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UT (Tax & Chancery) Case Number: UT/2025/000096

Upper Tribunal
(Tax and Chancery Chamber)

Hearing venue: Rolls Building, 7 Rolls Buildings,
Fetter Lane, London, EC4A 1NL

Heard on: 4 and 5 June 2026
Judgment date: 02 September 2026

INCOME TAX – transactions in securities – Part 13 Chapter 1 Income Tax Act 2007 – whether repayment of capital by limited company incorporated in England and Wales falls within section 685(6) Income Tax Act 2007 – no – whether section 685(6) contains an obvious error in referring to subsections (2)(a) and (b) – no – appeal dismissed

Before

JUDGE JONATHAN CANNAN
JUDGE ASHLEY GREENBANK

Between

THE EXECUTORS OF PAUL HUNT
JAMES HUNT
ROBERT DAVIS

Appellants

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellants: Laurent Sykes KC instructed by KPMG Ireland

For the Respondents: Imran Afzal KC, and Riya Bhatt, counsel, instructed by the General Counsel and Solicitor for His Majesty's Revenue and Customs

DECISION

Introduction

1. This is an appeal against a decision of the First-tier Tribunal (Tax Chamber) (the "FTT") released on 12 May 2025 (the "FTT Decision")[1]. The Appellants are the executors of Mr Paul Hunt, and Mr James Hunt and Mr Robert Davis. The Respondents are the Commissioners for His Majesty's Revenue and Customs ("HMRC").

2. In the FTT Decision, the FTT dismissed the appeals of the Appellants against counteraction notices issued by HMRC under Chapter 1, Part 13, Income Tax Act 2007 ("ITA") in relation to consideration received by the Appellants as part of a reduction of capital of Golf Holdings Ltd ("GHL") on 22 April 2015 (the "Capital Reduction"). In this decision notice, we refer to Chapter 1, Part 13 ITA as the "transactions in securities" or "TIS" legislation.

3. In summary, the FTT decided that the Capital Reduction met the conditions in section 685(2) ITA and section 685(6) ITA (as it was at the time) did not apply to exclude the Capital Reduction from the TIS legislation.

4. The Appellants applied to the FTT for permission to appeal on five grounds. The FTT granted permission to appeal on four of those grounds. The Upper Tribunal ("UT") granted permission to appeal on the remaining ground.

Relevant legislation

5. The issues in this appeal are essentially ones of statutory construction. So we will begin by setting out the relevant legislation. The provisions set out below are those which were in force for the periods relevant to this appeal, and so far as relevant to the issues in this appeal. References to section numbers in this decision notice are to the provisions of the ITA in force at that time unless otherwise stated or the context otherwise requires.

6. Under the transactions in securities legislation, HMRC can issue a notice (a "counteraction notice") to counteract "income tax advantages" arising from "transactions in securities" by making adjustments to the tax position of a person.

7. Section 684 set out the conditions that had to be met before a person could be liable to counteraction of an income tax advantage by the issue of a counteraction notice. At the relevant time, section 684 was in the following form:

> **684 Person liable to counteraction of income tax advantage**
>
> (1) This section applies to a person where—
>
> (a) the person is a party to a transaction in securities or two or more transactions in securities (see subsection (2)),
>
> (b) the circumstances are covered by section 685 and not excluded by section 686,
>
> (c) the main purpose, or one of the main purposes, of the person in being a party to the transaction in securities, or any of the transactions in securities, is to obtain an income tax advantage, and
>
> (d) the person obtains an income tax advantage in consequence of the transaction or the combined effect of the transactions.

[1] The FTT Decision is reported with neutral citation [2025] UKFTT 538 (TC). In this decision notice, we refer to paragraphs from the FTT Decision in the format "FTT [xx]".

(2) In this Chapter "transaction in securities" means a transaction, of whatever description, relating to securities, and includes in particular—

(a) the purchase, sale or exchange of securities,

(b) issuing or securing the issue of new securities,

(c) applying or subscribing for new securities, and

(d) altering or securing the alteration of the rights attached to securities.

(3) Section 687 defines "income tax advantage".

(4) …

8. As can be seen from section 684(1)(b), the TIS legislation could only apply in "circumstances" that "are covered by section 685". Section 685(1) provided that the circumstances covered by section 685 "are circumstances where condition A or condition B is met". In this appeal, we are only concerned with condition A.

9. The relevant provisions of section 685 were as follows:

> (2) Condition A is that, as a result of the transaction in securities or any one or more of the transactions in securities, the person receives relevant consideration in connection with –
>
> (a) the distribution, transfer or realisation of assets of a close company,
>
> (b) the application of assets of a close company in discharge of liabilities, or
>
> (c) the direct or indirect transfer of assets of one close company to another close company,
>
> and does not pay or bear income tax on the consideration (apart from this Chapter).
>
> ….
>
> (4) In a case within subsection (2)(a) or (b) "relevant consideration" means consideration which –
>
> (a) is or represents the value of –
>
> (i) assets which are available for distribution by way of dividend by the company, or
>
> (ii) assets which would have been so available apart from anything done by the company,
>
> (b) is received in respect of future receipts of the company, or
>
> (c) is or represents the value of trading stock of the company.
>
> …
>
> (6) The references in subsection (2)(a) and (b) to assets do not include assets which are shown to represent a return of sums paid by subscribers on the issue of securities, despite the fact that under the law of the country in which the company is incorporated assets of that description are available for distribution by way of dividend."

10. The transactions in securities legislation was introduced in the Finance Act 1960 ("FA 1960"). Since that time, it has gone through various iterations. The TIS legislation that was in force at the time of the transactions that are relevant to this appeal was contained in Chapter 1, Part 13 ITA in a form following material amendments made by the Finance Act 2010 ("FA 2010"). The TIS legislation was only in force in this form in the period between 24 March 2010 (following changes made by FA 2010) and 6 April 2016, when important amendments made by Finance Act 2016 ("FA 2016") took effect.

11. We will refer to those changes later in this decision together with the history of the legislation, which was also the subject of argument before us. For ease of reference, we have set out in the Appendix to this decision notice relevant extracts from the legislation at various stages in the legislative history including: when the TIS legislation was introduced in FA 1960; when it was enacted in the Income and Corporation Taxes Act 1970 ("ICTA 1970"); when it was enacted in the Income and Corporation Taxes Act 1988 ("ICTA 1988"); when it was enacted in ITA; and following amendments made by the FA 2016.

The facts

12. The facts are not in dispute. They are summarised in the FTT Decision at FTT [2] and [7]. We gratefully adopt that summary. It is set out below:

> 2. The consideration paid to the appellants for the 2015 Capital Reduction was £7,841,000 to Paul Hunt, £1,079,500 to James Hunt and £1,079,500 to Robert Davis ("the Consideration"). The appellants returned the Consideration on their tax returns as capital, subject to Capital Gains Tax.…
>
> 7. The relevant facts are however not controversial and are agreed between the parties as follows:
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> (1) GHL was incorporated in 2001 and at all material times it was a close company for the purposes of the TIS legislation.
>
> (2) In 2002 GHL acquired 100% of the shares in Wine Inns Ltd, James McCabe Ltd and City of Belfast Warehousing Ltd (the "Subsidiaries").
>
> (3) Prior to that acquisition, the shares in the Subsidiaries were held by the three appellants and by Pat McCormack. GHL acquired Pat McCormack's shares in the Subsidiaries for cash. GHL acquired the three appellants shares in the Subsidiaries by way of share for share exchanges with each share issued by GHL having a par value of £1 and £9 credited by GHL to the share premium account. In total £32,944,500 was credited to the share premium account.
>
> (4) As a result of GHL's acquisition of the Subsidiaries, the three appellants owned GHL which in turn owned the Subsidiaries. In early 2010 Paul Hunt owned approximately 78.4% of the shares in GHL and James Hunt and Robert Davis each owned approximately 10.8% of the shares.
>
> (5) In March 2010 GHL undertook a capital reduction whereby 1,000,000 shares were cancelled and £10 per share was repaid to the appellants. The number of cancelled shares for each appellant was in proportion to their percentage share ownership of GHL, so that their percentage share ownership of GHL remained the same after this capital reduction.
>
> (6) The subject of this appeal is the [Capital Reduction] whereby GHL cancelled a further 1,000,000 shares and in exchange £10 per share was credited to the appellants' loan accounts with GHL. Again the number of cancelled shares for each appellant was in proportion to their percentage share ownership so that each appellant's percentage share ownership remained the same after the [Capital Reduction].
>
> (7) GHL paid the Consideration set out in paragraph [2] to the appellants by way of a credit to each of their loan accounts with GHL and the appellants entered into agreements with GHL that provided for GHL to repay the appellants the amount held to their credit in their loan accounts by instalments over a period of time. The Consideration was nevertheless paid to and received by the appellants for tax purposes on the 22 April 2015 and therefore in the 2015/16 tax year.

(8) GHL's balance sheets as at 31 December 2014 and 31 December 2015 show a profit and loss account of approximately £12,000,000 and the appellants accept that at the time of the [Capital Reduction], GHL had distributable reserves in excess of £10,000,000.

(9) On 28 June 2018 HMRC wrote to each of the appellants stating that the TIS legislation might apply in relation to the [Capital Reduction]. After an exchange of correspondence between HMRC and the appellants' representative (KPMG), on 3 December 2021 HMRC sent each of the appellants a notice under section 695, stating that section 684 might apply.

(10) Each of the appellants then made a statutory declaration pursuant to section 696, stating that section 684 did not apply. On 8 February 2022 HMRC made a counter-statement pursuant to section 697. The matter was submitted to the Tribunal to determine whether there was a prima facie case for further action to be taken in relation to each appellant and on 10 March 2022 the [FTT] issued a conclusion stating that there was.

(11) On 4 April 2022 HMRC issued the counteraction notices and assessments as set out in paragraph [3] above. The appellants appealed against these to HMRC on 29 April 2022. On 13 May 2022 HMRC provided their view of the matter upholding their decision and offering a review. The appellants submitted their appeals to the Tribunal on 26 May 2022.

(12) On 16 November 2022, the [FTT] directed that these appeals be joined, and on 22 January 2024 the [FTT] directed that they be stayed until 30 days after the final determination of the Relevant Consideration Issue in an earlier appeal. The decision in the earlier appeal was issued by the First-tier Tribunal ("FTT") on 8 May 2024 (*Osmond and Allen v HMRC* [2024] UKFTT 00378 (TC) ("*Osmond*"). The Relevant Consideration Issue in that decision is not being appealed to the Upper Tribunal ("UT") in *Osmond* so the stay was lifted on 25 September 2024.

The issues before the FTT

13. Before the FTT, the Appellants accepted that, if section 685 applied, the remaining conditions for the issue of a counteraction notice were satisfied (FTT [12]).

14. The only issue before the FTT was whether the effect of section 685(6) was to exclude the repayment of capital which formed part of the Capital Reduction from the circumstances in section 685(2)(a) so that condition A could not be met (FTT [15]). The Appellants did not pursue a separate ground of appeal, which was referred to in their Notices and Grounds of Appeal to the FTT, to the effect that the consideration received by the Appellants pursuant to the Capital Reduction represented share capital and accordingly did not comprise and did not represent the value of assets available for distribution by way of dividend within section 685(4).

15. On the arguments before the FTT, that issue came down to two key questions:

(1) The first was whether section 685(6) ITA, which refers to section 685(2)(a) and (b), contained a drafting error and should instead be read as referring to section 685(4)(a)(i) and (ii)?

HMRC argued that there was a clear drafting error, which met the criteria set out by the House of Lords in *Inco Europe Limited v First Choice Distribution* [2000] 1 WLR 586 ("*Inco Europe*") for the tribunal to adopt an interpretation to correct the mistake. The Appellants argued that there was no obvious error and the criteria in *Inco Europe* were not met.

(2) The second was whether, as the Appellants argued, section 685(6) as drafted, on a proper construction, excluded all returns of subscribed capital from the scope of section 685(2), or whether, as HMRC argued, section 685(6) excluded only returns of subscribed capital where, under the law of the place of incorporation of the company, those sums were themselves legally distributable by way of dividend?

The FTT Decision

16. The FTT dismissed the appeals against the counteraction notices (FTT [71]). Its reasoning was, in summary, as follows:

(1) The FTT rejected HMRC's submission that section 685(6) contained an obvious drafting error capable of correction by the tribunal (FTT [69]).

(a) The FTT found that the purpose of the changes to the TIS legislation in FA 2010 was to "replicate and simplify" the provisions in section 689 and 690 ITA in their form prior to the FA 2010 changes (FTT [27]).

(b) The FTT therefore undertook a process of comparing the effect of section 685(6) as drafted (i.e. cross-referring to section 685(2)) with the position under the legislation before the FA 2010 changes to determine if the effect was to "replicate and simplify" the legislation.

(c) On the facts of this case, under the law prior to the changes made by FA 2010, the full amount of the consideration received by the Appellants pursuant to the Capital Reduction represented "the value of assets available for distribution by way of dividend" within section 689(3) ITA (as originally enacted and which became section 685(4) following the FA 2010 changes) as GHL had distributable reserves (over £10 million) which exceeded the amounts received by the Appellants in the Capital Reduction. The consideration therefore would have been "relevant consideration" (FTT [31]-[40]).

(d) Under the law before the FA 2010 changes, the effect of section 689(5) ITA (which became section 685(6)) was to exclude amounts which represented subscribed capital from the calculation of relevant consideration where, under the law of the place of incorporation, they could be returned by way of dividend (FTT [45]).

(e) The effect of section 685(6) including the cross-reference to section 685(2) was to exclude returns of subscribed capital by companies that, under their law of incorporation could distribute capital by way of dividend, from the circumstances in condition A. That might be considered a simplification within the stated purpose even if it did disturb the previous "level-playing field" created by the provision in its previous form (FTT [57]).

(f) Having concluded that section 685(6) was limited to cases where under the law of the place of incorporation of the company, those sums were themselves legally distributable by way of dividend, the FTT decided that the *Inco Europe* criteria were not met. The provision was clear on its face. It was not "abundantly clear" that the draftsman had inadvertently failed to give effect to the stated purpose of replicating and simplifying the legislation. (FTT [69]).

(2) The arguments as to the effect of section 685(6) as drafted centred on the meaning of the phrase "despite the fact that". The Appellants submitted that the phrase meant "even

where". HMRC submitted that it meant "where". The FTT found that the phrase in section 685(6) ITA should be construed as meaning "where" rather than "even where" having regard both to the wording of the section itself and to the manner in which the equivalent provision operated prior to the FA 2010 changes. On that basis, section 685(6) did not apply to exclude all returns of subscribed capital from the scope of section 685(2) as argued by the Appellants (FTT [60]-[67]).

The Grounds of Appeal

17. The Appellants applied to the FTT for permission to appeal on five grounds. The FTT granted permission on four of those five grounds.

18. The Appellants renewed their application before the UT. The UT granted permission to appeal on all five grounds, albeit that the UT commented in granting permission that the five grounds could be viewed as reasons in support of a single ground of appeal: that the FTT erred in law in its construction of section 685(6) ITA 2007.

19. In summary, the five grounds of appeal are that:

(1) the language of section 685(6) is consistent with the Appellants' case; the words "despite the fact that" simply clarify that the exclusion of assets representing returns of sums paid by subscribers from section 685(2) applied equally to cases where those assets could have been paid out by way of dividend;

(2) it was implausible that Parliament could have intended to place returns of capital from companies that can distribute capital in a better position than returns of capital from UK limited companies, which was the effect of the FTT Decision;

(3) section 685(6) is focussed on the nature of the assets that are paid out not on the amount that could be paid out;

(4) that the Appellants' construction of section 685(6) was consistent with authorities in relation to the manner in which the prior legislation was applied; and

(5) the FTT relied on preconceptions as to the effect of the Appellant's interpretation, in particular, it accepted at FTT [64] without explanation that it would drive a "coach and horses" through the TIS legislation. Further, the FTT's construction gave rise to double taxation of repayments of share capital and loans.

20. HMRC, while supporting the outcome of the FTT Decision, also maintain by Respondents' Notice that the FTT was wrong to conclude that section 685(6) does not contain a drafting error.

The issues before this tribunal

21. The overall issue before us is therefore whether section 685(6) ITA applies to exclude the Capital Reduction from the circumstances of condition A in section 685(2)(a).

22. In much the same way as before the FTT, this issue was addressed by the parties by reference to two key questions:

(1) The first was whether, as HMRC contend in their Respondents' Notice, section 685(6) ITA contained a drafting error in that the reference to "section (2)(a) and (b)" in section 685(6) should be a reference to "section 685(4)(a)(i) and (ii)", and, if so, whether the tribunal has the power to correct that error following the principles outlined by the House of Lords in *Inco Europe*? We refer to this question as the "drafting error issue".

(2) The second is whether, as the Appellants contend in their grounds of appeal, section 685(6) applies to exclude all returns of subscribed capital from section 685(2)(a) and is not limited in its application to returns of subscribed capital by companies which, under the law of their place of incorporation, are legally able to distribute assets that represent the return of sums paid by subscribers by way of dividend. We refer to this question as the "scope of section 685(6) issue".

The parties' positions

23. We received detailed written and oral submissions from Mr Afzal KC and Mr Sykes KC on these questions. We are grateful to them both for their carefully considered submissions. We will refer to their detailed submissions as we address the issues on this appeal. However, rather than set out their technical arguments at this stage, we will outline the parties' overall positions.

24. As a starting point, neither party fully supports the FTT Decision. The FTT itself recognised that the FTT Decision does not produce a "level playing field". It results in a position where repayments of subscribed capital by companies that under the law of their place of incorporation can distribute capital by way of dividend (typically some non-UK companies and UK unlimited companies) are excluded from the circumstances in section 685(2)(a) and (b) and so excluded from condition A, but repayments of subscribed capital by companies that cannot lawfully distribute capital by way of dividend (such as UK limited companies) are not.

25. The parties argue, however, for different "level playing fields". The parties' respective positions are as follows.

26. The Appellants say:

(1) as regards the drafting error issue, and in agreement with the FTT, the reference in section 685(6) to section 685(2)(a) and (b) is clear and is not an obvious error; the *Inco Europe* criteria are not met;

(2) as regards the scope of section 685(6) issue, and in disagreement with the FTT, section 685(6) applies to repayments of capital by all companies; the "despite the fact" wording is concessive and should be read as meaning "even where".

27. This reading of section 685(6), the Appellants say, achieves a level playing field: all returns of subscribed capital irrespective of where the company was incorporated are excluded from the circumstances set out in section 685(2)(a) or (b). Where a distribution (in the broad sense) is identifiable as being sourced from share capital or premium by reference to its accounting treatment, condition A does not apply. Section 685(4) is not in point.

28. HMRC say:

(1) as regards the drafting error issue, and in disagreement with the FTT, the reference in section 685(6) to section 685(2)(a) and (b) is an obvious error; it should be a reference to section 685(4)(a)(i) and (ii). The *Inco Europe* criteria are met and the tribunal is required to correct the error;

(2) as regards the scope of section 685(6) issue, and in agreement with the FTT, section 685(6) is limited to returns of subscribed capital by companies that can distribute share capital or share premium by way of dividend under their law of incorporation. The "despite the fact" wording should be read as meaning "where".

29. This reading of section 685(6), HMRC say, achieves a level playing field: all returns of subscribed capital can fall within the circumstances set out in section 685(2)(a) or (b). However, amounts representing a return of subscribed capital are excluded from "amounts available for distribution" in section 685(4)(a)(i) and (ii): in relation to UK limited companies and others that cannot lawfully distribute capital by way of dividend, simply because those amounts are not "available for distribution"; and in relation to companies that can lawfully distribute capital by way of dividend by virtue of section 685(6).

30. HMRC say that section 685(4) in effect creates a "cap". The relevant consideration is capped at the amount of the distributable reserves so that any amounts paid out on a return of capital can be relevant consideration to the extent that there are available distributable reserves equal to those amounts.

Discussion

31. For both parties, the two questions are interrelated because they both speak to the coherence of the overall regime.

Principles of statutory construction

32. As the issue before us is one of statutory construction, we will begin by reminding ourselves of the relevant principles of statutory construction.

33. As regards the general principles that we should take into account, Mr Afzal KC referred us to the judgment of Lord Hodge in *R(on the application of O (a child)) v Secretary of State for the Home Department* [2023] AC 255, [2002] UKSC 3 ("*R(O)*"), a judgment with which Lord Briggs, Lord Stephens and Lady Rose all agreed. Lord Hodge said this at [29]-[32]:

> 29. The courts in conducting statutory interpretation are "seeking the meaning of the words which Parliament used": *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG* [1975] AC 591, 613 per Lord Reid. More recently, Lord Nicholls of Birkenhead stated: "Statutory interpretation is an exercise which requires the court to identify the meaning borne by the words in question in the particular context." (*R v Secretary of State for the Environment, Transport and the Regions, Ex p Spath Holme Ltd* [2001] 2 AC 349, 396.) Words and passages in a statute derive their meaning from their context. A phrase or passage must be read in the context of the section as a whole and in the wider context of a relevant group of sections. Other provisions in a statute and the statute as a whole may provide the relevant context. They are the words which Parliament has chosen to enact as an expression of the purpose of the legislation and are therefore the primary source by which meaning is ascertained. There is an important constitutional reason for having regard primarily to the statutory context as Lord Nicholls explained in *Spath Holme*, p 397: "Citizens, with the assistance of their advisers, are intended to be able to understand parliamentary enactments, so that they can regulate their conduct accordingly. They should be able to rely upon what they read in an Act of Parliament."
>
> 30. External aids to interpretation therefore must play a secondary role. Explanatory Notes, prepared under the authority of Parliament, may cast light on the meaning of particular statutory provisions. Other sources, such as Law Commission reports, reports of Royal Commissions and advisory committees, and Government White Papers may disclose the background to a statute and assist the court to identify not only the mischief which it addresses but also the purpose of the legislation, thereby assisting a purposive interpretation of a particular statutory provision. The context disclosed by such materials is relevant to assist the court to ascertain the meaning of the statute, whether or not there is ambiguity and uncertainty, and indeed may reveal ambiguity or

uncertainty: *Bennion, Bailey and Norbury on Statutory Interpretation*, 8th ed (2020), para 11.2. But none of these external aids displace the meanings conveyed by the words of a statute that, after consideration of that context, are clear and unambiguous and which do not produce absurdity. In this appeal the parties did not refer the court to external aids, other than explanatory statements in statutory instruments, and statements in Parliament which I discuss below. Sir James Eadie QC for the Secretary of State submitted that the statutory scheme contained in the 1981 Act and the 2014 Act should be read as a whole.

31. Statutory interpretation involves an objective assessment of the meaning which a reasonable legislature as a body would be seeking to convey in using the statutory words which are being considered. Lord Nicholls, again in *Spath Holme* [2001] 2 AC 349, 396, in an important passage stated:

> "The task of the court is often said to be to ascertain the intention of Parliament expressed in the language under consideration. This is correct and may be helpful, so long as it is remembered that the 'intention of Parliament' is an objective concept, not subjective. The phrase is a shorthand reference to the intention which the court reasonably imputes to Parliament in respect of the language used. It is not the subjective intention of the minister or other persons who promoted the legislation. Nor is it the subjective intention of the draftsman, or of individual members or even of a majority of individual members of either House … Thus, when courts say that such-and-such a meaning 'cannot be what Parliament intended', they are saying only that the words under consideration cannot reasonably be taken as used by Parliament with that meaning."

32. In their written case the appellants sought to support their contention that a child's acquisition of substantial ties with the UK by spending time in the UK in the first ten years of his or her life created a complete entitlement to citizenship by referring to statements by a Government minister, Timothy Raison, to the Standing Committee which considered an amendment which became section 1(4) to the 1981 Act. Such references are not a legitimate aid to statutory interpretation unless the three conditions set out by Lord Browne-Wilkinson in *Pepper v Hart* [1993] AC 593, 640 are met. The three conditions are (i) that the legislative provision must be ambiguous, obscure or, on a conventional interpretation, lead to absurdity; (ii) that the material must be or include one or more statements by a minister or other promoter of the Bill; and (iii) the statement must be clear and unequivocal on the point of interpretation which the court is considering. It was not argued, and I am not satisfied, that the first and third conditions are met in this case. The court was not referred to any relevant provision of primary legislation that was said to be ambiguous and the statements in any event did not meet the stringent requirements of the third condition. Sir James Eadie in para 10 of the Secretary of State's written case referred to a ministerial statement in the House of Lords during the passage of the 2014 Act which sought to explain the policy behind what became section 68 of that Act. But it is not argued that this reference is admissible because the first condition in *Pepper v Hart* has been met. I am satisfied that there is no such ambiguity, obscurity or absurd result in the relevant statutory provisions which would allow the court to have regard to that statement.

34. The key principles that we take from this passage are:

(1) The process of statutory interpretation is one of seeking the meaning of the words that Parliament has used. Words and passages in a statute derive their meaning from their context. The words that Parliament has chosen to enact as an expression of the purpose of the legislation are therefore the primary source by which meaning is ascertained.

(2) External aids to interpretation therefore play a secondary role. Explanatory notes may cast some light on the meaning of a particular provision. Other sources may assist in

identifying the context of the legislation and so assist a court or tribunal in ascertaining the meaning of the statute and whether or not there is any ambiguity or uncertainty. But external aids cannot displace the meanings conveyed by the words of a statute that are clear and unambiguous and do not produce absurdity.

(3) Statutory interpretation involves an objective assessment of the meaning which Parliament would be seeking to convey by the statutory words. The phrase "the intention of Parliament" is a shorthand reference to the intention which the court reasonably imputes to Parliament in respect of the language used. It is not a reference to the subjective intention of the persons who promoted the legislation, the draftsman, or members of Parliament.

(4) Statements by government ministers in the course of parliamentary debates in relation to particular provisions are not a legitimate aid to statutory interpretation unless the conditions set out by Lord Browne-Wilkinson in *Pepper v Hart* [1993] AC 593 are met. However, reports of legislative debates may be referred to, outside the rule in *Pepper v Hart*, to supply context or identify the mischief at which legislation is aimed (*Bennion, Bailey and Norbury on Statutory Interpretation*, 9th ed (2026) ("*Bennion*"), paragraph 24.12).

Relevance of prior legislation and case law

35. Both parties referred extensively to the legislative history and the case law relating to it in support of their positions. Mr Afzal KC relies on the legislative history and the related case law in support of his submissions that the FA 2010 legislation contained an obvious error and that section 685(6) is confined to repayments of capital by companies that are otherwise able lawfully to distribute capital by way of dividend. Mr Sykes KC relies on the related case law to demonstrate that, irrespective of the wording of the legislation in its various iterations, repayments of subscribed capital have been excluded from the TIS legislation.

36. Nonetheless there were some differences between the parties as to the relevance of the legislative history of the transactions in securities legislation and the principles that we should derive from the case law that has considered it.

37. Mr Sykes KC referred us to the judgment of Lord Diplock in *Inland Revenue Commissioners v Joiner* [1975] STC 657 at p670 where, in the context of a counteraction notice under section 460 ICTA 1970, Lord Diplock counselled against reference to previous legislation to interpret the meaning of a consolidating statute unless the language of the consolidating statute was itself ambiguous.

38. Mr Afzal KC referred us to two sections from *Bennion*.

39. The first was paragraph 24.5 which concerns the relevance of earlier statutory provisions as an aid to interpretation. It states:

> In order to understand the meaning and effect of a provision in an Act it is essential to take into account the state of the previous law and, on occasion, its evolution.
>
> **Comment**
>
> At its most basic level, the purpose of an Act is normally to make changes in the law. In order to understand the meaning and effect of a provision it is essential to understand the state of the law at the time the Act was passed. The court cannot soundly judge the mischief that a provision is intended to remedy unless it knows the previous state of the law, the defects found to exist in that law, and the facts that caused the legislature to

> pass the legislation. Moreover, an Act is drafted against the backdrop of general legal principles and with a view to the Act taking its place in the wider scheme of statutory and common law rules. The courts will often look to the previous law to support a particular construction.
>
> …
>
> **Legislative evolution**
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> Where a subject has been dealt with by a developing series of Acts, the courts often find it necessary, in construing the latest Act, to trace the course of this development. By seeing what changes have been made in the relevant provision, and why, the court can better assess the provision's intended meaning.

40. The second was paragraph 24.6 which concerns the judicial interpretation of earlier legislation. It reads as follows:

> **Judicial interpretation of earlier legislation ('Barras principle')**
>
> (1) Where an Act uses a word or phrase that has been the subject of previous judicial interpretation in the same or a similar context it may be possible to infer that the legislature intended the word or phrase to bear the same meaning as it had in that context. This is sometimes known as the Barras principle.
>
> (2) This is at most a presumption the strength of which will vary according to the context: there is no rigid rule that words must be given the same meaning that they have been given in an earlier Act. The question in the end is always whether the legislature intended the term to be given the meaning it has been given previously.

41. We have taken these principles into account. We accept Mr Afzal KC's submission that neither principle depends upon any element of ambiguity in the statutory provision in question. However, the principles have their limits. Paragraph 24.5 concerns reference to prior legislation in order to determine the background against which a proposed legislative provision is being made. As can be seen from the related commentary, the relevance of the legislative history is similar to that of other external aids. Paragraph 24.6, known as the "Barras principle", concerns the reference to judicial interpretation of a word or phrase in earlier cases to be used as an aid to interpretation of a word or phrase that appears in the relevant statute in appropriate circumstances. But as the commentary in *Bennion* notes, it is no more than an assumption "the strength of which will vary according to the context". Prior judicial interpretation should be seen as no more than a starting point.

42. These principles cannot distract from the fundamental requirement which is to interpret the meaning of the statute before the tribunal – in our case section 685 following the FA 2010 changes – primarily by reference to the statutory context as described by Lord Hodge in *R(O)* at [29]. In this respect, we are also mindful of the words of Lord Nicholls in *R (on* the *application of Spath Holme Ltd) v Secretary of State for the Environment, Transport and the Regions* [2001] 2 AC 349 ("*Spath Holme*") which are referred to in the judgment of Lord Hodge in *R(O)* to which we refer earlier, in relation to the importance of statutory context as the basis of statutory interpretation that (*Spath Holme* p397):

> "Citizens, with the assistance of their advisers, are intended to be able to understand parliamentary enactments, so that they can regulate their conduct accordingly. They should be able to rely upon what they read in an Act of Parliament."

43. We also note Lord Nicholls' advice to courts and tribunals later in the same judgment "to approach the use of external aids with circumspection" (*Spath Holme* p398).

The development of the transactions in securities legislation

44. With those reservations in mind, we turn to the development of the TIS legislation. The legislation has gone through various iterations since it was first enacted in FA 1960. We will focus on the changes that have been made to those aspects of the legislation that are relevant for the purposes of this appeal. The relevant provisions are set out in the Appendix to this decision notice.

FA 1960

45. Section 28 FA 1960 permitted HMRC to issue a counteraction notice in the various circumstances set out in paragraphs (a) to (d) of subsection (2). The relevant circumstance for our purposes was set out in paragraph (d), but that paragraph drew on drafting that appears in paragraph (c). We will refer to the circumstance which was contained in paragraph (d) and which forms the basis of condition A in section 685(2) throughout its evolution as "circumstance D" in this decision.

46. Paragraph (d) applied when a person received a consideration as is mentioned in paragraph (c), namely "a consideration which either is, or represents, the value of assets which are (or apart from anything done by the company in question would have been) available for distribution by way of dividend". This is wording which under the TIS legislation following the FA 2010 changes is found in the definition of "relevant consideration" in section 685(4).

47. There was an exception from "assets" mentioned in paragraph (c) which is found below paragraph (d) amongst the definitions. It excluded from "assets" mentioned in paragraph (c) any "assets which (while of a description which under the law of the country in which the company is incorporated [are] available for distribution by way of dividend) are shown to represent a return of sums paid by subscribers on the issue of securities". This is wording which under the TIS legislation following the FA 2010 changes is largely found in section 685(6). However, on the wording of section 685(6), the cross-reference is to the description of the circumstance (in section 685(2)) not to the definition of relevant consideration (in section 685(4)).

48. The parties referred us to various extracts from the Parliamentary debates relating to the introduction of the TIS legislation in FA 1960. For the most part, these extracts concerned the introduction of an amendment to the legislation which became this exception. In the debates on the Finance Bill (clause 27) for 6 July 1960, Hansard records that the Attorney-General said this in relation to the amendment:

> The Attorney-General
>
> …This Amendment is designed to take out of the scope of Clause 27 payments which are, in effect, returns by overseas companies of subscribers' capital. Paragraph (d) of the Clause, as amended, is only intended to catch the considerations as defined in paragraph (c), representing in effect profits which the person in question receives in non-taxable form. It ought therefore to have no application to what is, in effect, a return of subscribed capital. The possibility that the Clause can go too wide in this respect arises in the company law of an overseas country, because that law may have the effect that certain amounts subscribed for shares are available for payment of dividends. For example, under South African law amounts subscribed for shares and put to the share account before 1952 are available for payment of dividends and would attract liability to tax as dividends if paid in this way to shareholders in the United Kingdom. If the South African company sought to escape this tax liability by making a bonus issue out of the share account the Clause would apply to impose a tax on capital paid in by the company subscribers, and it is the purpose of the Amendment to prevent that from happening. The Amendment accordingly says that assets mentioned in paragraph (c), assets available for distribution as dividends, do not include assets shown to represent

> a return of sums paid by subscribers on the issue of securities, although those assets might be of a description which was or would have been available for distribution by way of dividends under the law of the country in which the company is incorporated.

49. Later in the same debate, there is the following exchange:

> The Attorney-General
>
> I speak again by leave of the House. I assure the hon. and learned Member that this is necessary for this reason. If he will look again at paragraph (c)—I think it is convenient to look at it in the Bill— the consideration is something "which either is, or represents the value of, assets which are … available for distribution by way of dividend." That is the difficulty. Under the law overseas, as I gave the illustration, certain capital could be available for distribution under the law there by way of dividend. That brings the case clearly within paragraph (c). This makes it quite clear that where the sum being distributed, or which is capable of being distributed, by way of dividend which is in fact a return of capital to subscribers, that does not come within the scope of paragraph (c). We have proceeded on the basis of trying to define subsection (2) as closely as possible. We feel, in view of the use of the words "by way of dividend" in Clause 27, it is essential to make this Amendment, which can apply only to companies of the character to which I have referred, so as to make quite clear where there is a return of capital it does not come within the scope of paragraph (c) because it could be distributed "by way of dividend".
>
> Mr. Millan
>
> Would a payment of that sort be in any way taxable without this Amendment? I should have thought it would be attributable to the return of capital and could not be taxed in any case. Is the Attorney-General saying by implication that this is something which could be taxed?
>
> The Attorney-General
>
> I speak again by leave of the House. I was not saying anything by implication but merely dealing with the position of overseas companies.

50. The parties disagreed as to the basis on which it is appropriate to refer to these extracts. Mr Sykes KC submitted that the *Pepper v Hart* criteria were met but that he only need to refer to these extracts by way of confirmation of the conclusions that could be reached from other sources. He referred to these extracts in support of his submissions that the Parliamentary intention of the earlier legislation was that repayments of capital whether by UK incorporated or non-UK incorporated companies would not be caught by the TIS legislation and that was because it was necessary to have regard to the fund out of which a payment was made in determining whether it was an amount that was available for distribution by way of dividend. He referred in particular to the Attorney General's statement in the first extract above, "It ought therefore to have no application to what is, in effect, a return of subscribed capital" in this respect.

51. Mr Afzal KC's starting point was that it is permissible to refer to these extracts to supply context or as evidence of the mischief at which the provisions were aimed. However, if there is any ambiguity, the *Pepper v Hart* criteria would be met. He referred to these extracts in support of his submissions that the exception (in section 685(6)) was intended to cross-refer to the determination of the consideration (in section 685(4)) and that the exception was limited to companies that could lawfully distribute subscribed capital by way of dividend.

ICTA 1970 and ICTA 1988

52. We do not need to spend much time on the form of the TIS legislation in ICTA 1970 and ICTA 1988: the provisions are reorganised but the wording is largely retained. The circumstances are set out in separate subparagraphs of section 461 ICTA 1970 and then section 704 ICTA 1988. The relevant circumstance for our purposes (circumstance D) was in section 461D ICTA 1970 and then section 704D ICTA 1988. Once again, these provisions cross-referred to drafting that appears respectively in section 461C ICTA 1970 and then section 704C ICTA 1988. The wording of the exception which forms the basis of section 685(6) became section 461C(2) ICTA 1970 and then section 704C(2) ICTA 1988 but remained tied to the question of whether assets are available for distribution by way of dividend for the purpose of the definition of the consideration that was subject to circumstance D.

ITA 2007 (as enacted)

53. As part of the Tax Law Rewrite project, the TIS legislation was substantially rewritten. The Tax Law Rewrite materials did not, however, identify any intention to make a change in the law.

54. The relevant circumstances were set out in separate sections without the cross-references. Circumstance D was found in section 689 ITA. As can be seen from the extract that is set out in the Appendix:

> (1) the description of the transaction to which circumstance D relates is in section 689(2) ITA – being, for our purposes, the receipt of consideration "in connection with the distribution, transfer or realisation of assets of a relevant company";
>
> (2) the description of the consideration is set out in section 689(3) – this is the wording that under the TIS legislation following the FA 2010 changes is found in the definition of "relevant consideration" in section 685(4)(a);
>
> (3) the exception – which forms the basis of the wording of section 685(6) in the TIS legislation following the FA 2010 changes – is found in section 689(5) ITA but has been recast. It cross-refers to sub-section (3) (the description of the consideration) and includes for the first time the "despite the fact that" wording that is the subject of argument in this appeal.

FA 2010

55. Significant changes were made to the TIS legislation by FA 2010.

56. We have set out the provisions of the legislation following these changes earlier in the decision. The relevant provisions are in the new section 685. The key points to note for the purposes of this appeal are that the exception in section 685(6) cross-refers to the description of the transactions in section 685(2) and not the definition of the consideration (referred to as "relevant consideration") which is found in section 685(4). Section 685(6) uses the "despite the fact that" wording that first appeared in section 689 ITA when it was first enacted.

57. The changes made by FA 2010 were the subject of a consultation exercise undertaken by HMRC. The consultation document was published on 31 July 2009 and entitled "Simplifying Transactions in Securities Legislation" (the "2009 Consultation Document"). The proposals outlined in the consultation document were wide ranging. The changes to the legislation are described in the consultation document as "a fundamental and significant change in the approach and application of the TIS legislation" (paragraph 2.4). The proposed measures included:

(1) the repeal of several of the “circumstances” in which a counteraction notice could be issued;

(2) the reduction in the scope of the legislation to apply only to close companies;

(3) the incorporation of an exclusion for transactions involving a fundamental change of ownership of a company;

(4) a revised definition of “tax advantage” to simplify the means of calculating the amount of any advantage; and

(5) a revised purpose test.

58. The reduction in the number of circumstances in which a counteraction notice could be issued left only two circumstances to be reflected in the revised legislation: one based on the former circumstance D (at the time contained in section 689 ITA); and one based on circumstance E (at the time contained in section 690 ITA). These two circumstances were to be amalgamated into a revised provision the aim of which was to “replicate and simplify” those provisions (paragraph 5.3).

59. The 2009 Consultation Document did not refer to any specific material changes that were to be made to these two circumstances beyond the aim to “replicate and simplify” the legislation. The proposed drafting changes were, however, included in draft clauses set out in Annex C to the 2009 Consultation Document. That Annex included legislation to implement the proposals as a whole by repealing the entirety of sections 682 to 694 ITA (as enacted) and their replacement with entirely redrafted legislation. Amongst the new provisions was a draft of what became section 685, which was enacted in the same form in FA 2010. In particular, that draft included a draft of what became section 685(6) in the same form in which it was enacted in FA 2010 i.e. including the reference to section 685(2)(a) and (b).

FA 2016

60. As part of their arguments, the parties referred to changes made to the TIS legislation by FA 2016. Those changes only took effect after the transactions that are relevant for the purposes of this appeal, but for the sake of completeness, we will refer to them here.

61. In FA 2016, various changes were made. Amongst them section 685(6) was repealed. It was replaced by two new subsections: sub-section (7A) and subsection (7B). New section 685(7A) repeats the wording of section 685(6), but with two material changes: the first is to replace the reference to subsection (2)(a) and (b) with a reference to subsection (4)(a)(i) and (ii); and the second is to replace the “despite the fact that” wording with the words “merely because”. The revised legislation is set out in the Appendix to this decision.

62. As for the reasons for these changes, the Explanatory Notes that accompanied the draft legislation provide no helpful guidance. The Appellants, however, refer to the consultation document issued by HMRC in advance of the changes made by FA 2016. This consultation document was issued on 9 December 2015 and entitled “Company Distributions” (the “2015 Consultation Document”). It included an example in paragraphs 3.11 and 3.12 of the type of transaction at which this change was directed.

63. The example bears some similarity to the facts of this case. It was as follows:

A repayment of share capital (including share premium)

3.11 When a company repays part of the shareholders’ capital, the payment is not treated as a distribution. This recognises that where the company is merely returning to the shareholder what the shareholder originally paid in, there should not be an income tax charge. The government is satisfied that this is the correct position.

3.12 However, where it is possible to increase the amount of "capital" repaid to shareholders, the government is concerned that an opportunity to convert income to capital arises.

Example 2

Gavin is the sole shareholder of Gavin Industries Limited (GI Limited), which was formed with £100 of share capital. After successfully trading for a number of years GI Limited has retained profits of £250,000 and no other assets. Gavin decides to pay himself a dividend of £250,000, which is subject to income tax as a distribution.

Sebastian is the sole shareholder of Sebastian Industries (SI Limited), which was formed with £100 of share capital. After successfully trading for a number of years SI Limited also has retained profits of £250,000 and no other assets. For a number of reasons, Sebastian is advised to create a new holding company, SI Holdings Limited (SIH Limited), which is achieved via a share for share exchange in which SIH Limited issues £250,100 of share capital.

Sebastian now holds all of the share capital in SIH Limited, which holds all of the shares in SI Limited. SIH can repay £250,000 of share capital to Sebastian. This transaction is classed as a repayment of capital and is subject to CGT. Both Gavin and Sebastian will receive £250,000 from their companies, but, due to the creation of a holding company, Sebastian can benefit from lower CGT rates.

64. The comments in the 2015 Consultation Document appear to show that HMRC was aware of arguments that the TIS legislation may not apply to certain repayments of capital. Mr Afzal KC however points out that the consultation document also records in a footnote that the example to which we have referred above "does not reflect HMRC's view of the correct tax treatment in all circumstances".

Observations on the development of the TIS legislation

65. As can be seen from the above history of the legislation relating to circumstance D:

(1) the wording of the legislation (albeit in different formats) remained relatively consistent until the FA 2010 changes;

(2) in all legislation prior to the FA 2010 changes, the exception that appears in s685(6) was an exclusion to be taken into account in the determination of the consideration for the purposes of circumstance D and not an exclusion from the description of the transactions that could fall within circumstance D;

(3) the "despite the fact that" wording that appears in section 685(6) first appears in ITA as it was enacted as part of the Tax Law Rewrite.

Case law relating to earlier versions of the transactions in securities legislation

66. The parties referred us to various authorities decided under earlier versions of the transactions in securities legislation. We will refer to the four main authorities.

67. We were not referred to any case law authority directly concerning the version of the TIS legislation that was in force at the time of the Capital Reduction, that is, following the changes made by FA 2010 and before the amendments made by FA 2016. The relevance of the authorities is therefore limited to the extent that they assist in understanding the purpose and operation of provisions from which section 685 was derived.

Hague

68. The first authority is *Inland Revenue Commissioners v Hague* 44 TC 619 ("*Hague*"). The case concerned a share capital reorganisation, in which additional shares were paid-up out of capital redemption reserve (£60,000) and distributable reserves (£129,490). This was followed by a reduction and repayment of capital in an amount equal to the paid-up capital prior to the reorganisation (£284,235). The issue before the court was whether, and to what extent, the shareholder (Mr Hague) had received consideration representing the value of "assets... available for distribution by way of dividend" (or which would have been so available apart from anything done by the company) within the meaning of section 28(2)(c) FA 1960 (being the predecessor to section 685(4)).

69. The two significant features of the case for present purposes are that: (i) the repayment was made from an identified fund (the share capital account) containing different constituent elements, including both the original subscribed capital and amounts that had previously formed part of distributable reserves; and (ii) the amount of the distributable reserves of the company prior to the reorganisation significantly exceeded the amount that was repaid to the shareholders (see facts as found by the Commissioners para 4(5) at *Hague* p621G-H, and the reference to the facts made by Salmon LJ at *Hague* p639H).

70. In the High Court, counsel for Mr Hague argued that no part of the repayment of capital was attributable to the value of assets available for distribution by way of dividend (*Hague* p631E). Counsel for HMRC submitted that, notwithstanding that the payment was made out of share capital account, it was appropriate to attribute the repayment first to the amount in that capital account that represented the distributable reserves that had been capitalised (*Hague* p631F).

71. Cross J considered that an apportionment exercise was required, but did not agree with either approach. He said this (at *Hague* p631G):

> ... The payment made to Mr. Hague came out of a capital of £473,725, made up as to £284,235 and £60 ,000 of sums never available for distribution by way of dividend, and of £129,490 which prior to its capitalisation was available for distribution by way of dividend. Consequently, as I see it, the fraction to apply to the payment made to Mr. Hague is 129,490 over 473,725.

72. The effect of Cross J's apportionment was therefore to treat the proportion of the amount received by Mr Hague that was attributable to the value of assets available for distribution as being the proportion that the amount of distributable reserves that had been capitalised in the share capital reorganisation bore to the total capital after the reorganisation and prior to the repayment. The basis for this is not expressly stated. Cross J limited his analysis to the share capital account from which the repayment was made on the grounds that the payment "came out of capital of £473,725". He did not refer to the other reserves that were available. Instead, Cross J treated part of that account as available for distribution, we can only assume – it is not stated – on the basis that that amount represented assets that would have been available apart from something done by the company (the capitalisation).

73. On appeal, the Court of Appeal adopted HMRC's proposed method of apportionment. Danckwerts LJ said this (at *Hague* p637H-638A):

> On the second point the question is one of quantification. The learned Judge correctly states that the problem appears to be to discover how much of the sum received by Mr. Hague, which was obviously "the consideration" referred to in the section, was attributable to the £129,490 which prior to the capitalisation was available for distribution by way of dividend. The learned Judge rejected the submission on behalf

> of the taxpayer that none of it was so attributable, but he also rejected the contention on behalf of the Crown that the proportion of the sum received by Mr. Hague which was to be attributable to the £129,490 was the fraction 129,490 over 284,235, and adopted as the denominator for the fraction the figure of 473,725, which was the figure (in pounds) of the company's increased capital. The problem is not a simple one, but I have come to the conclusion that the fraction stated by Cross J. is not the correct one, and the denominator of 284,235 is the correct figure, being the amount (in pounds) that was distributed to the shareholders.

74. The Court of Appeal's approach was therefore: first, to identify the fund from which the payment was made; and second, to determine the extent to which a payment from that fund could be represented by assets available for distribution by way of dividend by, in effect, treating the amount of distributable reserves that had been capitalised in the share capital reorganisation as forming the first part of the identified capital that was repaid to the shareholders. This can be seen more clearly from the judgment of Salmon LJ where he said (at *Hague* p640D-G):

> I think perhaps this question can be tested in this way: Supposing that, instead of hitting upon the magic figure of £284,000 to pay out to the shareholders, the company, for exactly the same reasons as those expressed in the case, had decided to pay out £129,000 to the stockholders: £129,000 is taken from the undistributed profits and capitalised, together with the £60,000 to which I have already referred; then those capitalised profits and that capitalised £60,000 is issued in the form of bonus shares to stockholders, so that the total issued paid-up capital is £473,000, and then the capital is reduced by £129,000; that is very satisfactory from the point of view of the stockholders. Instead of £129,000 being distributed as a dividend, as it could have been, out of the accumulated profits, which would have had the uncomfortable result of making them liable to surtax, it comes to them as a reduction in capital. Now, could they say: "Oh, well, really you must look at this transaction as nothing more than an ordinary reduction in capital, and although I happen to have received the £129,000 which came into the capital from the undistributed profits, you can tax me only on £129,000 x 129 / 473"?
>
> I think this would be ridiculous, because it is quite obvious that the £129,000 of undistributed profits was put into the pockets of the stockholders. I do not think it makes the slightest difference that there was £284,000 paid out instead of £129,000; instead of the fraction being 129 over 129 (namely, the whole) as it would have been if £129,000 had been paid out, the right fraction is 129,000 / 284,000, since only £129,000 came out of undistributed profits.

75. The Appellants place considerable reliance on *Hague*. They say that the case demonstrates that where a payment can be identified as representing subscribed capital, that element is excluded from the operation of the TIS legislation even if the company retains distributable reserves. HMRC submit that *Hague* was decided by reference to a different legislative structure and does not determine the proper construction of section 685.

76. *Hague* is the only authority to which we were referred in which the court had to address directly a payment made from an identified fund (share capital account) containing elements attributable to both subscribed capital and reserves that would have been distributable but for steps taken by the company. The decision provides some support for the proposition that the source of the payment is relevant to the determination of the consideration that falls within circumstance D, rather than the enquiry under the predecessors of section 685(4) being directed solely to the total amount of distributable reserves available within the company at the relevant time. In that sense, the decision of the Court of Appeal in *Hague* is not consistent with the "cap" analysis of section 685(4) that Mr Afzal KC propounds and supports Mr Sykes KC's submission that the fund from which the payment was made must be respected.

77. We note, however, that the argument was not put to either the High Court or Court of Appeal in that form. HMRC's case before both Cross J and the Court of Appeal was limited to the argument that part of the consideration received by the shareholders equal to the amount of the capitalised reserves should be regarded as representing the value of assets that were available for distribution by way of dividend (or would have been so available apart from the capitalisation).

Brown

78. The next authority is *Inland Revenue Commissioners v Brown*, in which the High Court decision is reported at [1971] 1 WLR 11 ("*Brown HCT*") and the Court of Appeal decision is reported at [1971] 1 WLR 1495 ("*Brown CA*").

79. In that case, the taxpayer (Mr Brown) and his wife owned shares in six companies. Mr Brown transferred all of his shares in five of the companies to the sixth company in consideration for an amount in cash and loan notes. Payments to Mr Brown by the sixth company were funded by bank borrowing. The case concerned the application of section 28(2)(c) and (d) FA 1960. The principal issue was the meaning of the phrase "assets... available for distribution by way of dividend" in section 28(2)(c) FA 1960.

80. In the High Court, Megarry J held that "available" in that context meant legally available rather than commercially available. In reaching that conclusion, he referred to the predecessor of what became section 685(6). He regarded the provision as addressing circumstances in which, under the law of the relevant jurisdiction, assets representing subscribed capital were legally available for distribution by way of dividend. The provision therefore supported an interpretation of section 28(2)(c) FA 1960 based on legal availability for distribution.

81. Megarry J said this (at *Brown HCT* p26 D-H):

> There is one other part of subsection (2) to which I should refer. In the latter part of subsection (2) there are the words which I have already quoted, running
>
> > "the assets mentioned in paragraph (c) of this subsection do not include assets which (while of a description which under the law of the country in which the company is incorporated is available for distribution by way of dividend) are shown to represent a return of sums paid by subscribers on the issue of securities:"
>
> For brevity, I may call this the "foreign law clause." These words make it plain that whatever may be said by the law governing a foreign company, assets which represent a return of capital are not to be included in "assets" for the purposes of the subsection. The word "available" is there used in relation to what is legally available, and so, says Mr. Monroe, "available" simpliciter in paragraph (c) ought to be read in the same way.
>
> One may expand this argument a little. If "available" in paragraph (c) means "legally available," then the foreign law clause falls neatly into place. In the ordinary case, assets representing a return of capital are not "available" because they are not "legally available"; and even if the company is a foreign company and under the relevant law such assets are legally available, the foreign law clause prevents them being "available" for the purposes of paragraph (c). All companies are thus on the same footing. Furthermore, the word "available" in the foreign law clause can be read as "legally available" without difficulty.

82. The Court of Appeal affirmed that conclusion (*Brown CA* per Russell LJ at p499).

83. HMRC rely on these observations as supporting their interpretation of section 685(6) and, in particular, their submission that the predecessor provision was directed at and limited to companies

legally capable of distributing subscribed capital by way of dividend. The Appellants submit that the observations were not directed to the issue now before us, which concerns the effect of the changes made by FA 2010, and should be treated accordingly.

Addy

84. We were also referred to the judgment of Goff J, as he then was, in *Addy v IRC* 51 TC 71 ("*Addy*").

85. The case concerned a reconstruction and liquidation of a company under which the business and assets were transferred to a new company and the shareholders received shares in the new company and a distribution of cash in an amount that was less than the paid up capital of the original company. HMRC issued a counteraction notice in respect of the cash distribution. Goff J upheld the counteraction notice.

86. In discussing *Hague*, and the application of section 28(2)(c) and (d) FA 1960, Goff J observed that apportionment had been required in *Hague* because the repayment had come from a fund with several constituent elements, including share capital and capitalised reserves. But no such apportionment exercise was required on the facts in *Addy*. He said this at *Addy* (p83E-H):

> ...So construed, the section applies where, in connection with the distribution or transfer or realisation of profits or income or reserves or other assets, a person receives a consideration which either is or represents the value of assets available for distribution by way of dividend; and in my judgment those words are in no way limited to distributions out of revenue funds. The crucial words are "available for distribution by way of dividend", and that means legally so applicable: see *Commissioners of Inland Revenue v Brown* 2 47 TC 217, at page 235, where Megarry J. said: …. my conclusion is that the word 'available' in subs. (2)(c) and, by incorporation, in subs. (2)(d), bears the meaning of 'legally available' ", which conclusion and the reasons for it were unreservedly adopted by Russell L.J. when the case reached the Court of Appeal: see the same report at page 236. Oldco's capital reserve was so available. It is only the share capital itself, any share premium account (Companies Act 1948, s. 56) and any capital redemption reserve fund (s. 58) which are not available. Therefore, Mr. Bromley submits, there is no need for any apportionment because the amount distributed was less than the total available for distribution by way of dividend. In my judgment that is correct.
>
> Apportionment was necessary in *Hague's* case because the fund from which the distribution came had three constituent elements: the share capital, a capital redemption reserve fund and capitalised reserves. The first two were not available for distribution as dividend; the third was. The nature of the problem was clearly explained by Cross J. [1969] 1 Ch., at page 405 and 44 T.C., at page 631. The Court of Appeal accepted that this was the problem, although they adopted a different answer, since they considered the only aggregate to be taken into account was the actual amount distributed and not the total increase of capital. This, however, does not seem to me in any way to conflict with Mr. Bromley's analysis. Accordingly, in my judgment, the Commissioners were also correct in rejecting apportionment.

87. HMRC rely on *Addy* as supporting their analysis of what became section 685(4) as operating as a "cap" on the amount of relevant consideration. In this respect, they refer, in particular, to Goff J's acceptance of the argument that no apportionment is required where "the amount distributed was less than the total available for distribution by way of dividend". On the other hand, the Appellants note that Goff J distinguishes *Hague* by reference to the nature of the "fund from which the distribution came" and submit that the decision is at least consistent with an approach that requires attention to the source of the payment.

88. In our view, the conclusions that Mr Afzal KC seeks to draw from this aspect of *Addy* go too far. When Goff J states that "the amount distributed was less than the total available for distribution by way of dividend", he is clearly commenting on the case of *Brown* and the facts of the case before him. In neither case was a distribution made from a fund representing subscribed capital. In *Brown*, the consideration in question was the proceeds of the sale of shares in the relevant companies, which was funded by bank borrowings. *Addy* concerned a liquidation distribution, where the distribution was made out of an undifferentiated fund. Neither case involves a distribution, as in *Hague*, by reference to an identified fund, which included subscribed capital. Goff J was clearly aware of the detail of the decision in *Hague*; he distinguishes the facts in *Hague* from those before him. Goff J's comments contain no suggestion that *Hague* was wrongly decided. Indeed, his comments towards the end of the passage that we have quoted above suggest support for the analysis of the Court of Appeal in *Hague*.

89. The other aspect of Goff J's judgment in *Addy* to which we were referred were his comments on the wording in section 28(2) FA 1960 which is found in section 685(6). He said this (at *Addy* 84C-F):

> The Appellant's submission was that the Commissioners simply failed to discharge their statutory duty to exclude assets shown to represent a return of sums paid by subscribers on the issue of securities as provided in s. 28(2) in the passage immediately following the definition clause in para. (d) and that there is nothing in the Act about including or not excluding such assets if there be some quid pro quo. In my judgment, however, the passage in the section relied on has no application because it relates solely to foreign companies: see per Cross J. in *Hague's* case [1969] 1 Ch., at page 405 and 44 TC, at page 631, and per Megarry J. in *Commissioners of Inland Revenue v Brown* 47 TC 217, at page 234 - and his reasoning, it will be remembered, was adopted by Russell L.J. at page 236. Where the company is an English one assets representing share capital are excluded, but not because of this provision. It is because they are manifestly not available for distribution as dividend. In such circumstances, however, no problem arises unless, as in *Hague's* case, but not the instant case, the amount distributed exceeds the reserves, whether of a revenue or a capital nature, which are available for distribution as dividend. In my judgment, therefore, the Commissioners reached the right conclusion on this question, not precisely for the reasons which they state but for the reasons which I have just given.

90. *Addy* is therefore also authority for the view that – at least in the context of section 28(2)(c) FA 1960 – the wording that formed the basis of what is now section 685(6) should be regarded as limited to returns of subscribed capital by companies that, under the law of their place of incorporation, are legally able to distribute amounts in respect of share capital and/or premium. Goff J suggests the wording is restricted to foreign companies (and there are similar comments in the judgment of Cross J in *Hague* (see p631B-C)) but that point is clarified in the next case to which we must refer.

Bamberg

91. The final case is *Bamberg v HMRC* [2010] UKFTT 333 TC ("*Bamberg*"), a decision of Judge Avery Jones.

92. The facts of *Bamberg* are complicated, but, in summary, the taxpayer (Mr Bamberg) owned shares in a trading company (referred to in the report as "TTEL"). TTEL had positive distributable reserves. Mr Bamberg acquired shares in another company ("WCL"), which had negative distributable reserves, for a nominal sum. He also acquired loan notes issued by WCL at a substantial discount to their face value. Mr Bamberg transferred the shares in WCL to TTEL. WCL then repaid the loan

notes (held by Mr Bamberg) using funds borrowed from TTEL. HMRC issued a counteraction notice under section 703 ICTA 1988 in relation to the repayment of the loan notes by WCL.

93. One issue before the FTT was the scope of the exception in section 704C(2) ICTA 1988, which broadly reflected that in section 685(6). The FTT clarified the view expressed in the earlier authorities (including *Hague*, *Brown* and *Addy*) that the provision was confined to foreign companies which could distribute capital by way of dividend. The FTT confirmed that its effect was to exclude sums representing subscribed capital that were capable of distribution under the law of the place of incorporation of the relevant company from the calculation of amounts available for distribution in section 704C(1). That could include, for example, subscribed capital of UK incorporated unlimited companies (*Bamberg* [12]-[14]).

94. Another issue before the FTT was whether the repayment of the principal amount of the loan notes (representing amounts subscribed for the loan notes) could fall within the TIS legislation. On the wording of section 704C(1) and section 704D ICTA 1988, the FTT concluded that it could. The FTT said this at *Bamberg* [15]:

> 15. Having decided that C(2) can be applicable to a UK company, we do not consider that this assists Mr Thornhill's case. The effect of C(2) is that assets representing a return of sums paid by subscribers on the issue of securities are not available for distribution by way of dividend; it is not that the return of assets subscribed is never caught by Circumstance D. Suppose that WCL's loan stock had been TTEL's and that the Appellant had bought it at the same discount from the original subscriber, we do not consider that this would prevent Circumstance D from applying to the repayment of the loan stock in circumstances where there were distributable reserves. C(2) determines the maximum that can be paid as dividend as the amount of distributable reserves (not including a return of share capital if that is otherwise distributable). Even if the Appellant had received a repayment of the amount subscribed for the loan stock that would not prevent its being said that this was consideration in tax-free form that represented TTEL's distributable reserves. While this may look like overkill it is no different in principle from the sale of the shares of a D company for cash being potentially within Circumstance D. In both cases the Circumstance potentially applies and the taxpayer has to rely on the escape clause.

95. HMRC submit that *Bamberg* supports both their interpretation of the previous provisions and their contention that the legislation which is now reflected in section 685(4) operates as a cap determined by reference to distributable reserves. The effect is that – as in *Bamberg* – an amount which is in the form of a repayment of capital on shares or the principal amount of securities can be the subject of a counteraction notice to the extent of the company's distributable reserves.

Observations on the authorities

96. We take the following points from these cases.

> (1) First, we have not been referred to any case in which a court or tribunal has considered the application of the TIS legislation in the form following the FA 2010 changes.
>
> (2) Second, the case law authorities to which we have been referred provide support for HMRC's submission that the predecessors to section 685(6) were directed at companies where the law of their place of incorporation permitted subscribed capital to be distributed by way of dividend.
>
> (3) Third, in relation to HMRC's submission that the predecessors to what is now section 685(4) operated as a "cap" to determine an amount of consideration that could be regarded as available for distribution by way of dividend, the authorities are at best equivocal.

97. The clearest case in support of that proposition is *Bamberg*. It is a decision of the FTT and as such it is not authoritative but it is persuasive. Also, like *Brown* and *Addy*, it does not address a situation in which the consideration that is received by shareholders is derived from an identified fund (such as share capital account) that comprises, at least in part, amounts that have been subscribed for shares or securities. On the other hand, *Hague*, a decision of the Court of Appeal, provides some authority, in the context of the FA 1960 legislation, that where a payment was derived from an identified fund that to some extent comprises subscribed capital the enquiry is limited to the constituent elements of that fund and the extent to which those elements are available for distribution by way of dividend (or would have been so available apart from something done by the company).

98. That feature of *Hague* was subsequently noted without criticism in *Brown* and *Addy*. When asked at the hearing, Mr Afzal KC had no explanation for the decision in *Hague* consistent with his overall "cap" analysis of section 685(4). In our view, *Hague* suggests that, at least under the earlier legislation, where the payment is made from a specified fund regard should be had to the constituent elements of that fund in deciding whether the payment represents assets that are available for distribution by way of dividend. For the reasons that we give later in this decision, we do not need to decide how such a conclusion would affect the interpretation of the legislation following FA 2010 for the purposes of this appeal.

99. Accordingly, whilst the authorities assist in understanding the background to section 685, they do not provide a clear answer to the principal question of construction that arises in this appeal. That question must ultimately be determined by reference to the language and context of section 685 itself.

The drafting error issue

100. Having reviewed the background in terms of the development of the TIS legislation and the relevant case law relating to it, we turn to the construction of section 685(6) itself.

101. As we have mentioned, HMRC submits that the cross-reference to subsection (2)(a) and (b) found in section 685(6) was an error. The cross-reference should have been to subsection (4)(a)(i) and (ii). Furthermore, Mr Afzal KC submits that this tribunal has the power to correct that error as a matter of judicial interpretation of the provision.

102. Courts and tribunals have the power to correct obvious drafting errors. However, that power is strictly confined to plain cases of drafting mistakes. In *Inco Europe*, a case concerning amendments made to the Supreme Court Act 1981 by the Arbitration Act 1996, the House of Lords set out the criteria which should be met before a court or tribunal should exercise this power. Lord Nicholls said this at p592E-H:

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

> legislation: see per Lord Diplock in *Jones v. Wrotham Park Settled Estates* [1980] A.C. 74, 105–106. In the present case these three conditions are fulfilled.
>
> Sometimes, even when these conditions are met, the court may find itself inhibited from interpreting the statutory provision in accordance with what it is satisfied was the underlying intention of Parliament. The alteration in language may be too far-reaching…

103. In the present case, the FTT decided that these criteria were not met. The FTT found that it could not be abundantly sure that by inadvertence the draftsman and Parliament failed to give effect to the intended purpose of section 685(6). The FTT said this at FTT [69]:

> 69. When interpreting the words of subsection (6) purposively and in their context, we find that subsection (6) is clear on its face and the outcome of this appeal is the same irrespective of whether subsection (6) refers to subsection (4) or subsection (2) . It follows that we cannot, as required by Inco, be "abundantly sure… that by inadvertence the draftsman and Parliament failed to give effect to" the stated purpose of broadly replicating and simplifying the earlier provisions. On that basis we find that subsection (6) does not contain an obvious drafting error capable of correction by this Tribunal.

104. As we have described, the FTT identified the purpose of the FA 2010 changes as being to "replicate and simplify" the pre-existing law by reference to the 2009 Consultation Document; and it was not convinced that the changes made by FA 2010 (including the reference to subsection (2)(a) and (b)) were not an attempt at simplification of the existing law.

105. Before us, neither Mr Afzal KC nor Mr Sykes KC appeared to challenge the FTT's conclusion that the purpose of the FA 2010 changes was to "replicate and simplify" the TIS legislation in relation to circumstance D. Mr Afzal KC says, however, that it contains a clear drafting error. He points to the history of the legislation which he says demonstrates that the exclusion in what became section 685(6) was taken into account in the determination of the amount of the relevant consideration (to use the terminology of section 685) in every version of the legislation. The only exception was the legislation in force between the changes made by FA 2010 and the amendments to that legislation in the FA 2016.

106. In support of his interpretation, Mr Afzal KC submits that section 685(4) (the definition of "relevant consideration") operated, and the previous versions of the legislation operated, as a "cap" under which the consideration for a transaction which fell within the scope of the description in the circumstance D would be treated as subject to counteraction to the extent of the assets of the relevant company that were available for distribution by way of dividend. The predecessors to section 685(6), and section 685(6) itself, were intended to take out of account the value of assets that would be distributable but which relate to subscribed capital in some non-UK incorporated companies and UK incorporated unlimited companies in computing that cap. The assumption was that for other companies – in particular limited companies incorporated in the UK – the value of assets representing subscribed capital would not be regarded as available for distribution by way of dividend for the purpose of section 685(4) and so would be automatically excluded. In this way the legislation created a "level playing field".

107. For the reasons that we have given, in our view, the case law is not as clear as Mr Afzal KC suggests in support of his "cap" analysis. We do not need to decide the point for present purposes – and to reiterate, we do not do so – but, for the reasons that we have given, it seems to us that one tenable view of the predecessor legislation and related case law is that when a transaction involved consideration derived from a particular fund, which to some extent comprised subscribed capital, regard should be had to the constituent elements of that fund in determining whether or not the

consideration is or represents assets available for distribution by way of dividend. The existence of distributable reserves outside that fund would not be taken into account in determining the consideration.

108. We do not need to decide that point because the question of the operation of section 685(4) is not before us. Furthermore, to the extent that Mr Afzal KC relies on the point as part of his assertion that Parliament should be presumed to have intended to create consistent treatment between companies that can distribute subscribed capital by way of dividend, we cannot see that it adds very much given that a form of level playing field is also created on the alternative interpretation of the case law that we have described above.

109. Leaving that point to one side, we agree with the FTT that it is not "abundantly clear" that the reference to subsection (2)(a) and (b) was an inadvertent failure by the draftsman and Parliament to give effect to the purpose of the legislation. We accept Mr Afzal KC's point that in all previous versions of the predecessor legislation for circumstance D, the exclusion that is contained in section 685(6) operated as part of the determination of the consideration that was subject to counteraction. However, to our minds, it is not an untenable suggestion that as part of a process of intended "simplification" of circumstance D, the reference to subsection (2)(a) and (b) was a deliberate change intended to remove all or a class of repayments of subscribed capital from the scope of the TIS legislation altogether.

110. As a starting point, we do not accept that the natural reading of the legislation, including the reference to subsection (2)(a) and (b), produces a wholly unreasonable result. Depending upon the scope of the exclusion provided by section 685(6) – to which we will turn shortly – the effect is either to exclude all repayments of subscribed capital (on the Appellants' argument) or to exclude a class of repayments of capital made by companies that are lawfully able to distribute subscribed capital by way of dividend (on HMRC's arguments) from the TIS legislation.

111. Even on HMRC's case, repayments of capital by companies that cannot distribute subscribed capital by way of dividend will fall to be dealt with by section 685(4). If the "cap" for which Mr Afzal KC argues is the correct analysis of section 685(4), the value of assets representing subscribed capital in such companies will not be taken into account in determining that "cap" and so if there are no other assets available for distribution by way of dividend, there will be no "relevant consideration". If the correct analysis is that regard must be had to the fund from which the payment is made in calculating the amount of the "relevant consideration" in section 685(4) (see our discussion of *Hague* and *Addy* above), there will be no relevant consideration if the fund is comprised of subscribed capital. In both cases, the subscribed capital is left out of account. We accept that this conclusion does not produce the level playing field for which Mr Afzal KC contends, but that is not the test that we have to apply. Our job is to interpret the legislation as it is written not to engage in a search for absolute consistency in the approach to repayments of capital in companies that can and cannot distribute subscribed capital by way of dividend.

112. We also take into account the following factors in reaching our conclusion.

> (1) The reference to subsection (2)(a) and (b) is clear. There is a deliberate and specific reference to "assets" which are also referred to in section 685(2)(a) and (b). It is not a reference to, for example, subsection (2) as a whole, which would have included subparagraph (c) of subsection (2), and which does not refer to "assets" and to which section 685(6) cannot be relevant.

(2) The change was included in the draft legislation in Annex C to the 2009 Consultation Document and remained in the draft legislation throughout the Parliamentary process. It was not a "last-minute" change.

(3) The change was made as part of a collection of reforms to the TIS legislation referred to in the 2009 Consultation Document as "a fundamental and significant change in the approach and application of the TIS legislation".

(4) The change for which Mr Afzal KC argues is not a straightforward one. It is not a simple case of changing the reference to subsection (2) to subsection (4). If Mr Afzal KC is right, the change would have to be to sub-section (4)(a)(i) and (ii).

113. Although we place no great weight upon it, given that it relates to the legislation that took effect after the FA 2016 changes, we note that the 2015 Consultation Document and the changes that were made by the FA 2016 proceed on the basis that repayments of capital may be excluded from the TIS legislation following the changes made by FA 2010. We accept Mr Afzal KC's point that the 2015 Consultation Document includes a note to the effect that the tax treatment set out in the consultation document may not be accepted by HMRC. However, the very fact that the published consultation document recognises that this is a possible interpretation of the legislation supports our conclusion that it is not an untenable argument.

114. For these reasons we reject Mr Afzal KC's submission. We agree with the FTT that the *Inco Europe* criteria are not satisfied in this case. This is not, in our view, a plain case of a drafting mistake.

The scope of section 685(6) issue

115. Having concluded that we must treat section 685(6) as meaning what it says when it refers to subsection (2)(a) and (b), we now turn to the scope of section 685(6) in general.

116. On this question, the FTT decided that the words "despite the fact that" in section 685(6) should be read as meaning "where" and not "even where". The effect was that section 685(6) was confined to repayments of capital by companies that can distribute subscribed capital by way of dividend under the law of their place of incorporation. It is only such returns of capital that fall outside condition A by virtue of section 685(6) (FTT [60]-[67]). The Appellants contend that the FTT was wrong in reaching that conclusion.

117. As the UT noted when granting permission to appeal, the Appellants' five Grounds of Appeal are perhaps better described as reasons for a single ground of appeal that the FTT erred in its construction of section 685(6). Before we turn to those reasons, we should first address a separate reason that Mr Sykes KC raised in support of the Appellants' appeal.

118. In summary, Mr Sykes KC says that, on the facts, section 685(6) applies to payments made to the Appellants as part of the Capital Reduction even on the FTT's more restrictive construction. On this argument, he says that the cash paid to the Appellants as part of the Capital Reduction was an asset that was "available for distribution by way of dividend". This was because GHL had distributable reserves in excess of the total amount of the payments. On the facts, the cash could have been paid to the Appellants as dividends because GHL had sufficient distributable reserves. The cash was therefore, an asset of a description that under the law of the country in which GHL was incorporated was available for distribution by way of dividend. The "despite the fact that" wording (which Mr Sykes KC referred to as the "tailpiece") was met. Furthermore, Mr Sykes KC argued, the payment of that cash was also "shown to represent a return of sums paid by subscribers on the issue of securities" because it was paid as a repayment of capital. Section 685(6) was therefore engaged, and the payments were excluded from section 685(2)(a) and (b) by section 685(6).

119. Mr Afzal KC objected to this argument being raised. He said that it was a new argument that had not been raised before the FTT. We acknowledged Mr Afzal KC's objections but at the hearing we granted permission for the Appellants to raise the argument. We can deal with the point briefly.

120. In our view, this interpretation of section 685(6) misreads the tailpiece. It seems to us that, on a natural reading of section 685(6), the reference to "assets of that description" in the tailpiece is a reference to "assets which are shown to represent a return of sums to subscribers" in the first part of section 685(6). It is not, on the facts of the present case, a reference simply to the cash. It is a reference to the cash when it is returned to shareholders by way of repayment of capital. The subsection is asking whether, under the law of the place of incorporation of the company, the company could pay a dividend out of share capital and premium. It is not focussing on the nature of the asset itself. In our view, that is clear on the face of the legislation. That interpretation is also supported by the case law on the previous iterations of this provision to which we have referred above.

121. Mr Sykes KC's other arguments before us mirrored the Appellants' Grounds of Appeal. His first argument was a linguistic one. He says that the words "despite the fact that" are used in a concessive sense and not a conditional one so that the tailpiece reinforces the opening words and does not imply that the words of the tailpiece must always be satisfied. If our conclusion of the drafting error issue is correct, this means that the effect of section 685(6) is that all "assets which are shown to represent a return of sums paid by subscribers on the issue of securities" are excluded from assets within sub-section (2)(a) and (b). It does not matter whether under the law of the country in which the relevant company is incorporated, assets of that description (i.e. those that represent a return of sums paid by subscribers) are available for distribution by way of dividend.

122. If that were not the case, so the argument goes, assets which represent sums paid by subscribers on the issue of securities, but which could not be distributed by way of dividend, could be taken into account under subsection (4) in the determination of the amount of "relevant consideration". That would not create a level playing field. He says that the alternative construction is irrational and cannot be one that Parliament would have intended. It results in differential treatment for repayments of capital by companies that can distribute subscribed capital by way of dividend under the law of their place of incorporation (principally certain non-UK companies), which are excluded from counteraction, and repayments of capital by limited companies incorporated in the UK, which would only be excluded from counteraction by virtue of section 685(4) (whether on HMRC's interpretation or otherwise) if the repayment was not regarded as relevant consideration.

123. Mr Sykes KC points to circumstances in other statutes in which similar wording to that used in section 685(6) has been used to mean "even where". He referred us to section 1049(3) of the Corporation Tax Act 2010, section 90 of the Leasehold Reform, Housing and Urban Development Act 1993, and section 23B(11) of the Children Act 1989 by way of example. These are the provisions that are mentioned in the FTT Decision at FTT [60]-[61].

124. We agree that the words "despite the fact that" can mean "even where" in some circumstances, but whether they do in any given case will depend on the context. The use of those words in different contexts does not provide any material assistance. In the present case, we agree with the FTT's analysis at FTT [60]-[67] that the natural reading of section 685(6) is not that the "tailpiece" is clarifying the opening words, but rather that the tailpiece is a qualification for the operation of the provision as a whole.

125. This conclusion is supported by the legislative history. As we have identified, the "despite the fact that" wording was introduced in section 689(5) ITA when it was first enacted. In section 689(5), the "despite the fact that" wording clearly meant "where". The provision was intended to prevent

assets that represented subscribed capital being treated as available for distribution for the purposes of section 689(3) ITA (as enacted) <u>where</u> such assets could be distributed by way of dividend under the law of the country of incorporation of the relevant company. As we have seen from our discussion of the history of the legislation, that was the purpose of the exclusion throughout until the changes that were made by FA 2010. That interpretation is supported by the case law, in particular, *Brown*, *Addy*, and *Bamberg*.

126. We accept that the cross-reference in section 689(5) ITA as enacted was to sub-section (3) of that section (i.e. the definition of consideration) and not to section 689(2) (the description of transactions which fell into circumstance D). The same was the case in relation to all the predecessor legislation. We cannot discern any intention to change the meaning of the exclusion in the changes made in FA 2010. The wording of section 685(6) is, apart from the reference to subsection (2)(a) and (b), in exactly the same form as that in which it was enacted as section 689(5) ITA.

127. Mr Sykes KC also relies on the effect of the predecessor legislation, as reflected in the results of the case law. By reference to the case law to which we have referred above (principally *Hague*), he says that the results of those cases show that where consideration received by the taxpayer represents a repayment of subscribed capital, that amount is excluded from counteraction. He also referred to the extracts from Hansard to which we refer above in support of his argument that this was always the legislative intent.

128. As we have mentioned, we agree that one view of that case law is that, under the predecessor legislation, consideration was excluded to the extent that it could be demonstrated to be derived from an identified fund that represented subscribed capital (see our earlier analysis of the case law). However, to the extent that they are relevant, those cases concern the determination of the consideration that is relevant for the purposes of circumstance D, which in the form of the TIS legislation before us is found section 685(4). Mr Sykes KC does not rely on any argument that section 685(4) is not satisfied on the facts of this case. In their initial notices of appeal to the FTT, the Appellants gave as one of their grounds of appeal that the consideration represented share capital and not assets available for distribution and so was not relevant consideration within section 685(4). However, that argument was not pursued before the FTT or before us.

129. We do not agree that the analysis of Mr Sykes KC informs the interpretation of the scope of the exclusion in section 685(6). The purpose of that exclusion in previous versions of the legislation was, as Mr Afzal KC submits, to align repayments of capital by companies that could distribute subscribed capital by way of dividend in accordance with the law of their place of incorporation with the treatment of repayments of capital by limited companies incorporated in UK jurisdictions. That alignment was broken by the changes made in FA 2010 and, in particular, by the reference to subsection 2(a) and (b), but that change, does not, in our view, affect the scope of the exclusion.

130. Mr Sykes KC also submitted that interpreting section 685(6) as only excluding returns of capital by companies that under their law of incorporation were entitled to return subscribed capital by way of dividend will result in double taxation for the Appellants because both the Capital Reduction itself and any subsequent distribution of the reserves it is treated as representing will be subject to income tax. We do not agree with that submission. The legislation is simply determining the manner in which each receipt is taxed. If the TIS legislation applies, the consideration that is received as part of the Capital Reduction is taxed as income. Any subsequent distribution is then taxed by reference to the legislation that applies to it. That is not double taxation in the ordinary sense of the term. It is the separate taxation of two different transactions. We agree with the analysis of the FTT at FTT [66].

Disposition

131. Although our reasoning is rather different, we agree with the conclusions reached by the FTT on both the questions that are before us. We acknowledge that these conclusions do not achieve either of the level playing fields for which the parties argued. However, that is what, in our view, the legislation provided in the period in question. It might be regarded in some quarters as unfortunate and inconsistent, but it is not open to us to ignore the clear words of Parliament to achieve a more coherent result.

132. We dismiss the Appellants' appeal. We also reject the arguments raised by HMRC in their Respondents' Notice that we should correct a drafting error in section 685(6).

JUDGE JONATHAN CANNAN
JUDGE ASHLEY GREENBANK

RELEASE DATE: 02 September 2026

APPENDIX

Section 28 Finance Act 1960 (as enacted)

28 Cancellation of tax advantages from certain transactions in securities

(1) Where—

(a) in any such circumstances as are mentioned in the next following subsection, and

(b) in consequence of a transaction in securities or of the combined effect of two or more such transactions,

a person is in a position to obtain, or has obtained, a tax advantage, then unless he shows that the transaction or transactions were carried out either for bona fide commercial reasons or in the ordinary course of making or managing investments, and that none of them had as their main object, or one of their main objects, to enable tax advantages to be obtained, this section shall apply to him in respect of that transaction or those transactions:

…

(2) The circumstances mentioned in the foregoing subsection are that—

(a)…

(b)…

(c) the person in question receives, in consequence of a transaction whereby any other person—

(i) subsequently receives, or has received, an abnormal amount by way of dividend; or

(ii) subsequently becomes entitled, or has become entitled, to a deduction as mentioned in paragraph (b) of this subsection,

a consideration which either is, or represents the value of, assets which are (or apart from anything done by the company in question would have been) available for distribution by way of dividend, or is received in respect of future receipts of the company or is, or represents the value of, trading stock of the company, and the said person so receives the consideration that he does not pay or bear tax on it as income; or

(d) in connection with the distribution of profits of a company to which this paragraph applies, the person in question so receives as is mentioned in paragraph (c) of this subsection such a consideration as is therein mentioned.

In this subsection—

(i) references to profits include references to income, reserves or other assets,

(ii) references to distribution include references to transfer or realisation (including application in discharge of liabilities), and

(iii) references to the receipt of consideration include references to the receipt of any money or money's worth,

but the assets mentioned in paragraph (c) of this subsection do not include assets which (while of a description which under the law of the country in which the company is incorporated is available for distribution by way of dividend) are shown to represent a return of sums paid by subscribers on the issue of securities:

…

Sections 460 and 461 Income and Corporation Taxes Act 1970 (as enacted)

460 Cancellation of tax advantage

(1) Where—

(a) in any such circumstances as are mentioned in section 461 below, and

(b) in consequence of a transaction in securities or of the combined effect of two or more such transactions,

a person is in a position to obtain, or has obtained, a tax advantage, then unless he shows that the transaction or transactions were carried out either for bona fide commercial reasons or in the ordinary course of making or managing investments, and that none of them had as their main object, or one of their main objects, to enable tax advantages to be obtained, this section shall apply to him in respect of that transaction or those transactions:

….

461 The prescribed circumstances

The circumstances mentioned in section 460(1) above are—

…

C.—

(1) That the person in question receives, in consequence of a transaction whereby any other person —

(a) subsequently receives, or has received, an abnormal amount by way of dividend; or

(b) subsequently becomes entitled, or has become entitled, to a deduction as mentioned in paragraph B(1) above,

a consideration which either—

(i) is, or represents the value of, assets which are (or apart from anything done by the company in question would have been) available for distribution by way of dividend, or

(ii) is received in respect of future receipts of the company, or

(iii) is, or represents the value of, trading stock of the company,

and the said person so receives the consideration that he does not pay or bear tax on it as income.

(2) The assets mentioned in sub-paragraph (1) above do not include assets which (while of a description which under the law of the country in which the company is incorporated is available for distribution by way of dividend) are shown to represent a return of sums paid by subscribers on the issue of securities.

D.—

(1) That in connection with the distribution of profits of a company to which this paragraph applies, the person in question so receives as is mentioned in paragraph C(1) above such a consideration as is therein mentioned.

…

Sections 703 and 704 Income and Corporation Taxes Act 1988 (as enacted)

703 Cancellation of tax advantage

(1) Where—

(a) in any such circumstances as are mentioned in section 704 and

(b) in consequence of a transaction in securities or of the combined effect of two or more such transactions,

a person is in a position to obtain, or has obtained, a tax advantage, then unless he shows that the transaction or transactions were carried out either for bona fide commercial reasons or in the ordinary course of making or managing investments, and that none of them had as their main object, or one of their main objects, to enable tax advantages to be obtained, this section shall apply to him in respect of that transaction or those transactions.

…

704 The prescribed circumstances.

The circumstances mentioned in section 703(1) are—

…

C.—

(1) That the person in question receives, in consequence of a transaction whereby any other person —

(a) subsequently receives, or has received, an abnormal amount by way of dividend; or

(b) subsequently becomes entitled, or has become entitled, to a deduction as mentioned in paragraph B(1) above,

a consideration which either—

(i) is, or represents the value of, assets which are (or apart from anything done by the company in question would have been) available for distribution by way of dividend, or

(ii) is received in respect of future receipts of the company, or

(iii) is, or represents the value of, trading stock of the company,

and the person in question so receives the consideration that he does not pay or bear tax on it as income.

(2) The assets mentioned in sub-paragraph (1) above do not include assets which (while of a description which under the law of the country in which the company is incorporated is available for distribution by way of dividend) are shown to represent a return of sums paid by subscribers on the issue of securities.

D.—

(1) That in connection with the distribution of profits of a company to which this paragraph applies, the person in question so receives as is mentioned in paragraph C(1) above such a consideration as is therein mentioned.

…

Sections 684 and 689 Income Tax 2007 (as enacted)

684 Person liable to counteraction of income tax advantage

(1) This section applies to a person in respect of a transaction in securities or two or more such transactions if the person is in a position to obtain or has obtained an income tax advantage–

(a) in circumstances where any of the provisions specified in subsection (2) applies in relation to the person, and

(b) in consequence of–

(i) the transaction, or

(ii) the combined effect of the transactions.

(2) The provisions are–

…

section 689 (receipt of consideration in connection with relevant company distribution (circumstance D))

…

689 Receipt of consideration in connection with relevant company distribution (circumstance D)

(1) This section applies in relation to a person if subsections (2) to (4) apply.

(2) The person receives consideration in connection with–

(a) the distribution, transfer or realisation of assets of a relevant company (see section 691), or

(b) the application of such assets in discharge of liabilities.

(3) The consideration–

(a) is or represents the value of–

(i) assets which are available for distribution by way of dividend by the company, or

(ii) assets which would have been so available apart from anything done by the company,

(b) is received in respect of future receipts of the company, or

(c) is or represents the value of trading stock of the company.

(4) The person so receives the consideration that the person does not pay or bear income tax on it (apart from this Chapter).

(5) The assets mentioned in subsection (3) do not include assets which are shown to represent a return of sums paid by subscribers on the issue of securities, despite the fact that under the law of the country in which the company is incorporated assets of that description are available for distribution by way of dividend.

(6) In this section references to the receipt of consideration include references to the receipt of any money or money's worth.

Section 685 Income Tax Act 2007 (following amendment by Finance Act 2016)

685 Receipt of consideration in connection with distribution by or assets of close company

(1) The circumstances covered by this section are circumstances where condition A or condition B is met.

(2) Condition A is that, as a result of the transaction in securities or any one or more of the transactions in securities, [a relevant person]2 receives relevant consideration in connection with—

(a) the distribution, transfer or realisation of assets of a close company,

(b) the application of assets of a close company in discharge of liabilities, or

(c) the direct or indirect transfer of assets of one close company to another close company,

and the relevant person does not pay or bear income tax on the consideration (apart from this Chapter).

…

(4) In a case within subsection (2)(a) or (b) "relevant consideration" means consideration which—

(a) is or represents the value of—

(i) assets which are available for distribution by way of dividend by the company, or

(ii) assets which would have been so available apart from anything done by the company,

(b) is received in respect of future receipts of the company, or

(c) is or represents the value of trading stock of the company.

(5) In a case within subsection (2)(c) or (3) "relevant consideration" means consideration which consists of any share capital or any security issued by a close company and which is or represents the value of assets which—

(a) are available for distribution by way of dividend by the company,

(b) would have been so available apart from anything done by the company, or

(c) are trading stock of the company.

…

(7A) The references in subsection (4)(a)(i) and (ii) to assets do not include assets shown to represent return of sums paid by subscribers on the issue of securities merely because the law of the country in which the company is incorporated allows assets of that description to be available for distribution by way of dividend.

(7B) The references in subsections (4)(a)(i) and (5)(a) to assets which are available for distribution by way of dividend by the company include assets which are available for distribution to the company by way of dividend by any other company it controls.