bramwell relied on the judgment of Lord Millett in *Arrowtown*.

66. We hope that we do not weary the reader by repeating that we do not consider that Mr Bramwell is entitled to make that submission. And we record that we are unclear as to whether Mr Bramwell’s submission was in the alternative as to his other submissions as to why Bupa Finance’s contractual obligation to pay Earn-Out Consideration to Tawa deprived Bupa Finance of a beneficial entitlement to distributions made by CX Re, or whether the finding of a sole tax avoidance purpose on the part of Bupa Finance was critical to his submissions to engage a purposive construction of Section 403C at all. Neither did Mr Bramwell reconcile his submission to proposition (vii) (using our numbering) we have set out in paragraph 64, where Lewison J articulates the directly contrary proposition (see also *SPI*, paragraph 26, per Lord Nicholls). However, it is unsatisfactory to leave the matter in suspense and we consider it sensible to decide the point as a matter of law, as this case may go further.

67. Put shortly, in *Arrowtown*, non-voting shares with no commercial content were issued by a company in order artificially to create a group, for stamp duty purposes. The non-voting shares were held not to constitute “issued share capital”. Mr Bramwell relied on paragraph 157 of Lord Millett’s judgment, in which Lord Millett observed:

> “*... The words “issued share capital” ... properly construed, mean share capital issued for a commercial purpose and not merely to enable the taxpayer to claim that the requirements of [the provisions which confer stamp duty relief] have been complied with. It follows that the [shares] ... are not “share capital” within the meaning of [the relevant provisions], and should be disregarded when calculating the proportions of the nominal share capital owned by [the respective shareholders].*”

Thus, said Mr Bramwell, Lord Millett was deciding that shares issued solely for a tax avoidance purpose (“*merely to enable the taxpayer to claim that the requirements of [the relieving section] have been complied with*”) were properly to be disregarded. We do not consider that Lord Millett decided this at all. In *Arrowtown*, shares were issued by one company to another artificially to create a stamp duty group but were

effectively valueless. They had a right to dividends only in a year in which the net profits of the issuing company exceeded a sum larger than the gross national product of the USA and a right to a distribution on a winding up only after the holders of all of the other shares had received a distribution of HK $100,000 billion per share (see paragraph 62 of Lord Millett's judgment). At paragraph 151 of his judgment, Lord Millett identifies the question as

> "*"not whether "share capital" is a legal or commercial concept, but whether share capital with the characteristics of the [relevant shares]* ***and*** *issued for the sole purpose of complying with the statutory formula were within the contemplation of the legislature ...*" (emphasis added).

At paragraph 152, Lord Millett observed that

> "*The shares were created and issued in order to meet the qualifications for exemption from stamp duty ... They had no other purpose ... ...they had no commercial content at all. They carried no rights to dividends or capital on a winding up. If shares are considered as a bundle of rights, they had barely even a shadowy existence.*"

And at paragraph 155, Lord Millett observed that whether or not relief is available

> "*... depends on whether the test is satisfied in circumstances contemplated by the section, that is to say where it can be said that the bodies are genuinely associated so that the transfer does not involve a significant change of ownership.*"

68. Lord Millett, in "disregarding" the non-voting "B" shares clearly did not do so on the sole ground that they were issued for the tax avoidance purpose (or no commercial purpose). Rather, Lord Millett expressly identifies their lack of "commercial content" and, we consider, therefore identifies that they were only issued for tax avoidance reasons. But it is not the absence of commercial purpose (or the presence of the tax avoidance purpose) which led to Lord Millett disregarding the shares. Rather it was the lack of "commercial content" which was, of course, informed by the absence of any commercial purpose. Indeed, it is difficult to see why, if Mr Bramwell's submission was correct, Lord Millett bothered to consider the "commercial content" (or its absence) of the non-voting shares at all. And it would follow equally, on Mr Bramwell's submission, that shares issued for a tax avoidance reason with substantive rights (that is with more than "shadowy" rights to dividends and rights on a winding up) would also be "disregarded", for which we can discern no rational basis in principle or authority.

69. We therefore reject Mr Bramwell's proposition that transactions effected solely for tax avoidance purposes are properly to be disregarded for that reason alone, in construing tax statutes purposively.

**Application of the Principles of Purposive Construction to Bupa Finance's Receipt of Distributions from CX Re**

70. Applying proposition (i) set out at paragraph 64, we must first identify the transaction (here the payment of a notional distribution by CX Re to Bupa Finance, in the light of Bupa Finance's obligation to pay Earn-Out Consideration to Tawa) and ask whether that transaction answers the "statutory description" in Section 403C(2)(b), as supplemented by Schedule 18.

71. To consider the relationship of Bupa Finance and CX Re "realistically" and considering its "overall effect" (applying propositions (ii) and (iii) in paragraph 64), there is no doubt that the receipt of any distribution from CX Re by Bupa Finance and Bupa Finance's obligation to pay Earn-Out Consideration to Tawa, of an amount equal to that distribution (or, if distributions had exceeded the Benchmark Amount, 95% of such distributions) should be viewed as a composite whole. The obligation to pay the Earn-Out Consideration under Clause 3.2 of the SPA was part of the very terms on which Bupa Finance acquired its shares in CX Re. Furthermore, the "Earn-Out Consideration" was not, in any sense, contingent consideration paid by Bupa Finance to Tawa on the basis that the parties were unsure as to the true value of CX Re at the time at which Bupa Finance acquired its shares in CX Re, so that the Earn-Out Consideration reflected additional consideration payable by Bupa Finance to CX Re because CX Re had shown, in some period of time, that CX Re was worth more than the Initial Consideration (here just $1). The Earn-Out Consideration had nothing to do with the value of the shares acquired by Bupa Finance at the time of their acquisition. Distributions may or may not be made by CX Re (in fact none were). Tawa, under Clause 3.2 of the SPA, had no control over whether it received any Earn-Out Consideration or not. It was a matter for CX Re (and Bupa Finance in relation to dividends voted for by Bupa Finance) as to whether CX Re made any income or capital distributions. The Earn-Out Consideration was a mechanism by which the value of any distributions, income or capital, if (and only if) made by CX Re, were passed by Bupa Finance to Tawa.

72. To discern the purpose of Section 403C, and Section 403C(2) in particular, applying propositions (iv) and (v) in paragraph 64 (the purpose of a provision is ascertained from the text of the provision and the legislative scheme of which the provision forms part), is straightforward. Section 403C restricts consortium relief to the minimum strength of "identity" between consortium member (here Bupa Finance) and consortium company (here CX Re) by reference to the connecting factors of the beneficial ownership of shares, the beneficial entitlement to (notional) distributions and the beneficial entitlement to assets on a notional winding up. Section 403C(2)(b) and Schedule 18, paragraph 2, applying *Wood Preservation*, *Sainsbury* and *Ayerst*, provides a "statutory description" of a "beneficial entitlement" to distributions (here the notional distribution is a notional cash distribution of £100, as CX Re had no profits in the overlapping period: see above) by requiring that the owner of a distribution has (directly or indirectly, according to Schedule 18, paragraph 6) "more than a mere legal shell" of ownership rights in that distribution. Put another way the person "entitled" to a distribution, in order to have a "beneficial entitlement", must have, "at least to some extent" a right (even with the consent of another) to dispose of the distribution and to enjoy its "fruits". The draftsman of section 403C is content to

restrict consortium relief (by reducing the "relevant fraction") only where the rights mentioned in section 403C(2)(a), (b) and (c) amount to a "mere legal shell". In the light of the relevant authorities, we cannot discern any other statutory policy which underpins section 403C.

73. In the context of a cash distribution we take the rights relevant to demonstrating a beneficial entitlement to distributions as a right to assign the benefit of the distribution and to enjoy its "fruits", which we take to be a right to ownership of any interest on the cash distribution, if placed, say, on deposit and (in this case, since CX Re had a US Dollar functional currency and Bupa Finance had a Sterling functional currency) a right to enjoy the benefit of any foreign currency profits, should the value of the US Dollar rise as against Sterling (albeit at the expense of being exposed to foreign currency losses, if the value of the US Dollar fell).

74. Our observations on the nature of the Earn-Out Consideration mechanism in Clause 3.2 of the SPA, against the background of the self-evident statutory purpose of Section 403C(2), as construed in the relevant authorities, does not deprive Bupa Finance of a beneficial entitlement to the distributions it receives from CX Re.

75. Bupa Finance certainly had "more than a mere legal shell" in relation to its entitlement to any dividend (actual or notional) made by CX Re. Of the notional cash distribution of £100 in the notional "profit distribution" under Schedule 18, paragraph 2, Bupa Finance was free to spend or retain the cash. If Bupa Finance spent the cash, of course Bupa Finance would have to fund the Earn-Out Consideration by other means (borrowing or seeking an injection of share capital). It is irrelevant that Bupa Finance may have been required (as it clearly was at the material times) to utilise any distribution to fund the Earn-Out Consideration payable to Tawa. We note in passing however, that it is not agreed between the parties that Bupa Finance would in every case be compelled to fund the Earn-Out Consideration with the distribution (ironically given that the notional cash distribution in Schedule 18, paragraph 2 is of £100, it is unclear to us why Bupa Finance could not, if it was so inclined, assume either debt or equity funding of £100 to pay the (notional) Earn-Out Consideration). The fact is that Bupa Finance was entitled to use the distribution proceeds or not as Bupa Finance's commercial affairs dictated. It is irrelevant that cash is, as Mr Bramwell put it, "fungible". Of course that is correct. But the statutory question is whether Bupa Finance had a beneficial entitlement to the distribution, not whether or not Bupa Finance was commercially able to retain the distribution proceeds indefinitely. As Mr Peacock pointed out, Bupa Finance did not hold any distribution as constructive trustee for any party at all, certainly not Tawa (HMRC did not contend otherwise). Bupa Finance was entitled to the benefits of (and exposed to the risks of) any foreign currency fluctuations for cash distributions made in US dollars, for 10 days (irrespective of whether the distribution was used to fund the payment of the Earn-Out Consideration or not). As we have already mentioned, Bupa Finance would have been entitled to any interest arising on a cash distribution for 10 days (and indefinitely if the Earn-Out Consideration was financed from other resources). The fact that £100 is of course a small cash sum (so that interest over 10 days and the quantum of foreign currency fluctuations will also be very small) is neither here nor there; the draftsman has selected a notional sum for a notional profit distribution. 46.18% of that notional sum (£100), if notionally distributed to Bupa Finance, will generate interest and be

exposed to foreign currency fluctuations, in Bupa Finance's hands. And Bupa Finance was entitled to assign the benefit of the distributions to any party. All of this amounts to far more than a "mere legal shell".

76. We also note that Mr Bramwell submitted that it was not for him to locate where (if anywhere) beneficial ownership of any distribution made by CX Re to Bupa Finance lay. Of course it is true that the statutory question is whether or not an owner (here of notional distribution proceeds) has the incidents of "beneficial ownership" (or entitlement): *Wood Preservation*. But since the task of the Tribunal is to analyse the transaction under scrutiny "realistically" so as to ascertain its "overall effect", it is a useful cross check to locate where (if anywhere) beneficial ownership of CX Re's distributions lay, given the terms of Clause 3.2 of the SPA. If an analysis which deprives Bupa Finance of a "beneficial entitlement" to CX Re's distributions is "unrealistic" in its analysis as to who, if anyone, has a "beneficial" entitlement to those distributions, that is a sign that the analysis has gone wrong. And especially in the light of the observations of the Court of Appeal (in *Sainsbury*, at 326b, per Lloyd LJ and at 331c-d, per Nourse LJ) that commercial contracts do not generally put beneficial ownership into suspense, it is helpful to identify where, if not in Bupa Finance, beneficial entitlement to CX Re's distributions lay (or put another way, why it is "realistic" to view Bupa Finance as having no beneficial entitlement to the relevant distributions).

77. Here, quite separately from our positive finding that Bupa Finance had more than a "mere legal shell" and thus had a "beneficial entitlement" to CX Re's distributions, we observe that it is not "realistic" to treat the beneficial entitlement to those distributions as being in suspense, in a manner analogous to discretionary trust property. We have observed, several times, that Bupa Finance is entitled to do what it wants with CX Re's distributions, one option being to fund its obligations under Clause 3.2 of the SPA.

78. Neither is it realistic to view the beneficial entitlement of CX Re's distributions as resting with some other party. The only other candidate in this appeal who might be said to be beneficially entitled to CX Re's distributions is Tawa. But Tawa is entitled only to an amount of cash equal to CX Re's distributions, not to the distribution itself. The fungible nature of cash does not affect this observation. Thus Tawa cannot be said to be beneficially entitled to CX Re's distributions.

79. Our positive conclusion that Bupa Finance had a beneficial entitlement to CX Re's distributions is thus consistent with our conclusion that the relevant beneficial entitlement cannot "realistically" be said to be in suspense or rest with any other party.

80. We are reinforced in our conclusion by the approach of the High Court in *Piggott v Staines Investments Co Ltd* [1995] STC 114. There, as part of a scheme (again the details are not relevant here) a subsidiary (BATCo) paid a dividend of £176.6 million to its immediate parent (Staines Investments Co Ltd), which paid on a dividend, of exactly the same amount, in a preordained (and therefore composite), tax-driven transaction to its immediate parent (BAT) (per Knox J at 129-140). The success of the scheme depended on the dividends in each case being respected as such and not

recategorised as a composite transaction where BATCo engineered a payment direct to BAT (so that there was no dividend paid by either BATCo to Staines Investment Co Ltd, or by the latter to BAT). The Crown accepted (as HMRC must do in this appeal) that "enduring steps" in a preordained series of transactions cannot be disregarded. So neither BATCo, nor Staines Investments Co Ltd, nor BAT could be disregarded in seeking to ascertain the true nature of the composite transaction (see 141a-b). It followed, in Knox J's judgment, that the dividends paid by BATCo to Staines Investments Co Ltd and by Staines Investments Co Ltd to BAT could not be recategorised as a multilateral contract under which BATCo made a payment directly to BAT. Knox J observed that:

> "*If a company…receives a dividend from below which…should be paid on to the holding company…the natural thing is for it to be paid on up the line by way of dividend. To invent a contract which removes the power of the company in the middle tier…to do the normal and natural thing…seems…not so much to recharacterise as to denature a perfectly ordinary transaction…[e]ven if one postulates a contractual obligation on Staines to pay the sum involved to BAT, that does not in my view mean that the receipt from Staines was any the less a dividend forming part of the receipts by Staines. A contract with another company regarding the manner in which profits are to be dealt with does not seem to me to turn the profits into anything else.*"

(at 142e-g).

81. Thus, in *Piggott v Staines Investments Co Ltd*, even a contractual obligation to deal in a particular way with the receipt of a dividend, say to pay an onward dividend, as part of a composite transaction, would, in Knox J's view, not prevent the two dividends from being treated as separate dividends. The "realistic" appraisal of the relevant transactions does not permit a recategorisation of the two dividends as a single payment by the "bottom" company (BATCo) to the "top" company (BAT).

82. Applying that approach here, the notional distribution received by Bupa Finance from CX Re must be respected as such. The contractual obligation under Clause 3.2 of the SPA of Bupa Finance to pay the Earn-Out Consideration to Tawa does not denature that distribution by CX Re. And (separately) the distribution received by Bupa Finance and the payment by Bupa Finance under Clause 3.2 cannot be ignored and treated as a payment by CX Re to Tawa. Thus *Piggott v Staines Investments Co Ltd* confirms that the relevant transaction (even looking at the overall effect of the composite transaction whereby the value of any distribution received by Bupa Finance is passed to Tawa under Clause 3.2 of the SPA) for the purposes of TA 1988, Section 403C(2)(b), is the receipt of a notional distribution of £46.18 by Bupa Finance from CX Re and the statutory question is whether Bupa Finance's ownership rights to that notional distribution amount to more than a "mere legal shell". As we have observed, the answer to that statutory question is "yes".

83. Indeed, Mr Bramwell's argument to the contrary proves too much and leads to the absurdity suggested by Mr Peacock. We have already discounted the relevance of any tax avoidance purpose in construing Section 403C in the light of Clause 3.2 of the

SPA. It follows that Mr Bramwell's submission, if correct, means that any contractual obligation on the part of any company to fund contractual obligations out of distributions deprives that company of a beneficial entitlement to the distribution (and denies group/consortium relief to that extent). So a company which undertook, say, to a lender, to fund interest payments out of distributions received from its subsidiaries would be deprived of beneficial entitlement to those distributions and lose the benefit of group/consortium relief to that extent. We cannot discern any intelligible purpose why the draftsman of Section 403C(2)(b) should wish to have Section 403C construed in this way.

84. Neither is our conclusion affected by the decision, or the reasoning, of the Privy Council in *Carreras*, or that of the House of Lords in *SPI*, on which Mr Bramwell relied heavily.

85. In *Carreras*, a sale of a subsidiary was made by a vendor company to a purchasing company in consideration of the issue of a debenture by the purchaser, which debenture was redeemed for cash 14 days later. The issue and redemption of the debenture was effected to avoid Jamaican "transfer tax" which was otherwise payable on cash consideration. The Privy Council considered that "*the relevant transaction for the purposes of [the Jamaican Transfer Tax legislation] comprised both the issue and the redemption of the debenture and that [the]…transaction, taken as a whole, could not be appropriately characterised as an exchange of shares for a debenture.*" (paragraph 13, per Lord Hoffmann). That the "*relevant transaction*" was a composite transaction which was the disguised payment of cash made through the surrogate of the debenture was "*not merely contemplated (the redemption of any debenture may be said to be contemplated) but intended by the parties as an integral part of the transaction…*" (paragraph 16, per Lord Hoffmann).

86. In *SPI*, one party (Scottish Provident Institution) transferred gilts to another party, Citibank plc, but then re-acquired those gilts from Citibank plc. The details of the scheme are irrelevant to this appeal. What mattered in *SPI* was that the scheme's success depended on Citibank plc being properly considered to be "entitled" to the gilts, prior to their re-acquisition by Scottish Provident Institution. Both parties intended that the gilts, once sold by Scottish Provident Institution to Citibank plc, would be re-acquired by Scottish Provident Institution (see paragraphs 4-6, per Lord Nicholls). However, to avoid the transaction in gilts being disregarded altogether as a composite transaction where no gilts were sold or re-acquired at all (which would mean that the scheme failed), the parties included commercially irrelevant contingencies in option agreements through which Scottish Provident Institution would re-acquire the gilts, which, if they occurred, would mean that Scottish Provident Institution could not exercise its option to re-acquire the gilts (see paragraphs 21, 22, per Lord Nicholls). Scottish Provident Institution's submission was that these commercially irrelevant contingencies, although inserted for no commercial purpose, protected the scheme transactions from being dismissed as a composite transaction (where nothing happened and Citibank plc was not "entitled" to the gilts). The House of Lords rejected Scottish Provident Institution's approach, on the basis that the self-imposed contingencies were themselves part of the composite transaction, inserted by the parties merely as an acceptable risk to disguise a composite transaction where no "entitlement" to the gilts passed to Citibank plc, as a

transaction which indeed resulted in a sale to Citibank plc (resulting in an "entitlement" for Citibank plc to the gilts) on the one hand and a re-acquisition by Scottish Provident Institution on the other. Once these self-imposed contingencies were viewed as part of the very composite transaction itself, that composite transaction was properly viewed as a transaction, the overall effect of which was that Citibank plc was never "entitled" to the gilts (paragraph 23). Incidentally, contrary to Mr Peacock's submissions, the absence of the need for Scottish Provident Institution physically to deliver the gilts to Citibank plc, or for Citibank plc physically to deliver gilts back to Scottish Provident Institution played no part in the reasoning of the House of Lords at all. (The absence of any obligation physically to deliver the gilts was merely recorded as part of the Crown's arguments before the Special Commissioners at paragraph 16; the reasoning of the House of Lords at paragraphs 20-26 makes no reference to the absence of an obligation for physical delivery at all).

87. Furthermore, neither *Carreras*, nor *SPI*, are in point in this appeal. In *Carreras* the issue and redemption of a debenture were ignored and the transaction was treated as a composite transaction with an overall effect of the payment of disguised cash consideration. In *SPI* self-imposed contingencies intended to disguise a composite transaction were ignored where the ownership of gilts did not pass at all (and no party other than the original owner became "entitled" to the gilts). The relevant transaction was treated as one where no entitlement arose to Citibank plc despite the disguise. In both cases the Privy Council and the House of Lords respectively assessed the "overall effect" of the relevant transactions by reference to the parties' own intentions.

88. In this appeal, we have already observed that the contractual obligation to pay Earn-Out Consideration was a mechanism by which the value of any distributions made by CX Re to Bupa Finance were passed by Bupa Finance to Tawa. But the question in this appeal is not whether Bupa Finance is somehow "entitled [to retain the value of any distribution it receives indefinitely on the particular facts of this case]." The statutory question in this appeal is whether, given the composite transaction whereby Bupa Finance passes the value of any distribution it receives from CX Re to Tawa, by paying the Earn-Out Consideration under Clause 3.2 of the SPA, within 10 business days of receipt of the distribution, Bupa Finance has more than a "mere legal shell" of ownership rights to that (cash) distribution. For the reasons we give above, the answer is "yes".

89. Of course it might be a very different analysis if the facts were that Bupa Finance had no access to any benefits of ownership of the cash for the 10 days between receipt of the distribution and the payment of the Earn-Out Consideration (so no right to assign the distribution, no right to interest or to take the benefit of/be exposed to foreign currency fluctuations). If these were the facts, we would ignore any features of a transaction which sought to disguise the absence of the "benefit" of ownership (to use Harman LJ's phrase). But that is not this case. HMRC have run their case on the basis that Clause 3.2 *of itself* deprives Bupa Finance of a beneficial entitlement to distributions received from CX Re, irrespective of the commercial circumstances of CX Re. Thus *Carreras* and *SPI* do not assist HMRC.

90. We make brief final observations as to the relevance of Bupa Finance's "purpose" in acquiring shares in CX Re. Applying propositions (vi) and (vii) in paragraph 64 (no appeal to purpose, if Parliament has so comprehensively articulated the relevant "statutory description" that an appeal to "purpose" is excluded, albeit that solely tax-driven transactions are, although not always, likely to fail to answer the "statutory description" in question), Section 403C(2) and Schedule 18 contain highly detailed rules as to the calculation of the "relevant fraction". As we observe above, fluctuations in entitlements within an accounting period are averaged out (Section 403C(2), tailpiece); certain share rights are ignored and changes in shares rights are anticipated, if, in either case, this would reduce the "relevant fraction" (Schedule 18, paragraphs 4, 5, 5B). There is no mention of "purpose" in any of these provisions. And none of the authorities which have construed "beneficial ownership" (*Ayerst*, decided by the House of Lords, *Wood Preservation* and *Sainsbury* by the Court of Appeal) made any reference to "purpose" being relevant to "beneficial ownership" at all. Thus even if Mr Bramwell had been entitled to make submissions as to Bupa Finance's purpose in acquiring shares in CX Re, in the context of Section 403C(2)(b) (and Section 403C as a whole), the presence or absence of a sole "tax avoidance" purpose is irrelevant.

***Indofood International Finance Ltd v JP Morgan Chase Bank NA, London Branch [2006] EWCA Civ 158 ("Indofoods")***

91. We asked the parties to make submissions on *Indofoods*. This is because the term "beneficial ownership", in relation to interest, was construed by the Court of Appeal in this case, in the context of Article 11 of "the Interest Article" of the Indonesia-Netherlands Double Tax Treaty. The context is curious. The action was a commercial action which concerned the construction of a trust deed governed by English Law (which is why the action was raised in the High Court and reached the Court of Appeal). However, the trust deed applied to a transaction effected originally from Indonesia and the Court of Appeal was asked to decide how an Indonesian Court would construe the Indonesia-Netherlands Double Tax Treaty, in order that the trust deed might be properly construed and administered.

92. The relevant facts in *Indofoods* are these: a Mauritian tax resident company had borrowed from the market. One question (of several) before the Court of Appeal was, if (for reasons we need not articulate, the question was hypothetical) the Mauritian company lent those funds to a Netherlands tax-resident company, which, in turn, on-lent those funds to its Indonesian tax-resident parent company, whether Article 11 of the Indonesia-Netherlands Double Tax Treaty would apply to reduce withholding tax (from 20% of the interest paid to 10%) on the Indonesian company's interest payments to the Netherlands tax-resident company. The issue was whether the Netherlands company could be said to be the "beneficial owner", within Article 11 of the Indonesia-Netherlands Double Tax Treaty, of the interest paid to it by the Indonesian company, given that the Netherlands company was obliged, in turn, to pay an amount equal to that interest to the Mauritian tax-resident company, which had borrowed from the market.

93. The Court of Appeal held that the Netherlands company would not be the beneficial owner of the interest it would have received from the Indonesian company. The test

of beneficial ownership was, for the purposes of Article 11 of the Indonesia-Netherlands Double Tax Treaty, a "substance over form" test, governed in part by Indonesia Income Tax Law, in part by the OECD Commentary on the Model [Double Tax Treaty] Convention (on which the Indonesia-Netherlands Double Tax Treaty was based) and in part by the UN Commentary on the Model Convention (see paragraph 18d, per the Chancellor). The notion of "beneficial ownership" took an "*international fiscal meaning" which connoted a "full privilege to directly benefit*" from the interest (paragraph 42), which was clearly not present for the hypothetical Netherlands company, in respect of interest it received but which it effectively had to pay on to another company (here the Mauritian company) (paragraphs 43 and 44).

94. A notion of "*[holding a] full privilege to directly benefit [from receipts]*" is a self-evidently very different test of "beneficial ownership" to ownership rights which amount to "more than a mere legal shell." However, both parties agreed (Mr Peacock made submissions, which Mr Bramwell adopted in their entirety) that *Indofoods* is not relevant to this appeal, on the basis that the meaning ascribed to "beneficial ownership" by the Court of Appeal in *Indofoods* was an "international fiscal meaning" appropriate to Double Tax Treaties (the Indonesia-Netherlands Double Tax Treaty at that), informed at least in part by Indonesian Income Tax Law and the OECD and UN Commentaries on the Model Convention, none of which are relevant to the construction of TA 1988, Section 403C. Thus, the parties agreed that the authorities which have construed "beneficial ownership" to which we have referred (*Wood Preservation*, *Ayerst*, *Sainsbury*) are undisturbed by *Indofoods*. We are grateful to the parties for their submissions (with which we agree) in relation to a case which otherwise would inevitably have raised questions in relation to its application to contexts outside the scope of International Fiscal Law.

## Conclusion and Disposal

95. We allow the appeal.

Mrs Justice Asplin

Judge Julian Ghosh QC

Release Date: 16 June 2014

## SCHEDULE TO JUDGMENT

**BEFORE THE FIRST-TIER TRIBUNAL (TAX)** **TC/2011/09264**
**SITTING IN LONDON**

**B E T W E E N**

**BUPA INSURANCE LIMITED**

**Appellant**

**- and -**

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

**Respondents**

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**STATEMENT OF AGREED FACTS AND ISSUES**

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### A. Introduction

1. This appeal concerns a consortium claim for group relief made under Income and Corporation Taxes Act 1988 (**"TA 1988"**) s.402(3) and s.406(2). The Appellant (**"Bupa Insurance"**) sought to utilise trading losses, surrendered by CX Reinsurance Company Limited (**"CX Re"**), by setting them against profits in its accounting period ended 31 December 2006. HMRC amended Bupa Insurance's self-assessment tax return for that accounting period (**"the Bupa Insurance 2006 return"**) to refuse Bupa Insurance's claim to utilise those losses. Bupa Insurance appeals against that amendment.

### B. CX Re

2. At all material times CX Re was a UK-resident limited company, incorporated in the UK, and carrying on a trade of reinsurance. CX Re stopped writing new reinsurance contracts in August 2001, and thereafter its trade consisted of carrying out its existing reinsurance contracts and managing its portfolio of investments (in the reinsurance industry such a company is described as being "in run-off"). At all material times the functional currency of CX Re was US Dollars (**"USD"**), and CX Re had an authorised share capital of 400,000,000 fully-paid ordinary shares, each with a par value of £1 (GBP 1).

3. Tawa UK Limited (now Tawa plc - **"Tawa"**), was formed in 2001 for the purpose of acquiring and managing insurance and reinsurance companies in run-off. At all relevant times Tawa was a UK-resident limited company, incorporated in the UK and majority-owned by Financière Pinault SCA. On 31 October 2002 Tawa purchased the entire issued share capital of CX Management Company Limited (which then owned all of the issued share capital of CX Re) from Continental Casualty Company (a

company based in Illinois, USA) (**"CCC"**).[1] Tawa intended to generate value through the management of CX Re's run-off, principally through the commutation of outstanding policies (i.e. by making cash payments in order to settle future liabilities) and thereby shortening the duration of the run-off period of CX Re. On 16 March 2004, following a group restructuring, CX Re became a directly held and wholly owned subsidiary of Tawa. Tawa continued to own the entire issued share capital of CX Re until 21 March 2006, on which date CX Re had an issued share capital of 343,924,280 ordinary shares.

4. On 31 October 2002 CX Re entered into a contractual run-off management agreement (**"ROMA"**) with Tawa Management Ltd (**"Tawa Management"**), a UK-resident wholly-owned subsidiary of Tawa, under which Tawa Management managed the run-off of CX Re's reinsurance business. This arrangement remained in place following the CX Re share sale on 21 March 2006 (see section D, below), although the terms of the ROMA were amended on that date.

5. Prior to 2006, CX Re had a 31 December year end for accounting purposes. During 2006 CX Re had two accounting periods: the first ran from 1 January 2006 – 20 March 2006, and the second ran from 21 March 2006 – 31 December 2006. CX Re drew up separate accounts for the two accounting periods. In its accounting period ended 31 December 2006 CX Re made a trading loss for tax purposes of USD 474,876,681[2]. This loss resulted, in the main, from an election under Finance Act 2000 s.107(4) (**"section 107(4)"**) in respect of CX Re's accounting period ended 20 March 2006[3]. Section 107(4) allowed general insurers, such as CX Re, to disclaim any part of the technical provisions which would be taken into account in computing its trading profits for a particular accounting period. Where an insurer made this election, the deduction for that part of the technical provisions was carried forward into the next accounting period. In effect, section 107(4) allowed CX Re, and other general insurers, to defer losses into a future period. As a result, CX Re had USD 474,876,681 of trading losses available for surrender, by way of group relief, in respect of the period 21 March – 31 December 2006.

## C. <u>Other relevant persons</u>

6. Bupa Finance plc (**"Bupa Finance"**) was, at all material times, a UK-resident public limited company, incorporated in the UK. Bupa Finance was, and remains, a member of the Bupa group, headed by The British United Provident Association Limited. The Bupa group is a leading provider of health insurance and health and care facilities and services. Bupa Finance was, and remains, a holding company in the Bupa group, and also issues listed debt as part of the Bupa group's overall funding strategy. As set out below (in Section D), Bupa Finance acquired shares in CX Re on 21 March 2006 and

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[1] Prior to that date CX Re had been called CNA Reinsurance Company Limited; its name was changed to CX Reinsurance Company Limited immediately after the acquisition of its parent company by Tawa.

[2] This was equivalent to GBP 254,311,938 at the 1:1.8673 exchange rate used in CX Re's tax computation.

[3] The tax accounting process for this is reproduced at Schedule 4.

thereby became a member of the consortium that owned CX Re. For all relevant years Bupa Finance had accounting periods running from 1 January – 31 December.

7. Bupa Insurance was, at all material times, a UK-resident limited company, incorporated in the UK. Bupa Insurance's principal activity was the provision of private medical insurance products to individuals and businesses. At all material times Bupa Insurance was a wholly owned subsidiary of Bupa Finance. The two companies were therefore in the same group for the purposes of group relief, and Bupa Finance was the "link company" (under TA 1988 s.406(1)(a)) through which Bupa Insurance sought to make its claim for consortium relief. For all relevant years Bupa Insurance had accounting periods running from 1 January – 31 December.

8. Nationwide Building Society (**"Nationwide"**) was, at all material times, a UK-resident building society. As set out below, on 21 March 2006 Nationwide acquired shares in CX Re, and thereby became a member of the consortium that owned CX Re.

## D. CX Re share sale

9. The essential elements of the transactions with which this appeal is concerned were notified to HMRC by KPMG under Finance Act 2004 s.308 (Disclosure of Tax Avoidance Schemes) and allocated the reference number 32771423.

10. In February 2006, KBC Peel Hunt Ltd, brokers for what was referred to as "Project Moneta", issued a bundle of documents to groups that had expressed an interest in the project (including the Bupa group). The documents included an "Information Memorandum", referred to in HMRC's Statement of Case at paragraph 2, which explained how Project Moneta could provide access to the losses accumulated by CX Re.

11. On 21 March 2006 CX Re reorganised its authorised[4] share capital, by means of a special resolution, into 399,995,720 fully-paid ordinary A shares (with a par value of GBP 1) (**"A shares"**) and 4,280 fully-paid ordinary B shares (also with a par value of GBP 1) (**"B shares"**). Both classes of share gave shareholders equal rights to participate in dividends paid by, and distributions in a winding-up of, CX Re (i.e. they ranked *pari passu* with regard to economic rights in CX Re), however B shares gave their holders voting rights whereas A shares did not. Immediately after its reorganisation the issued share capital of CX Re, which continued to be wholly owned by Tawa, consisted of 343,920,000 A shares and 4,280 B shares.

12. After the share capital of CX Re had been reorganised, Tawa sold part of its shareholding in CX Re to four other persons (Bupa Finance, Nationwide, Paul Jardine and Philip Marcell) (**"the CX Re share sale"**) under the terms of a Share Purchase Agreement with Bupa Finance and Nationwide, dated 21 March 2006 (**"the SPA"**), and two separate agreements with the individual shareholders, each dated 20 March 2006. Following the CX Re share sale the shareholdings in CX Re were as set out in Schedule 1 of this document, and shown in the structure chart at Schedule 2. Bupa

[4] HMRC's Statement of Case is inaccurate in referring to a reorganisation of "issued" share capital in para. 3.3.

Finance and Nationwide held the shares that they acquired in CX Re as investments and not on trading account.

13. The amount payable by both Bupa Finance and Nationwide as consideration for the purchase of their shares in CX Re consisted of two amounts: "Initial Consideration" and "Earn Out Consideration". Bupa Finance and Nationwide each paid USD 1 as Initial Consideration for the shares (SPA clause 3.1.1). The Earn Out Consideration payable by Bupa Finance and Nationwide was calculated under SPA clause 3.2 as an amount equal to their respective shares of 100% of any distributions (of profits or capital) made to shareholders by CX Re up to USD 171,000,000 (**"the Benchmark Amount"**), and 95% of any subsequent distributions (of profits or capital) made by CX Re in excess of the Benchmark Amount (in each case, less corporation tax due, if any, in respect of the distribution[5]). Bupa Finance and Nationwide were liable to pay amounts of Earn Out Consideration under the SPA within 10 business days of Tawa receiving notification that CX Re had made a distribution (of profits or capital) to its shareholders.

14. Tawa commissioned a report from the Tawa group actuaries to determine the projected surplus that would be generated, following the CX Re share sale, by the run-off of CX Re. The report concluded that there was a 52% probability of the surplus from the run-off of CX Re's business exceeding the Benchmark Amount and that Bupa Finance and Nationwide would receive a return on their Initial Consideration of USD 1. The report set out the probabilities of a range of pre-tax profitable outcomes for Bupa Finance and Nationwide in relation to their shareholdings in CX Re (the figures for Bupa Finance are set out in Schedule 3 to this document).

15. At all relevant times Paul Jardine and Philip Marcell were non-executive directors of CX Re, and unconnected to Tawa. They both paid the undiscounted net asset value, as at 31 December 2005, of the shares that they acquired (being GBP 23.31 – approximately USD 41) as consideration for the purchase of their shares. These acquisitions were effected to ensure that Tawa did not have more than 50% of the voting rights in CX Re, and that Bupa Finance and Nationwide would each have less than 20% of the voting rights in CX Re. This allowed Bupa Finance and Nationwide to account for their shareholdings in CX Re, under the applicable accounting standards, as investments and not to equity account for them.

16. In addition to the SPA, a number of the relevant parties entered into the following further agreements on 21 March 2006 (the effect of which can be seen from their terms):

    i. Shareholders Agreement;

    ii. Tax Agreement;

    iii. Trust Deed;

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[5] If the aggregate amount of distributions (of profits or capital) made by CX Re exceeded the Benchmark Amount, then any further amounts of Earn Out Consideration were correspondingly reduced by only 95% (as opposed to 100%) of any corporation tax payable by Bupa Finance/Nationwide in respect of their shares of those distributions.

iv. Incentive Agreement;

v. Deed of Release;

vi. Supplemental Deed of Charge;

vii. Amendment to the ROMA.

17. At all relevant times CX Re was required to be, and was, authorised by the Financial Services Authority ("**FSA**"). Under the terms of Financial Services and Markets Act 2000, the FSA operate a "Change of Control" regime in relation to authorised persons, under which any new "controller" of an authorised person requires prior FSA approval. This regime is intended to ensure that any new "controller" is a fit and proper person. The acquisition of shares in CX Re by each of Bupa Finance and Nationwide needed to be approved by the FSA under their change in control rules, as both Bupa Finance and Nationwide obtained more than 10% of the shares and voting power in CX Re. By means of notices dated 14 March 2006, both Bupa Finance and Nationwide were approved by the FSA as "controllers" of CX Re.

18. No dividends have, to date, been paid on the CX Re shares held by Bupa Finance and no arrangements have ever been put in place by Bupa Finance or Tawa in relation to the payment of Earn Out Consideration.

## E. <u>The Consortium Claim</u>

19. As set out above, CX Re had USD 474,876,681 (equivalent to approximately GBP 254,311,938) of trading losses available to be surrendered by way of group relief in respect of its accounting period ending 31 December 2006. Bupa Insurance made a consortium claim to utilise GBP 96,285,001 of those losses ("**the Consortium Claim**") in relation to the "overlapping period" for its accounting period ending 31 December 2006 and the accounting period of CX Re ending on the same date (i.e. the period 21 March - 31 December 2006). This claim, if valid, would have the effect of reducing the corporation tax liability of Bupa Insurance, for its accounting period ended 31 December 2006, by GBP 28,885,500.30.

20. Pursuant to the terms of the Tax Agreement, referred to above, GBP 13,273,756.59 was payable by Bupa Insurance to CX Re for the losses it surrendered to Bupa Insurance for its accounting period ended 31 December 2006.

21. Bupa Insurance made the Consortium Claim in the Bupa Insurance 2006 return. HMRC began an enquiry into the Bupa Insurance 2006 return, and formally refused the Consortium Claim on 17 May 2011 by amending that return in a closure notice. Bupa Insurance appealed (under Finance Act 1998 Schedule 18, paragraph 34(3)) against that amendment in a letter to HMRC, dated 16 June 2011, and at the same time requested a review of HMRC's decision. HMRC confirmed its position in a letter dated 25 August 2011, and gave notice of the conclusion of its review on 7 October 2011.

## F. <u>The Issue of Law</u>

22. The sole issue to be determined in this appeal is whether, in the period 21 March 2006 – 31 December 2006 (the *"overlapping period"*), for the purposes of TA 1988 section 403C(2)(b), Bupa Finance (as a "link company" under TA 1988 section 406(1)(a))

was *“beneficially entitled”* to a percentage of *“any profits available for distribution to equity holders”* of CX Re (so as to determine the *“relevant fraction”* that should apply to limit the amount of losses of CX Re that may be set against the total profits of Bupa Insurance).

23. The method for determining the percentage of “any *profits available for distribution to equity holders*” to which an equity holder is beneficially entitled is set out in TA 1988 Sch.18 para.2(1). Under that paragraph, “profits” are equated with “total profits” as defined by TA 1988 s.9(3). It is agreed that the total profits of CX Re for the period in question were nil so that there is an assumed distribution of £100: see Sch.18 para.2(1)(b).

24. It is common ground between the parties that, if Bupa Finance would have been *“beneficially entitled”* to a percentage of that distribution, the "*relevant fraction*" for the purposes of section 403C(2)(b) was that percentage and the appeal of Bupa Insurance must be allowed. It is also common ground between the parties that if Bupa Finance would not have been *“beneficially entitled”* to a percentage of that distribution, then the *“relevant fraction”* is 0% and the appeal of Bupa Insurance must be refused.

Schedule 1

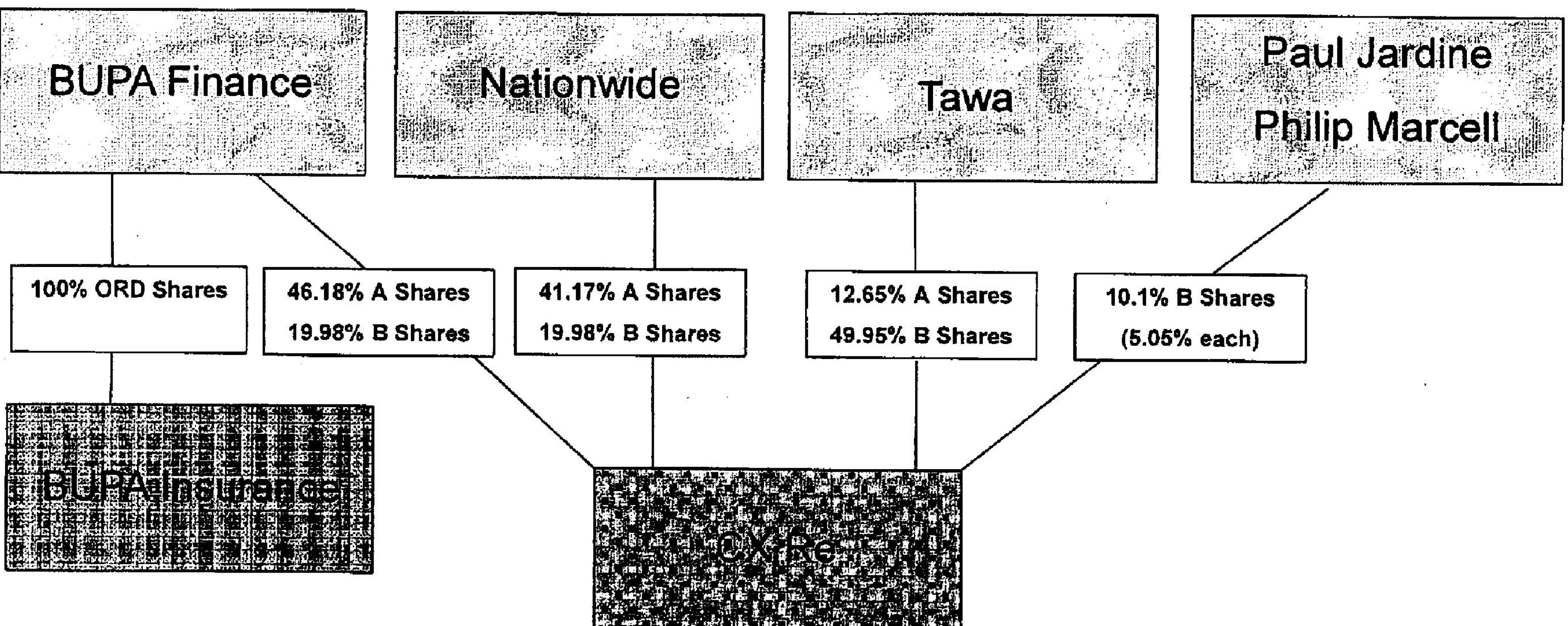
| Shareholder | A shares | Percentage of A shares | B shares | Percentage of B shares | Total shareholding in CX Re | Percentage of issued ordinary share capital of CX Re owned |
|---|---|---|---|---|---|---|
| Tawa | 43,500,321 | 12.6484 | 2,138 | 49.9533 | 43,502,459 | 12.6488 |
| Bupa Finance | 158,824,368 | 46.1806 | 855 | 19.9766 | 158,825,223 | 46.1803 |
| Nationwide | 141,595,311 | 41.1710 | 855 | 19.9766 | 141,596,166 | 41.1707 |
| Paul Jardine | 0 | 0 | 216 | 5.0467 | 216 | 0.0001 |
| Philip Marcell | 0 | 0 | 216 | 5.0467 | 216 | 0.0001 |
| **TOTAL** | **343,920,000** | **100.00** | **4,280** | **100.00** | **343,924,280** | **100.0000** |

## Schedule 3

| Probability given by stochastic model produced by Tawa | Economic return on shares in CX Re held by Bupa Finance (USD) |
|---|---|
| 50% | 63,205 |
| 40% | 263,059 |
| 30% | 464,875 |
| 20% | 708,135 |
| 10% | 1,033,642 |
| 0% | 2,482,699 |

# Schedule 2

CX Re share ownership from 21 March 2006



## Schedule 4

CX Reinsurance Company Limited

Accounts adjustments for period from 21 March 2006 to 31 December 2006

| | $ | $ |
|---|---:|---:|
| Profits per accounts | | 1,242,000 |
| ***Add:*** | | |
| Legal and professional fees | 215,044 | |
| Technical provisions disclaimed under s.107(4) for the period ended 31 December 2006 | 17,721,179 | |
| ***Total additions:*** | | **17,936,223** |
| ***Deduct:*** | | |
| Technical provisions disclaimed under s.107(4) FA 2000 for the period ended 20 March 2006 | (403,192,224) | |
| Interest under s.107(3) FA 2000 | (90,862,680) | |
| ***Total deductions:*** | | (494,054,904) |
| ***Adjusted loss (profits per accounts plus total additions minus total deductions):*** | | **(474,876,681)**[6] |

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[6] Adjusted loss represents the book profits, the technical provisions disclaimed under s.107(4) FA 2000 and the adding back of legal fees, minus technical provisions disclaimed under s.107(4) FA 2000 for the previous period and interest arising by virtue of s. 107(3) FA 2000.