TC05680

Appeal number: TC/2014/06843

CAPITAL GAINS TAX – Gift of business asset to UK-resident company by transferor with non-UK resident relatives – Hold-over relief claim disallowed by HMRC – Whether claim precluded by s 167 Taxation of Chargeable Gains Act 1992 – Yes – Whether construction of s 167 conforming with ECHR and EU law – Yes – Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

WILLIAM REEVES **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN BROOKS

Sitting in public at the Royal Courts of Justice, Strand, London WC2 on 7, 8 and 9 February 2017

Kevin Prosser QC and David Yates, instructed by Slaughter and May, for the Appellant

David Goy QC and Sarah Abram, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. On 1 April 2010 Mr William Reeves, a US citizen who was neither resident or ordinarily resident in the UK, disposed of his interest in a business carried on by BlueCrest Capital Management LLP ("BlueCrest") transferring it by way of a gift to WHR Investments Limited ("WHR"), a new UK incorporated and resident company of which he was the sole shareholder and director. In his amended 2009-10 self-assessment tax return, Mr Reeves claimed hold-over relief from capital gains tax ("CGT") under s 165 of the Taxation of Chargeable Gains Act 1992 ("TCGA") in relation to the gift to WHR. HM Revenue and Customs ("HMRC") subsequently opened an enquiry into that return and by a closure notice, dated 1 September 2014, disallowed the hold-over relief claim on the basis that it was precluded by s 167 TCGA.

2. Mr Kevin Prosser QC and Mr David Yates, who appear for Mr Reeves, contend that as a literal construction of the s 167 TCGA would produce an irrational, arbitrary, unjust and absurd result a purposive interpretation should be adopted allowing the claim to hold-over relief. Alternatively they argue that, if the statutory language does not admit such a purposive interpretation, a literal construction should not be applied as s 167 TCGA does not conform to Article 1 of the First Protocol ("A1P1") or Article 14 of the European Convention on Human Rights ("ECHR"). Neither, they say, does it conform to European Union ("EU") law (in that it restricts the free movement of capital).

3. For HMRC, Mr David Goy QC and Ms Sarah Abram contend that the hold-over relief claim is precluded by s 167 TCGA and that this does not give rise to any absurdity or illogicality. Additionally, they submit that because there is no "possession" of which Mr Reeves would be deprived or have interfered with the ECHR is not engaged. They also contend that the EU law arguments advanced on behalf of Mr Reeves are misconceived as it is the freedom of establishment not the free movement of capital that is engaged but even if this were not the case the free movement of capital it is not restricted by s 167(2) TCGA and, even it was, it is a justified and proportionate measure.

4. It is therefore necessary to consider the construction of the domestic legislation and whether it is compliant with the ECHR and EU law. In doing so, although carefully considered, in reaching my conclusions it has not been necessary to mention every argument advanced on behalf of the parties.

Facts

5. The facts are not disputed. The following 'Statement of Agreed Facts and Issues' was produced by the parties:

> (1) This appeal concerns the treatment for CGT purposes of a gift made on 1 April 2010 by Mr William Reeves (the "Disposal") of an interest, including a share of the goodwill, in a business carried on by BlueCrest.

(2) BlueCrest carried on business as a private hedge fund in the UK. However, in late 2009 BlueCrest began planning for a change in its operations aimed at moving its business out of the UK.

(3) Mr Reeves, a US citizen, was one of two founders of the hedge fund business in 2000. At the time, he was a UK resident and ordinarily resident. Mr Reeves ceased to be UK resident and ordinarily resident in 2007 when he moved back to the US.

(4) On the date of the Disposal Mr Reeves held a 7.4% interest in BlueCrest, represented by allocations of "income points" and "capital points" each of which came to a little over 76 million (out of a total of more than a billion such "points").

(5) Although Mr Reeves was no longer resident or ordinarily resident in the UK, his share of the goodwill of the business was a "chargeable asset" in relation to him for CGT purposes. Accordingly, the proposed emigration of BlueCrest would have triggered a deemed disposal of that share (under s 25(3) TCGA).

(6) Mr Reeves established WHR on 26 January 2010; the company was incorporated and resident in the UK and Mr Reeves was at all relevant times the sole shareholder and director. On 1 April 2010 he gifted substantially the whole of his interest in BlueCrest to WHR (that is, all except 100 "income points" and 100 "capital points"), producing a chargeable gain of £33,636,557 (the "Gain").

(7) On 20 December 2011, Mr Reeves and WHR made a joint claim for hold-over relief on the Disposal, thereby amending Mr Reeves' self-assessment tax return for the year ended 5 April 2010.

(8) An enquiry into the return was opened on 26 September 2012. On 2 May 2013, HMRC indicated that it considered the claim invalid because of s 167(2) TCGA. The enquiry was closed on 1 September 2014 and HMRC amended Mr Reeves' return to disallow the claim on the basis of s 167(2) TCGA.

(9) Mr Reeves appealed to HMRC on 16 September 2014 and requested a review of the decision. By way of letter dated 1 December 2014, HMRC notified Mr Reeves that the decision to disallow hold-over relief was upheld.

(10) Mr Reeves appealed to the First-tier Tribunal on 24 December 2014.

(11) The parties agree that HMRC's interpretation is correct on a literal interpretation of s 167(2) TCGA. That is because Mr Reeves' wife (among others) was at the time of the Disposal neither resident nor ordinarily resident in the UK and, as an "associate" of his, could be deemed to "control" WHR.

(12) The sole issue in this appeal is whether WHR was within section 167(2) TCGA when it is given a purposive interpretation. If it was, then it is agreed that by virtue of section 167(1) TCGA, section 165(4) TCGA did not apply, and therefore the Disposal did not qualify for hold-over relief. But if it was not, then it is agreed that the Disposal did qualify.

Relevant Legislation

6. The relevant provisions of the TCGA, in force at the time of the disposal provided:

58 Spouses and civil partners

(1) If, in any year of assessment,—

(a) an individual is living with his spouse or civil partner, and

(b) one of them disposes of an asset to the other,

both shall be treated as if the asset was acquired from the one making the disposal for a consideration of such amount as would secure that on the disposal neither a gain nor a loss would accrue to the one making the disposal.

(2) This section shall not apply—

(a) if until the disposal the asset formed part of trading stock of a trade carried on by the one making the disposal, or if the asset is acquired as trading stock for the purposes of a trade carried on by the one acquiring the asset, … or

(b) if the disposal is by way of donatio mortis causa,

but this section shall have effect notwithstanding the provisions of section 18 or 161, or of any other provisions of this Act fixing the amount of the consideration deemed to be given on a disposal or acquisition.

165 Relief for gifts of business assets

(1) If—

(a) an individual ("the transferor") makes a disposal otherwise than under a bargain at arm's length of an asset within subsection (2) below, and

(b) a claim for relief under this section is made by the transferor and the person who acquires the asset ("the transferee") …,

then, subject to … sections 166 [and] 167 …., subsection (4) below shall apply in relation to the disposal.

(2) An asset is within this subsection if—

(a) it is, or is an interest in, an asset used for the purposes of a trade, profession or vocation carried on by—

(i) the transferor, or

…

(3) …

(4) Where a claim for relief is made under this section in respect of a disposal—

(a) the amount of any chargeable gain which, apart from this section, would accrue to the transferor on the disposal, and

(b) the amount of the consideration for which, apart from this section, the transferee would be regarded for the purposes of capital gains tax as having acquired the asset …,

shall each be reduced by an amount equal to the held-over gain on the disposal.

(5) …

(6) …, the reference in subsection (4) above to the held-over gain on a disposal is a reference to the chargeable gain which would have accrued on that disposal apart from subsection (4) above …

166 Gifts to non-residents

(1) Section 165(4) shall not apply where the transferee is neither resident nor ordinarily resident in the United Kingdom.

(2) Section 165(4) shall not apply where the transferee is an individual … if that individual —

(a) though resident or ordinarily resident in the United Kingdom, is regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the United Kingdom, and

(b) by virtue of the arrangements would not be liable in the United Kingdom to tax on a gain arising on a disposal of the asset occurring immediately after its acquisition.

167 Gifts to foreign-controlled companies

(1) Section 165(4) shall not apply where the transferee is a company which is within subsection (2) below.

(2) A company is within this subsection if it is controlled by a person who, or by persons each of whom—

(a) is neither resident nor ordinarily resident in the United Kingdom, and

(b) is connected with the person making the disposal.

(3) For the purposes of subsection (2) above, a person who (either alone or with others) controls a company by virtue of holding assets relating to that or any other company and who is resident or ordinarily in the United Kingdom is to be regarded as neither resident or ordinarily resident there if—

(a) he is regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the United Kingdom, and

(b) by virtue of the arrangements he would not be liable in the United Kingdom to tax on a gain arising on a disposal of the assets.

…

286 Connected persons: interpretation

(1) Any question whether a person is connected with another shall for the purposes of this Act be determined in accordance with the following subsections of this section …

(2) A person is connected with an individual if that person is the individual's spouse or civil partner, or is a relative, … of the individual ….

(4) Except in relation to acquisitions or disposals of partnership assets pursuant to bona fide commercial arrangements, a person is connected with any person with whom he is in partnership, and with the spouse or civil partner or a relative of any individual with whom he is in partnership.

…

(6) A company is connected with another person, if that person has control of it or if that person and persons connected with him together have control of it.

(8) In this section "relative" means brother, sister, ancestor or lineal descendant.

…

288 Interpretation

(1) In this Act, unless the context otherwise requires—

"control" shall be construed in accordance with section 416 of Income and Corporation Taxes Act 1988

7. Section 416 of Income and Corporation Taxes Act 1988 ("ICTA") provided:

Meaning of "associated company" and "control"

(1) …

(2) For the purposes of this Part, a person shall be taken to have control of a company if he exercises, or is able to exercise or is entitled to acquire, direct or indirect control over the company's affairs, and in particular, but without prejudice to the generality of the preceding words, if he possesses or is entitled to acquire—

(a) the greater part of the share capital or issued share capital of the company or of the voting power in the company; or

(b) such part of the issued share capital of the company as would, if the whole of the income of the company were in fact distributed among the participators (without regard to any rights which he or any other person has as a loan creditor), entitle him to receive the greater part of the amount so distributed; or

(c) such rights as would, in the event of the winding-up of the company or in any other circumstances, entitle him to receive the greater part of the assets of the company which would then be available for distribution among the participators.

(3) Where two or more persons together satisfy any of the conditions of subsection (2) above, they shall be taken to have control of the company.

(4) For the purposes of subsection (2) above a person shall be treated as entitled to acquire anything which he is entitled to acquire at a future date, or will at a future date be entitled to acquire.

(5) For the purposes of subsections (2) and (3) above, there shall be attributed to any person any rights or powers of a nominee for him, that is to say, any rights or powers which another person possesses on his behalf or may be required to exercise on his direction or behalf.

(6) For the purposes of subsections (2) and (3) above, there may also be attributed to any person all the rights and powers of any company of which he has, or he and associates of his have, control or any two or more such companies, or of any associate of his or of any two or more associates of his, including those attributed to a company or associate under subsection (5) above, but not those attributed to an associate under this subsection; and such attributions shall be made under this subsection as will result in the company being treated as under the control of five or fewer participators if it can be so treated.

8. Insofar as applicable s 417 ICTA provided:

(1) …

(2) …

(3) For the purposes of this Part "associate" means, in relation to a participator—

(a) any relative or partner of the of the participator:

(b) …

(c) …

and has a corresponding meaning in relation to a person other than a participator

(4) In subsection (3) above "relative" means spouse or civil partner, parent or remoter forebear, child or remoter issue, or brother or sister.

Construction of the legislation

9. It is accepted that under a literal interpretation of the above legislation Mr Reeves is not entitled to hold-over relief. This is because although WHL is controlled by (and therefore by virtue of s 286(6) TCGA connected with) Mr Reeves, s 416(6) ICTA attributes his control of the company to his non-resident wife and children (his relatives and associates as defined by s 417 ICTA). Therefore, for CGT purposes, WHL is a company controlled by a person or persons neither resident nor ordinarily resident in the UK and hold-over relief is precluded by s 167 TCGA.

10. Mr Prosser contends that such a literal construction conflicts with the clear purpose of s 167 TCGA which, he submits, should be considered in conjunction with s 166 TCGA. The purpose of s 166 TCGA, he says, is plain, it is to deny a hold-over relief for a gift that would take the business asset directly outside the charge to CGT because the transferee is non-UK resident and could dispose of the asset tax-free. The purpose of s 167, he submits, is equally plain, it is to deny hold-over relief for a gift that would take the business asset indirectly outside the charge to CGT because, although the company is UK resident it is controlled by a non-UK resident person who could dispose of the controlling interest in the company indirectly disposing of the asset, tax-free.

11. I did not understand Mr Goy to dispute that this was the purpose of the legislation. Indeed, he described s 167(2) TCGA as an anti-avoidance provision to prevent assets being taken out of ambit of UK CGT, ie preventing a UK resident person being able to give chargeable assets to a UK resident company owned by a non-resident connected person who could then sell his interest free from CGT.

12. Support for such a purpose can be found in an Inland Revenue Press Release of 14 March 1989 'Reform of Capital Gains Tax Rules for Gifts' which states:

> "1. In his budget the Chancellor proposes to reform the Capital Gains Tax relief for gains by individuals and trusts. Under the present law tax on any gain accrued up to the date of the gift of an asset can normally be deferred.
>
> 2. One of the original reasons for introducing this deferral was the existence of a simultaneous charge to capital transfer tax. With no general inheritance tax charge on lifetime giving, that rationale no longer applies. In addition, the CGT deferral has come to be widely used not just to postpone gains but also to reduce or eliminate the tax charge on gains up to the date of gift. This reform, by substantially restricting the scope of the deferral, will make it much more difficult to use the relief for tax planning.
>
> 3. The main features of the reform are: —
>
> —gifts of business assets (including unquoted shares in trading companies and holding companies of trading groups
>
> …

It continues:

> "Technical Changes
>
> …
>
> 13. The new rules will also deny a deferral under the gift's relief provisions for certain arrangements designed to take business assets outside the Capital Gains charge, for example by transferring business assets to a company, the shares are in which are owned by a non-resident trust".

13. In addition to the example in paragraph 13 of the Press Release Mr Prosser cited what he described as a "very different" example in which a UK resident transferor, "T", gives shares in a UK-resident company to his daughter "D" who is also UK resident. Clearly the arrangement is not designed to take the business asset outside the charge to tax and, as D is UK resident, neither s 166 nor s 167 TCGA would apply as nothing in the structure of the arrangement would cause the asset to come out of the charge to tax, this is irrespective of whether D might have intended to subsequently become non-resident. However, if D had an adult son, "S", who was non-UK resident, eg working in Africa for a few years, and had no interest in, and nothing to do with the company, Mr Prosser submits that it cannot be one of the purposes of s 167 TCGA to deny hold-over relief just because S, the grandson of T and son of D who owns the shares in the company, is non-UK resident as would be the case if a literal construction of s 167 TCGA and s 416(6) ICTA were adopted.

14. He therefore contends that, in the circumstances, the legislation should be interpreted in such a way so as to give effect to its purpose.

15. In *Pollen Estate Trustees v HMRC* [2013] STC 1479 Lewison LJ, giving the judgment of the Court of Appeal, observed, at [24] that:

> "The modern approach to statutory construction is to have regard to the purpose of a particular provision and interpret its language, so far as possible, in a way which best gives effect to that purpose. This approach applies as much to a taxing statute as any other: *Inland Revenue Commissioners v McGuckian* [1997] 1 WLR 991, 999; *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51; [2005] 1 AC 684 (§ 28). In seeking the purpose of a statutory provision, the interpreter is not confined to a literal interpretation of the words, but must have regard to the context and scheme of the relevant Act as a whole: *WT Ramsay Ltd v Commissioners of Inland Revenue* [1982] AC 300, 323; *Barclays Mercantile Business Finance Ltd v Mawson* (§ 29). The essence of this approach is to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found: (*Barclays Mercantile Business Finance Ltd v Mawson* (§ 32)."

16. Mr Prosser says that such an approach is possible in the present case because under s 288 TCGA "control" is to be construed in accordance with s 416 ICTA "unless the context otherwise requires". Mr Prosser relies on *Floor v Davis (Inspector of Taxes)* [1980] AC 695 in which Viscount Dilhorne said (at 709) that if the construction of the applicable legislation led to it:

> "…being unworkable, or if not workable to a result that Parliament could not have intended, then it can be concluded that an intention contrary to the application of the Interpretation Act appears and that it is not to be so construed."

Accordingly, Mr Prosser submits that the context of this case does "otherwise require" and, as such, s 416 ICTA should be construed omitting sub-section (6) which concerns "fictional control" and is in contrast to s 167 TCGA which concerns "real" control of a company.

17. It is not disputed that part of a definition can be disapplied if the context requires. The difference between the parties being whether the context in the present case requires s 416(6) ICTA to be disapplied.

18. Mr Goy contends that there is nothing in the context of the present case that enables s 416(6) ICTA to be disregarded. He relies on the fact of Mr and Mrs Reeves being associates and Mrs Reeves being non-resident. He gives the example, if s 416(6) were to be disregarded, of a company controlled by a UK resident with a non-UK resident spouse who could transfer business assets to the company claiming hold-over relief under s 165 TCGA. He could then give his interest in the company to his spouse relying on s 58 TCGA to incur no liability to CGT. The spouse could then sell those shares free of CGT relying on his or her non-residence achieving in two steps what could not be achieved in one, namely taking the asset outside the ambit of CGT. He makes the point that had the company in his example been initially controlled by a non-UK resident spouse, the question of s 167(2) TCGA not applying just would not have arisen.

19. Although, as Mr Prosser contends, there is no reason why a transferor in Mr Goy's example with a non-resident spouse, if his aim was to transfer assets outside the ambit of CGT, would wish to first transfer an asset into a company when he could simply use s 58 TCGA to transfer it directly to his wife free of CGT. However, Mr Goy submits, irrespective of s 58 TCGA, the clear aim of s 167(2) TCGA is to prevent hold-over relief being used to take the asset out of UK CGT. It is therefore necessary, he says, for "control" to be given a wide meaning as is apparent from s 416(2) ICTA itself.

20. As Lord Hoffman observed in *R v Inland Revenue Commissioners, ex parte Newfields Developments Ltd* [2001] STC 901, at [11]:

> "The effect of these cumulative definitions is that for the purpose of deciding whether a person 'shall be taken to have control of a company' under s 416(2) [ICTA], it may be necessary to attribute to him the rights and powers of persons over whom he may in real life have little or no power of control. Plainly the intention of the legislature was to spread the net very wide."

21. Mr Goy contends that it is apparent from s 416(2) TCGA that "control" can be deemed to exist without actual control and does not presuppose the ownership of rights in a company at all. He argues that it is illogical to accept that s 416(2) TCGA can apply even though there is no ownership of rights and says that s 416(6) TCGA

should not apply on a like ground. However, Mr Prosser's response is to say that this type of control, where a person with no interest in a company instructs a person with such an interest pursuant to an agreement in accordance with his wishes, either did not occur to Parliament or that it was thought that such a scenario would never or hardly ever occur in practice. He referred to the one case in which this type of control has been considered where the Court of Appeal had held that, on the facts, there was no such control (see *Deutsche Bank Group Services (UK) Limited v HMRC* [2014] STC at [102]).

22. Returning to s 416(6) TCGA, Mr Goy accepts that its application could be said to have a wider application than necessary but this, he says, is not uncommon with anti-avoidance legislation and commended the approach of Morritt LJ in *Steele (Inspector of Taxes) v EVC International NV (formerly European Vinyls Corp (Holdings) BV)* [1996] STC 785, where he said, at 796, referring to an argument of counsel for the taxpayer:

> "… that if the Crown is right on this issue then it will have the unforeseen and unwelcome consequence that the consortium relief made available by s 402 of the Income and Corporation Taxes Act 1988 will be withheld by s 410(2)(iii) in just those circumstances in which it is to be presumed that Parliament intended it to be available. This was not disputed by counsel for the Crown. He informed us that the Crown has had the point in mind since it first emerged in the judgment of Lightman J and will consider what to do about it if this appeal is dismissed. But he also observed, in my view rightly, that s 410 was an anti-avoidance provision which like many other such provisions sometimes covers a wider area than that strictly necessary to achieve its object."

23. Mr Goy also cautions against reliance on the use of such examples such as that of S, above, citing Chadwick LJ in *Foulser and another v MacDougall (Inspector of Taxes)* [2007] STC 973 at [64]:

> "We were pressed in the course of the hearing with an elaborate argument—advanced for the first time in a supplemental skeleton argument dated 12 October 2006—based on examples which, it is said, demonstrate that, as a matter of policy, it could not have been the intention of the legislature that s 286(7) TCGA 1992—or s 839(7) ICTA 1988—should (in the absence of some provision as those in s 177(7) TCGA 1992 or s 736(4) ICTA 1988) have any independent application. I hope it will not be thought discourteous—or lacking in respect to the ingenuity with which that argument was formulated and advanced—if I do no more than draw attention to the observation of Morritt LJ, when faced with a similar argument in *Steele v EVC* [1996] STC 785 at 796). He pointed out that the fact that the Revenue's construction of s 839(7) ICTA 1988 might have unforeseen and unwelcome consequences—in that case, the denial of consortium relief made available by s 402 ICTA 1988 by the operation of s 410(2)(iii) in just those circumstances in which it was to be presumed that Parliament intended it to be available—was no reason for not construing s 839(7) ICTA 1988 in accordance with its terms. In my

> view the effect of s 286(7) TCGA 1992, in relation to the enquiry required under s 167(2)(b), is clear. I am not persuaded that the Court should refuse to give to the section the effect which, as a matter of construction, it was plainly intended to have in that context on the basis that, in other contexts, the section might be found to have unforeseen or unwelcome consequences."

24. Mr Prosser, however, contends that HMRC's reliance on *Steele v EVC* and *Foulser v MacDougall* is misplaced as a plain and ordinary construction of a statutory provision (s 286 TCGA) cannot be rejected just because to do so may produce anomalies in other contexts, ie other statutory provisions (eg s 402 ICTA) which apply the first provision, and not in other factual situations governed by the first statutory provision. The present case, he says, concerns the construction of "control" in the context of s 167 TCGA which under s 288 TCGA is not to be construed in accordance with s 416 ICTA if that context otherwise requires. Accordingly, it is therefore legitimate, and Mr Prosser submits necessary, to consider whether in the context of s 167 TCGA construing it in accordance with s 416(6) will produce injustice and absurdity.

25. In addition to the above "S" example, Mr Prosser relies on the relationship between s 166(1) and (2) and s 167(2) and (3) TCGA. Sections 166(1) and (2) TCGA provide that hold-over relief is not available when the transferee is non-UK resident or treated as such by virtue of any double taxation treaty. However, it is necessary for s 166(2) TCGA to refer to the asset as it is necessary to consider whether as a result of the treaty that person will not be liable to tax on the disposal of the asset. Similarly, he says, s 167(3) TCGA is making explicit what is implicit in s 167(2) TCGA, namely by focusing on real as opposed to fictional control of the company.

26. Mr Goy contends that the reference to control by virtue of the holding of assets 167(3) TCGA can be clearly contrasted with s 167(2) TCGA in which such a requirement is absent. This, he says, is a clear example that where Parliament intended to limit the general definition of control it has done so. He also relies on s 96(10) TCGA, which in contrast to s 167 TCGA, expressly excludes s 416(6) ICTA.

27. Section 96(10) TCGA provides:

> … the question of whether a company is controlled by a person or persons shall be construed in accordance with section 416 of [ICTA], but in deciding that question for those purposes no rights or powers of (or attributed to) an associate or associates of a person shall be attributed to him under s 416(6) if he is not a participator in the company.

Mr Goy submits that as Parliament has sought to limit the definition of control in s 96(10) and 167(3) TCGA but not in s 167(2) TCGA, the obvious conclusion is that this was deliberate and Parliament did not intend that control, for the purposes of s 167(2) TCGA, should be given the restricted interpretation advance on behalf of Mr Reeves.

28. However, Mr Prosser says that the effect of s 416(6) on s 167(2) TCGA was overlooked by Parliament and this is apparent from answers given to the Standing Committee considering the provisions of 1991 Finance Bill given by Mr Maude, on 13 June 1991, who said:

> "The provisions … deal with payments by trustees to a company under a beneficiary's control, and to a beneficiary by a company under a trustee's control. The provisions strengthen the existing charge in an increasingly important area of the law. The definition of control for the provisions is the same as that which is adopted for income tax purposes [ie s 416 ICTA]. It provides that only can a person's own rights and powers be taken into account in determining whether or not he or she controls the company, but also those of any associates. That term includes a person's relatives and the trustees of the settlement if which he or she is the settlor or beneficiary.
>
> We have received representations to the effect this could result in payments by trustees being attributed for tax purposes to individuals who have no interest in the company. That would go wider than we intended, and therefore the amendment limits the definition of "control" so that only those who have an interest in the company will fall within the provisions."

29. Mr Prosser submits that if Parliament was unaware of the effect of s 416(6) ICTA in 1991 it was clearly not aware of it in 1989 when what is now s 167 TCGA came into force (originally as s 126B of the Capital Gains Tax Act 1989). As he put it, "it is not as if there was a sort of corporate forgetting between 1989 and 1991." He contends that even if the context does not otherwise require 'control' in s 167(2) TCGA to be construed omitting s 416(6) ICTA its inclusion is a clear drafting error that should be corrected.

30. Before considering whether the context requires control in s 167(2) TCGA to be construed with the omission of s 416(6) ICTA, it is convenient to first set out the conditions necessary to rectify a statutory "drafting error".

31. These were considered by Lewison LJ in *Pollen Estate Trustees* where he said:

> "25. In *Inco Europe Ltd v First Choice Distribution* [2000] 1 WLR 586, 592 Lord Nicholls said:
>
> > "It has long been established that the role of the courts in construing legislation is not confined to resolving ambiguities in statutory language. The court must be able to correct obvious drafting errors. In suitable cases, in discharging its interpretative function the court will add words, or omit words or substitute words. …
> >
> > 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."
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> 26. This approach applies also to taxing statutes. In *Luke v IRC* [1963] AC 557, 576 Lord Reid said:
>
> "To apply the words literally is to defeat the obvious intention of the legislation and to produce a wholly unreasonable result. To achieve the obvious intention and produce a reasonable result we must do some violence to the words. This is not a new problem, though our standard of drafting is such that it rarely emerges. The general principle is well settled. It is only where the words are absolutely incapable of a construction which will accord with the apparent intention of the provision and will avoid a wholly unreasonable result, that the words of the enactment must prevail."”

32. Therefore, before a correction can be made it is necessary to be “abundantly sure” of the intended purpose of the statute or provision in question; that by inadvertence the draftsman and Parliament failed to give effect to that purpose in the provision in question; and the substance of the provision Parliament would have made.

33. Mr Prosser contends that all three conditions are satisfied. The purpose of the legislation is to deal with cases of real, as opposed to fictional control, by the non-resident; Parliament, by overlooking the effect of s 416(6) ICTA, failed to give effect to that purpose; and the provision that would have been made can be divined from either s 167(3) or s 96(10) TCGA. In any event as Lewison LJ said at [49] in *Pollen Estate Trustees*:

> “We are not Parliamentary draftsmen; and it is sufficient that we can be confident of the gist or substance of the alteration, rather than its precise language.”

34. However, Mr Goy does not accept that any of the *Inco Europe* tests have been met. He says that I cannot be abundantly sure the purpose of s 167(2) TCGA was not to allow powers of a person to be attributed to his or her spouse as allowing such attribution precludes what would otherwise be a method that might, in certain circumstances, be used to avoid CGT by taking assets outside its ambit. Mr Goy also contends that it is difficult to say that the draftsman inadvertently failed to give effect to the purpose in question. Having clearly dealt with whatever problem that was

perceived in s 167(3) TCGA, Mr Goy also raises the difficulty of justifying an argument that the draftsman failed by inadvertence to deal with it in s 167(2) TCGA. The better view, he says, is that the section was intended to have a wide impact. In relation to the third requirement, the provision that Parliament would have made, Mr Goy submits that it is also difficult to say that it is abundantly clear that the ownership of shares in a company would have been made a requisite.

35. Having carefully considered the *Inco Europe* criteria, while it does seem likely that the effect of importing the definition of "control" in s 416(6) ICTA into s 167 TCGA was not considered by Parliament, especially in view of the answers given to the Standing Committee in relation to what became s 96(10) TCGA, I am not confident that I can be "abundantly sure" that this is the case given the comments of Morritt LJ in *Steele v EVC* in relation to anti-avoidance provisions, such as s 167 TCGA, which can cover a wider area than that strictly necessary to achieve their object and of the wide and sometimes unforeseen and unwelcome consequences of such a provision.

36. Accordingly, as I cannot be abundantly sure that the second of the *Inco Europe* conditions has been satisfied, it is not possible to "correct" the legislation in the way sought on behalf of Mr Reeves. As such, it is necessary to consider whether in accordance with s 288 TCGA, the context "otherwise requires" s 416(6) ICTA to be disapplied.

37. I have already referred, in paragraph 18, above, to Mr Goy's submissions on control being attributed to a non-UK resident spouse to argue that s 416(6) ICTA should not be disapplied. Indeed, he relies on no other claim that anybody else is an associate. As Mr Goy put it, HMRC "rely upon the positon of Mrs Reeves, full stop." He did not engage in the wider definition of associate in s 417 ICTA which includes, in addition to spouse, a child. Neither did he engage what the position would be in the circumstances as set out in the "S" example given by Mr Prosser. However, even if Mr Goy is right about the intention of Parliament in relation to a non-UK resident spouse, it does appear to be somewhat irrational and illogical to preclude hold-over relief because of the attribution of "control" in a company to a non-UK resident child, such as S in the example, who has absolutely no interest in the company or its operation.

38. That said, and despite Mr Prosser's persuasive argument to the contrary, given that, as Morritt LJ observed in *Steele v EVC*, anti-avoidance provisions do sometimes have a greater scope than strictly required with possible unforeseen and unwelcome consequences (such as that in Mr Prosser's example), I am, on balance, unable to conclude that Parliament necessarily intended control for the purposes of s 167(2) TCGA to refer to, what Mr Prosser called "real" as opposed to "fictional" control. It therefore follows that s 416(6) ICTA cannot be disapplied with the result that hold-over relief is precluded by s 167(2) TCGA.

39. It is therefore necessary to consider whether s 416(6) ICTA should be disapplied for non-compliance with the ECHR or EU law. However, before doing so,

and although not strictly necessary in view of my conclusion on s 167(2) TCGA, I shall first briefly address HMRC's alternative argument.

HMRC's alternative argument

40. This was predicated on the assumption that I had accepted that s 167(2) TCGA did not preclude the hold-over relief claim on the basis of either the context "otherwise required" s 416(6) ICTA not to apply or that a "correction" to the legislation could be made on *Inco Europe* principles.

41. HMRC's argument, which was described by Mr Prosser as novel as it appears to conflict the guidance in HMRC's CGT Manual (see CG66912 – *Gifts 14/3/89+: gifts of business assets where relief not available*), is that s 167(2) TCGA should be constructed so as to preclude hold-over relief where, in cases such as the present, a transfer is made by a non-UK resident transferor to a UK-resident company that he controls. Although such a transferor, being non-UK resident, would be liable to CGT on a disposal of a business asset under s 10(1) TCGA (which provides that a non-UK resident is liable to CGT on the disposal of UK assets used for the purposes of a trade carried on by him in the UK through a branch or agency) he would, if hold-over relief were available on the transfer to his wholly owned resident UK company, be able to dispose of his interest in the company without a liability to CGT contrary to the statutory purpose of s 165 TCGA.

42. Mr Goy contends that the three *Inco Europe* conditions are met. First, the purpose of s 167(2) TCGA being to preclude hold-over relief from applying to anyone using non-resident status to take assets out of the ambit of CGT; secondly, Parliament inadvertently failed to give effect to that purpose; and finally, it is necessary for words to be inferred into s 167(2) TCGA so that it applies to a non-resident transferor who has control of the transferee company. It is not necessary, as Lewison LJ said in *Pollen Estates* (see paragraph 33, above), to identify the precise words required provided the gist or substance of the alteration is clear.

43. However, I agree with Mr Prosser that s 167 TCGA is concerned with a transferor passing control rather than retaining control of a company, its purpose being to prevent the asset being taken out of the charge to CGT by passing control to a non-UK resident person prohibiting the owner from doing indirectly what he is prevented from doing directly by s 166 TCGA. The residence status of a transferor is not addressed by s 166 TCGA. That section is not concerned with a non-UK resident transferor to whom the asset is within s 10 TCGA who transfers the asset to a non-UK resident transferee to whom the asset is also within s 10 TCGA. This, Mr Prosser submits, suggests that Parliament was simply not concerned with the residence status of the transferor.

44. Additionally, Mr Prosser refers to s 162 TCGA (roll-over relief) which allows a transfer of business assets to a company in return for shares, by a transferor whether or not UK resident, without a charge to CGT arising. Although a UK resident transferor would be liable to CGT on a subsequent disposal of those shares a non-UK resident transferor would not. I accept Mr Prosser's submission that it is perfectly

possible that Parliament was sanguine about permitting a non-UK resident transferor to transfer business assets to a UK resident company that he controlled.

45. In the circumstances I cannot be "abundantly sure" that Parliament intended that hold-over relief under s 165 TCGA should not be available to a non-UK resident transferor making a gif of a business asset to a company he controlled or, even if that relief was to be denied in such circumstances, that Parliament inadvertently failed to give effect to that purpose.

46. Accordingly, had it been necessary to decide the point, I would have rejected HMRC's alternative argument.

ECHR arguments

47. Mr Prosser contends that precluding hold-over relief s 167 TCGA breaches For Mr Reeves' rights under A1P1 (protection of property) and Article 14 (the right not to be discriminated against) of the ECHR. He submits that it is possible to adopt a Convention compliant construction of s 167 TCGA to disapply s 416(6) ICTA which does not go against the grain or a cardinal feature of the legislation. However, he accepts that had I accepted HMRC's alternative argument he would not be able to rely on the ECHR arguments that he advances.

48. Mr Goy's primary argument is that Mr Reeves has not been deprived of a possession within A1P1 and as A1P1 is not engaged it follows that neither is Article 14 which "complements the other substantive provisions of the Convention and the Protocols" (see *Abdulaziz, Cabales and Balkandali v United Kingdom* (1985) 7 EHRR 471 at [71]). Alternatively, if A1P1 and Article 14 are engaged Mr Goy contends that there is no interference with protected rights and no discrimination and that there is an objective justification for the application of s 416(6) ICTA in the definition of "control" for the purposes of s 167 TCGA.

49. Section 3 of the Human Rights Act 1998 ("HRA") provides:

> (1) So far as it is possible to do so, primary legislation and subordinate legislation must be read and given effect in a way which is compatible with Convention Rights.
>
> (2) This section—
>
> (a) applies to primary legislation and subordinate legislation whenever enacted;
>
> (b) does not affect the validity, continuing operation or enforcement of any incompatible primary legislation; and
>
> (c) does not affect the validity, continuing operation or enforcement of any incompatible subordinate legislation if (disregarding any possibility of revocation) primary legislation prevents removal of the incompatibility.

50. Considering s 3 HRA in *Ghaidan v Godin-Mendoza* [2004] 2 AC 557 Lord Nicholls said:

> "26. Section 3 is a key section in the Human Rights Act 1998. It is one of the primary means by which Convention rights are brought into the law of this country. Parliament has decreed that all legislation, existing and future, shall be interpreted in a particular way. All legislation must be read and given effect to in a way which is compatible with the Convention rights 'so far as it is possible to do so'. This is the intention of Parliament, expressed in section 3, and the courts must give effect to this intention."

He continued:

> "28. One tenable interpretation of the word 'possible' would be that section 3 is confined to requiring courts to resolve ambiguities. Where the words under consideration fairly admit of more than one meaning the Convention-compliant meaning is to prevail. Words should be given the meaning which best accords with the Convention rights.
>
> 29. This interpretation of section 3 would give the section a comparatively narrow scope. This is not the view which has prevailed. It is now generally accepted that the application of section 3 does not depend upon the presence of ambiguity in the legislation being interpreted. Even if, construed according to the ordinary principles of interpretation, the meaning of the legislation admits of no doubt, section 3 may nonetheless require the legislation to be given a different meaning. The decision of your Lordships' House in *R v A (No 2)* [2002] 1 AC 45 is an instance of this. The House read words into section 41 of the Youth Justice and Criminal Evidence Act 1999 so as to make that section compliant with an accused's right to a fair trial under article 6. The House did so even though the statutory language was not ambiguous.
>
> 30. From this it follows that the interpretative obligation decreed by section 3 is of an unusual and far-reaching character. Section 3 may require a court to depart from the unambiguous meaning the legislation would otherwise bear. In the ordinary course the interpretation of legislation involves seeking the intention reasonably to be attributed to Parliament in using the language in question. Section 3 may require the court to depart from this legislative intention, that is, depart from the intention of the Parliament which enacted the legislation. The question of difficulty is how far, and in what circumstances, section 3 requires a court to depart from the intention of the enacting Parliament. The answer to this question depends upon the intention reasonably to be attributed to Parliament in enacting section 3.
>
> 31. On this the first point to be considered is how far, when enacting section 3, Parliament intended that the actual language of a statute, as distinct from the concept expressed in that language, should be determinative. Since section 3 relates to the 'interpretation' of legislation, it is natural to focus attention initially on the language used in the legislative provision being considered. But once it is accepted that section 3 may require legislation to bear a meaning which departs from the unambiguous meaning the legislation would otherwise bear, it becomes impossible to suppose Parliament intended that the operation of section 3 should depend critically upon the particular form of words

> adopted by the parliamentary draftsman in the statutory provision under consideration. That would make the application of section 3 something of a semantic lottery. If the draftsman chose to express the concept being enacted in one form of words, section 3 would be available to achieve Convention-compliance. If he chose a different form of words, section 3 would be impotent.
>
> 32. From this the conclusion which seems inescapable is that the mere fact the language under consideration is inconsistent with a Convention-compliant meaning does not of itself make a Convention-compliant interpretation under section 3 impossible. Section 3 enables language to be interpreted restrictively or expansively. But section 3 goes further than this. It is also apt to require a court to read in words which change the meaning of the enacted legislation, so as to make it Convention-compliant. In other words, the intention of Parliament in enacting section 3 was that, to an extent bounded only by what is 'possible', a court can modify the meaning, and hence the effect, of primary and secondary legislation.
>
> 33. Parliament, however, cannot have intended that in the discharge of this extended interpretative function the courts should adopt a meaning inconsistent with a fundamental feature of legislation. That would be to cross the constitutional boundary section 3 seeks to demarcate and preserve. Parliament has retained the right to enact legislation in terms which are not Convention-compliant. The meaning imported by application of section 3 must be compatible with the underlying thrust of the legislation being construed. Words implied must, in the phrase of my noble and learned friend Lord Rodger of Earlsferry, 'go with the grain of the legislation'. Nor can Parliament have intended that section 3 should require courts to make decisions for which they are not equipped. There may be several ways of making a provision Convention-compliant, and the choice may involve issues calling for legislative deliberation."

A1P1

51. The first of the ECHR issues to arise in the present case is whether, as Mr Prosser contends, A1P1 is engaged. This is dependent on whether Mr Reeves has been deprived of a "possession".

52. Under A1P1, 'Protection of property':

> Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

53. Clearly, the reference to the "payment of taxes" recognises that such a requirement is, in principle, within the scope of A1P1.

54. In *R (on the application of St. Matthew's (West) Ltd and others) v Her Majesty's Treasury and another; sub nom R (on the application of APVCO 19 Ltd and others) v HM Treasury* [2015] STC 2272 Vos LJ observed, at [45], that:

> "Looking at the matter from first principles, the taxpayer can be assumed to have the relevant tax as a possession before he enters into the relevant transaction – in this case the purchase of property. But when he purchases the property under the first contract and transfer, SDLT becomes payable under sections 42-44 of the Finance Act 2003. The taxpayer also enters into an agreement for an option which gives him an argument that the SDLT charged under sections 42-44 is not payable. It is now common ground that the argument as to the meaning of section 45 (before the legislative changes) does not constitute an existing possession for A1P1 purposes, because the claim is not sufficiently certain or established within the principles set out in *Kopecky supra*. But the money available to pay the SDLT must, in my judgment, be affected by the argument as to whether it is payable to HMRC. Of course, the money is a possession in one sense, but it is a possession impressed with an arguable claim by HMRC, which prevents it being properly regarded as a possession for A1P1 purposes.

55. Referring to the observations of Vos LJ, and similar comments made by Green J in *R (on the application of Walapu) v HMRC* [2016] STC 1682 at [120] that, "a dispute about tax suffices to take the sums in question out of the notion of 'possessions'", Mr Goy contends that if the offending provision, s 416(6) ICTA were to be disapplied Mr Reeves would be left with a claim to hold-over relief that was still disputed by HMRC albeit on the basis of the alternative argument, which I have rejected, ie that s 167(2) TCGA applies where the non-UK resident transferor controls the company to which he made the transfer.

56. Mr Prosser, however, referred to *Fessal v HMRC* [2016] SFTD 585 in which the Tribunal (Judge Beare and Mrs Wilkins), after noting that HMRC had conceded for the purposes of that case that the money which Mr Fessal would be deprived of if assessments were upheld was a 'possession', went on to say:

> "47. But we would add that, even if HMRC had not accepted that, we would have held that upholding the assessments would deprive Mr Fessal of a "possession". We note that there have been a number of recent decisions which might at first glance appear to cast doubt on that conclusion – for example, the decision of the Court of Appeal in *R (on the application of St. Matthew's (West) Ltd and others) v Her Majesty's Treasury and another; sub nom R (on the application of APVCO 19 Ltd and others v Her Majesty's Treasury and another)* ([2015] STC 2272); ("*St Matthews*") and the decision of Green J in *Walapu v Revenue and Customs Commissioners* ([2016] EWHC 658 (Admin)) ("*Walapu*").
>
> 48. In the former case, there had been a retrospective legislative change which put beyond doubt the fact that SDLT was payable in relation to a transaction which the taxpayers had implemented whereas, prior to the legislative change, it was arguable that no such SDLT was payable. It was held that the effect of the legislative change was not to deprive the

taxpayers of a "possession" because whether or not the SDLT was payable was in dispute prior to the change. But that is very different from the facts in the present case, where the legislation in respect of which the A1P1 override is being considered is the very legislation which enables HMRC to claim the tax, as opposed to legislation which post-dates HMRC's claim to the tax. Putting this another way, the legislation which was at issue in the *St Matthews* case was the retrospective legislative change that removed from the taxpayer an argument that no SDLT was payable but did no more than that. A secondary consequence of that was that the SDLT became payable but the SDLT was already arguably payable before the legislative change. As Vos LJ put it in paragraph [49] of the decision:

> "It would be different if the appellants had been challenging the imposition of SDLT itself".

49. A similar distinction arises in relation to the *Walapu* case. The facts in that case were that the taxpayer challenged, on (inter alia) the grounds of the A1P1, an obligation to pay a disputed amount of tax under an "accelerated payment notice". In relation to the A1P1 argument, Green J held that, even if the tax that was the subject of the "accelerated payment notice" was a "possession", the taxpayer was not deprived of that tax because he would get it back with interest if he was successful in the substantive appeal. However, he also stated (at paragraph 120) that the tax in question was not a "possession" because it was the subject of a dispute. Again, this decision can be explained by distinguishing between the legislation in respect of which the A1P1 override was being claimed by the taxpayer in the *Walapu* case - the requirement to pay tax in advance – and the legislation which gave rise to the taxpayer's alleged obligation to pay the tax in the first place. Where the legislation in respect of which the A1P1 override is being claimed is not the legislation giving rise to the taxpayer's alleged obligation to pay tax in the first place, the fact that there is a dispute between the taxpayer and HMRC as to whether or not the tax is payable will mean that the taxpayer has no "possession" for the purposes of applying the A1P1 to the subject legislation. However, where, as in the present case, the legislation at issue is the legislation which determines whether HMRC is entitled to assess Mr. Fessal to tax in the first place, the tax which is the subject of the assessment must be capable of being a "possession" if the A1P1 is to have any application in the field of tax law.

50. In short, to conclude that no part of the sum which is claimed by HMRC in this case amounts to a "possession" for Mr. Fessal would be to prevent the A1P1 from having any application in the context of tax legislation. Moreover, if that were to be the conclusion to be derived from the above line of cases, then it would be inconsistent with other decisions in relation to the application of the A1P1 in a tax context, such as *Burden v United Kingdom (Application No 13378/05)* ([2008] STC 1305)."

57. Notwithstanding the comments of the Tribunal Mr Goy contends that there is nothing in *Fessal* that is inconsistent with HMRC's case that Mr Reeves is deprived not of a possession but only an argument that he does not have to pay CGT.

58. However, I agree with Mr Prosser who says that HMRC's argument is fundamentally misconceived as it requires consideration of A1P1 after accepting, as I have, that HMRC's primary argument concerning the construction of s 416(6) ICTA is correct but before reaching a decision on HMRC's alternative argument. It is only necessary to consider the ECHR argument if, as is the case, HMRC succeed on their primary argument but their alternative argument fails. If HMRC had succeeded on the alternative argument, as Mr Prosser accepted, it cannot be said that s 167 TCGA breached Mr Reeves' human rights.

59. In this case, as in *Fessal*, the legislation in respect of which the A1P1 override is being considered, s 167(2) TCGA, is the very legislation which enables HMRC to claim the tax. Accordingly, I find that A1P1 is engaged as there is the possibility of Mr Reeves being deprived of a possession.

60. In *R (on the application of Huitson) v HMRC* [2011] QB 174 Kenneth Parker J, after citing A1P1, referred, at [75], to the "following general propositions did not appear in dispute" in that claim, of which the following are applicable to the present case:

> (1) In securing the payment of taxes, a national authority must strike a "fair balance" between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights, including the right that a person enjoys to "the peaceful enjoyment of his possessions": see, for example, *National & Provincial Building Society v United Kingdom* (1997) 25 EHRR 127, para 80.
>
> (2) In framing and implementing policies in the area of taxation, the state will enjoy "a wide margin of appreciation and the court will respect the legislature's assessment in such matters unless it is devoid of reasonable foundation": the *National & Provincial* Building *Society* case, at para 80. The domestic analogue of the margin of appreciation is the discretionary area of judgment and is especially wide in the field of social and economic policy: see, for example, *R v Director of Public Prosecutions, Ex p Kebilene* [2000] 2 AC 326, 380 e –381 d, per Lord Hope of Craighead. It has been said that "greater deference will be due to the democratic powers where the subject matter in hand is peculiarly within their constitutional responsibility": *International Transport Roth GmbH v Secretary of State for the Home Department* [2003] QB 728, para 85, per Laws LJ. In *Wilson v First County Trust Ltd (No 2)* [2004] 1 AC 816, para 70 Lord Nicholls stated that the readiness of a court to depart from the views of the legislature depends upon the circumstances, "one of which is the subject matter of the legislation. The more the legislation concerns matters of broad social policy, the less ready will be a court to intervene."
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> (3) None the less the court will carefully examine all the relevant circumstances, including the history of challenged provisions, to determine whether a fair balance has been struck: see, for example, the detailed analysis by the European court in *James v United Kingdom* (1986) 8 EHRR 123, 143–148.

61. In the Court of Appeal in *Huitson* [2011] STC 1860, Mummery LJ referred to "the judge's incontrovertible propositions" and said, at [29] that Kenneth Parker J had:

> "… identified the "fair balance" principle: in securing the payment of taxes a national authority must strike a fair balance between the general interests of the community and the protection of the individual's fundamental rights, including the right to possessions in Article 1. In that balancing exercise the national authority has a margin of appreciation under the Convention and a discretionary area of judgment under domestic law. The area of appreciation and judgment is wide in matters of social and economic policy."

It is also clear from the decision of the Court of Appeal in *Huitson*, at [37] and [57], that it is necessary to consider whether the provisions in question impose and unreasonable burden on a particular complainant, in this case Mr Reeves, rather than their potential impact in other cases and on other individuals.

62. In *Lobler v HMRC* [2015] STC 1893, Proudman J said, albeit obiter:

> "82. Tax legislation in itself can be a legitimate aim in the public interest because the collection of taxes is of clear public benefit and is therefore granted 'additional deference and latitude': see *NKM v Hungary* [2013] STC 1104 (at para 50). At paras 56–57, the ECtHR said:
>
> > '56. The court further reiterates that the levying of taxes constitutes in principle an interference with the right guaranteed by [A1P1] and that such interference may be justified under the second paragraph of that article, which expressly provides for an exception in respect of the payment of taxes or other contributions. However, this issue is nonetheless within the court's control …
> >
> > 57. … it is naturally in the first place for the national authorities to decide what kind of taxes or contributions are to be collected. The decisions in this area will commonly involve the appreciation of political, economic and social questions which the Convention leaves within the competence of the states parties, the domestic authorities being better placed than the court in this connection.'
>
> 83. Given this wide margin of appreciation in relation to tax legislation, in order for the ITTOIA to amount to a breach of an ECHR right, the interference with that right must be 'devoid of reasonable foundation': see *Gasus* and *National & Provincial Building Society v UK* [1997] STC 1466, 25 EHRR 127 (esp at para 80).
>
> 84. The interference could be justified if it satisfied the following three tests (apparently articulated to define 'manifestly devoid of reasonable basis') in *NKM* ([2013] STC 1104 at paras 48, 59 and 60): (i) the legislation must be sufficiently accessible, precise and foreseeable in its application; (ii) the legislation must pursue a legitimate aim in the public interest; and (iii) the interference with the right to peaceful

> enjoyment must be proportionate in the sense that it strikes a fair balance between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights.

She went to say, at [89]:

> (i) and (ii) of the *NKM* test however carry less weight in the determination of a breach of A1P1 if the test in favour of proportionality fails. It was said in *NKM* [2013] STC 1104 at para 60:
>
> > 'Even if [the interference with A1P1] has taken place subject to the conditions provided for by law—implying the absence of arbitrariness—and in the public interest, an interference with the right to the peaceful enjoyment of possessions must always strike a “fair balance” between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights. In particular, there must be a reasonable relationship of proportionality between the means employed and the aim sought to be realised by the impugned measure.'”

63. In the particular case of Mr Reeves, Mr Goy refers to him having originally owned a chargeable asset within the ambit of CGT and, by enveloping it within a company, he seeks to avoid the charge to CGT that would otherwise arise in respect of his interest in BlueCrest on ceasing to be UK resident. Additionally, he faces no liability to CGT on selling the shares in the company. In such circumstances, Mr Goy says, if the provisions in question apply to Mr Reeves because of his wife’s non-UK resident status, they will have operated to prevent him from converting a chargeable asset into a non-chargeable asset thus avoiding CGT. Therefore, he submits, it cannot be said that the provisions have no reasonable foundation in their impact on Mr Reeves as they preserve the integrity of the UK tax base.

64. Mr Prosser, on the other hand, contends that s 167 TCGA has no rational foundation. However wide the margin of appreciation, he says, it would be just as irrational to deny hold-over relief to Mr Reeves by treating Mrs Reeves as having control of WHR as it would be to deny relief by treating their children as having control. Relying on the obiter comments of Proudman J in *Lobler* he contends that the application of s 416(6) ICTA to s 167 TCGA is devoid of reasonable foundation if it does not have a legitimate aim or is not proportionate.

65. I should also mention, as is clear from the observation of Barling J in *Allan v HMRC* [2015] STC 890 at [40] that:

> … the hurdle for those alleging infringement of A1P1, particularly in the context of taxation provisions, has understandably been described as 'very high' (see, for example, para [60] of the recent judgment of Andrews J in *R (on the application of St Matthews (West) Ltd) v HM Treasury* [2014] EWHC 1848 (Admin), [2014] STC 2350). Tax measures are seen as entitled to particular deference in the light of the second para of A1P1 itself. Indeed counsel were only able to point to two decisions of the European Court of Human Rights in which the

court has held that the wide margin of appreciation in respect of such a measure has been exceeded so as to result in an infringement of A1P1."

66. Barling J continued to briefly describe the main features of these two decisions:

> "41. In *R.Sz. v Hungary* [2013] ECHR 41838/11, the applicant was paid benefits to which he was entitled on the termination of his employment, and was taxed on those benefits at the rate then applicable. Some time later, without any forewarning or transitional provisions, the applicable rate of tax was increased with retrospective effect to 98%, and an additional tax charge was imposed on the applicant. In holding that the measure entailed an 'excessive and individual burden' the court emphasised that it was targeted only at a specific group, namely those paid from the public purse, while all others—the majority—were exempt. Further, the applicant had received the benefits (less the then applicable tax) some time in advance of the relevant tax change and additional levy, which amounted to almost total deprivation. The lack of warning and of any transitional provision to enable him to adjust, were said to be liable to have caused considerable personal hardship.
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> 42. *Hentrich v France* (1994) 18 EHRR 440, [1994] ECHR 13616/88 concerned a right of compulsory purchase of land by the state which, as the Court of Human Rights found, 'operated arbitrarily and selectively and was scarcely foreseeable, and … was not attended by the basic procedural safeguards.' In effect, where any real estate had been purchased the state could exercise the power of pre-emption without the original purchaser having the right to make submissions to a court as to whether the price he or she had paid for the land was too low or as to whether he had bought it in good faith. The pre-emption right was applied rarely and arbitrarily 'for the sole purpose of warning others against any temptation to evade taxes.' As such the applicant 'as a selected victim of the exercise of the right of pre-emption …' bore an individual and excessive burden 'which could have been rendered legitimate only if she had had the possibility … of … challenging the measure taken against her …'
>
> 43. On any view these two cases involved extreme circumstances: in *Hungary* there was an unsignalled, retrospective, and discriminatory tax charge amounting to almost total deprivation of benefits designed to serve a social purpose, namely to protect an employee on the termination of his or her employment. In *Hentrich* the state had arbitrarily exercised a rarely-used right of pre-emption to deprive the applicant of land she had purchased, in circumstances where she had no effective recourse to legal challenge. It is interesting to note that notwithstanding the 'individual and excessive burden' which the applicant was held to have borne as a 'selected victim of the exercise of the right of pre-emption', the measure would still have been within the margin of discretion available to the state if the applicant had had an effective means of challenging it."

67. I am somewhat sympathetic to Mr Prosser's argument that it is irrational to deny relief to Mr Reeves because Mrs Reeves and their children are treated under s 167

TCGA, by virtue of s 416(6) ICTA, of having control of WHA, especially given HMRC's failure to engage with the position of the children. However, given the "high hurdle" in *Allan* and the wide margin of appreciation identified by Barling J in that case and Proudman J in *Lobler*, as Mr Reeves has had an effective means of challenging it, I am unable to conclude that the legislation complained of, s 167 TCGA, is devoid of reasonable foundation amounting to a breach of his rights under A1P1 ECHR.

Article 14 ECHR, 'Prohibition of discrimination',

68. Article 14 ECHR provides:

> The enjoyment of the right and freedoms set forth in this Convention shall be secure without discrimination in any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, associations with a national minority, property, birth or other status.

69. Article 14 was considered by the House of Lords in *AL (Serbia) v Secretary of State for the Home Department* [2008] 1 WLR where Baroness Hale said:

> "21. First, as was said in *Abdulaziz, Cabales and Balkandali v United Kingdom* (1985) 7 EHRR 471, para 71:
>
> > "Article 14 complements the other substantive provisions of the Convention and the Protocols. It has no independent existence since it has effect solely in relation to 'the enjoyment of the rights and freedoms' safeguarded by those provisions. Although the application of article 14 does not necessarily presuppose a breach of those provisions—and to this extent it is autonomous—there can be no room for its application unless the facts at issue fall within the ambit of one or more of the latter."
>
> …
>
> 22. Secondly, as the court first explained in the *Belgian Linguistic Case (No 2)* (1968) 1 EHRR 252, 284, para 10:
>
> > "In spite of the very general wording of the French version ('sans distinction aucune'), article 14 does not forbid every difference in treatment in the exercise of the rights and freedoms recognised … The competent national authorities are frequently confronted with situations and problems which, on account of the differences inherent therein, call for different legal solutions; moreover certain legal inequalities tend only to correct factual inequalities."
>
> The court then went on to "look for the criteria which enable a determination to be made as to whether or not a given difference in treatment … contravenes article 14". They found these in the principle which they articulated then and has since been repeated many times

over. A recent example is in *Stec v United Kingdom* (2006) 43 EHRR 1017, para 51:

> "A difference of treatment is, however, discriminatory if it has no objective and reasonable justification; in other words, if it does not pursue a legitimate aim or if there is not a reasonable relationship of proportionality between the means employed and the aim sought to be realised. The contracting state enjoys a margin of appreciation in assessing whether and to what extent differences in otherwise similar situations justify a different treatment."

70. The discrimination alleged in the present case is that Mr Reeves has been denied hold-over relief under s 165 TCGA because he has non-UK resident relatives, namely his wife and children. Mr Prosser contends that discrimination exists because if Mr Reeves did not have a wife (or children) or did not have a non-UK resident wife (or children) he would be entitled to claim hold-over relief and that he is being discriminated against because he does. Such discrimination, he says, cannot be justified.

71. Mr Goy contends that, when considering the position of Mr Reeves there is no discrimination as had he been a UK resident with a non-resident wife he would have been treated exactly the same. He further contends, relying on *Stec v United Kingdom* (as cited by Baroness Hale), that even if there was a difference in treatment because a non-UK resident person such as Mr Reeves is more likely to have a non-UK resident wife than someone who is resident in the UK, the attribution of powers under s 416(6) ICTA precluding a possible method of avoiding tax be removing assets outside the ambit of CGT has an objective and reasonable justification, namely to protect the integrity of the UK tax system and is therefore not discriminatory.

72. Although, as previously, Mr Goy did not engage with the question of the non-UK resident children I agree with him that Mr Reeves has not been treated differently to any other person with a non-UK resident wife and children and therefore has not been subject to any discrimination.

EU law arguments

73. Under s 2 of the European Communities Act 1972 and article 4(3) of the Treaty on the Functioning of the European Union ("TFEU") UK legislation, whenever enacted, is to be interpreted in conformity with directly effective EU law. Arguments on EU law were advanced by Mr David Yates, on behalf of Mr Reeves, and for HMRC by Ms Sarah Abrams. I am grateful to them both for their clear and succinct submissions.

74. In essence, Mr Yates contends that a literal construction of s 167(2) TCGA would breach the right to free movement of capital and that an EU compliant construction, which does not go against the grain or any cardinal feature of the legislation, should be adopted.

75. Ms Abram says that if any free movement right under the TFEU is engaged it is the freedom of establishment rather than free movement of capital. However, if it is the free movement of capital that is engaged she contends that s 167(2) TCGA falls within the exception in article 64(1) TFEU. Ms Abram further submits that s 167(2) TCGA does not in any event restrict the free movement of capital but that even if it did it is a justified and proportionate measure.

76. It is therefore necessary to consider, first, which freedom under the Treaty on the Functioning of the European Union ("TFEU") is applicable, free movement of capital or freedom of establishment; secondly, whether the exception in article 64(1) TFEU is engaged; thirdly, whether, s 167(2) does, in fact, restrict the free movement of capital; and finally if it does whether it is nevertheless justified and proportionate. It is common ground that Mr Reeves has to succeed on all of these issues for his appeal to be allowed.

77. Before turning to these issues it is convenient to first set out the relevant articles of the TFEU (insofar as applicable to the present case):

> **Article 63**
>
> (ex Article 56 TEC)
>
> 1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.
>
> 2. Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited.
>
> **Article 64**
>
> (ex Article 57 TEC)
>
> 1. The provisions of Article 63 shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Union law adopted in respect of the movement of capital to or from third countries involving direct investment – including in real estate – establishment, the provision of financial services or the admission of securities to capital markets. In respect of restrictions existing under national law in Bulgaria, Estonia and Hungary, the relevant date shall be 31 December 1999.
>
> 2. Whilst endeavouring to achieve the objective of free movement of capital between Member States and third countries to the greatest extent possible and without prejudice to the other Chapters of the Treaties, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall adopt the measures on the movement of capital to or from third countries involving direct investment – including investment in real estate – establishment, the provision of financial services or the admission of securities to capital markets.

…

78. Additionally, the relevant parts of the Council Directive of 24 June 1988 (88/361/EEC) provide:

Article 1

1. Without prejudice to the following provisions, Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States. To facilitate application of this Directive, capital movements shall be classified in accordance with the Nomenclature in Annex I.

…

ANNEX I

NOMENCLATURE OF THE CAPITAL MOVEMENT REFERRED TO IN ARTICLE 1 OF THE DIRECTIVE

In this Nomenclature, capital movements are classified according to the economic nature of the assets and liabilities they concern, denominated in either national currency or in foreign exchange.

The capital movements listed in this Nomenclature are taken to cover:

— …

— operations to liquidate or assign assets built up, repatriation of the proceeds of liquidation thereof or immediate use of such proceeds within the limits of Community obligations.

…

I — DIRECT INVESTMENTS

1. Establishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the acquisition in full of existing undertakings.

2. Participation in new or existing undertaking with a view to establishing or maintaining lasting economic links.

…

XI **— PERSONAL CAPITAL MOVEMENTS**

A — Loans

B — Gifts and endowments

C — Dowries

D — Inheritance and legacies

…

EXPLANATORY NOTES

For the purposes of this Nomenclature and the Directive only, the following expressions have the meanings assigned to them respectively:

> **Direct investments**
>
> Investments of all kinds by natural persons or commercial, industrial or financial undertakings, and which serve to establish or to maintain lasting and direct links between the person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity. This concept must therefore be understood in its widest sense.
>
> The undertakings mentioned under I-1 of the Nomenclature include legally independent undertakings (wholly-owned subsidiaries) and branches.
>
> As regards those undertakings mentioned under I-2 of the Nomenclature which have the status of companies limited by shares, there is participation in the nature of direct investment where the block of shares held by a natural person of another undertaking or any other holder enables the shareholder, either pursuant to the provisions of national laws relating to companies limited by shares or otherwise, to participate effectively in the management of the company or in its control.
>
> Long-term loans of a participating nature, mentioned under I-3 of the Nomenclature, means loans for a period of more than five years which are made for the purpose of establishing or maintaining lasting economic links. The main examples which may be cited are loans granted by a company to its subsidiaries or to companies in which it has a share and loans linked with a profit-sharing arrangement. Loans granted by financial institutions with a view to establishing or maintaining lasting economic links are also included under this heading.

Which TFEU freedom applies

79. Unlike free movement of capital, under article 63 which applies to third countries freedom of establishment is only applicable to of EU Member States as article 49 TFEU makes clear. This provides:

> Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.
>
> Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.

80. In *DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte* (Case C-164/12) [2014] STC 1345 the Court of Justice of the European Union ("CJEU")[1] considered the position in which two Austrian limited partners in a limited partnership established in Germany transferred their interests to a general partner, a German company, receiving shares in the capital of the German general partner in return. The general partner then dissolved the limited partnership which, as a result, no longer had an establishment in Germany. Under German law that transaction and the loss of a permanent establishment in Germany meant that the gains from the issue of the shares could not be taxed and as a result under German tax law the transfers to the general partner were subject to tax at their going concern rather than their book value.

81. Although on its facts all interested parties that submitted observations, as well as the referring court, accepted that on its facts the case "may be linked to the freedom of establishment, the CJEU in its judgment stated:

> "29. As regards the question whether national legislation falls within the scope of one or other of the freedoms of movement, according to well established case-law, it is the purpose of the legislation concerned that must be taken into consideration (see Case C157/05 *Holböck* [2007] ECR I-4051, paragraph 22, and Case C-182/08 *Glaxo Wellcome* [2009] ECR I-8591, paragraph 36).
>
> 30. It is also clear from the case-law that the Court will in principle examine the measure in dispute in relation to only one of those two freedoms if it appears, in the circumstances of the main proceedings, that one of them is entirely secondary in relation to the other and may be considered together with it (Case C-452/04 *Fidium Finanz* [2006] ECR I-9521, paragraph 34, and *Glaxo Wellcome*, paragraph 37).
>
> 31. The Court has held that national legislation not intended to apply only to those shareholdings which enable the holder to exert a definite influence on a company's decisions and to determine its activities but which applies irrespective of the size of the holding which the shareholder has in a company may fall within the scope of both Article 49 TFEU and Article 63 TFEU (Case C-543/08 *Commission* v *Portugal* [2010] ECR I-11241, paragraph 43 and the case-law cited).
>
> 32. As regards the purpose of the provisions of the UmwStG 1995 at issue in the main proceedings, it is apparent from the order for reference that they are intended to protect the fiscal interests of the Federal Republic of Germany in relation to capital gains generated in Germany territory where the international allocation of the right to impose taxes may undermine those interests.
>
> 33. In particular, the legislation in question is directed at capital gains on assets contributed by investors who are no longer subject to tax in Germany on gains arising as a result of the transfer of such assets from a limited partnership to a capital company.

[1] Although I have referred, in this section of the decision, to the CJEU it should also be read, where appropriate, as a reference to the European Court of Justice

> 34. It follows from this, first, that the application of the legislation at issue in the main proceedings to an individual case is not dependent on the extent of an investor's interest in the limited partnership whose share in the partnership is transferred to a capital company in return for company shares. Thus, under that legislation, the investor is not required to have a holding which enables him to exert a definite influence on the partnership's decisions, or indeed those of the capital company.
>
> 35. Indeed, to restrict the application of the legislation at issue in the main proceedings to cases in which the interest in the limited partnership that is transferred is held by an investor with a definite influence on the decisions of the partnership would be inconsistent in the light of the objective of protecting the fiscal interests of the Federal Republic of Germany.
>
> 36. Second, it is clear that, in the main proceedings, the obligation which the capital company is under to assess the assets contributed in return for shares at their value as part of a going concern is justified by the fact that the transferring companies are no longer subject to unlimited liability to tax in Germany in respect of gains accrued there, since the partnership in which they were limited partners has been dissolved.
>
> 37. Accordingly, the legislation at issue in the main proceedings has less bearing on the procedure for establishment than on the procedure for the transfer of assets between a limited partnership and a capital company.
>
> 38. It follows from all the foregoing considerations that the legislation at issue in the main proceedings must be examined solely in the light of free movement of capital, enshrined in Article 63 TFEU."

82. The CJEU stated, in *Test Claimants in the FII Group Litigation v HMRC* (No 3) (Case C-35/11) [2013] Ch 341 that:

> "96. … in a context such as that at issue in the main proceedings which relates to the tax treatment of dividends originating in a third country, it is sufficient to examine the purpose of national legislation in order to determine whether the tax treatment of such dividends falls within the scope of the Treaty provisions on the free movement of capital.
>
> 97. Since the chapter of the Treaty on freedom of establishment does not contain any provision which extends the application of its provisions to situations concerning the establishment of a company of a member state in a third country or the establishment of a company of a third country in a member state (see *Holböck v Finanzamt Salzburg-Land* (Case C-157/05) [2007] ECR I-4051, para 28; *Fidium Finanz AG v Bundesanstalt fur Finanzdienstleistungsaufsicht* (Case C-452/04) [2007] All ER (EC) 239; [2006] ECR I-9521, para 25; the *Scheunemann* case, para 33; the order in *Skatteverket v A and B* (Case C-102/05) [2007] ECR I-3871, para 29; and the order in *Test Claimants in the CFC and Dividend Group Litigation v Inland Revenue Comrs* (Case C-201/05) [2008] ECR I-2875, para 88),

legislation relating to the tax treatment of dividends originating in third countries is not capable of falling within the scope of article 49 TFEU.

98. Where it is apparent from the purpose of such national legislation that it can only apply to those shareholdings which enable the holder to exert a definite influence on the decisions of the company concerned and to determine its activities, neither article 49 TFEU nor article 63 TFEU may be relied upon: see *Test Claimants in the Thin Cap Group Litigation v Inland Revenue Comrs* (Case C-524/04) [2007] ECR I-2107, paras 33, 34, 101 and 102 and the order in *Lasertec Gesellschaft fur Stanzformen mbH v Finanzamt Emmendingen* (Case C-492/04) [2007] ECR I-3775, paras 22 and 27; see also the order in *Skatteverket v A and B*, paras 4, 25–28.

99. On the other hand, national rules relating to the tax treatment of dividends from a third country which do not apply exclusively to situations in which the parent company exercises decisive influence over the company paying the dividends must be assessed in the light of article 63 TFEU. A company resident in a member state may therefore rely on that provision in order to call into question the legality of such rules, irrespective of the size of its shareholding in the company paying dividends established in a third country: see *Skatteverket v A* (Case C-101/05) [2007] ECR I-11531, paras 11 and 27.

100. Since the Treaty does not extend freedom of establishment to third countries, it is important to ensure that the interpretation of article 63(1) TFEU as regards relations with third countries does not enable economic operators who do not fall within the limits of the territorial scope of freedom of establishment to profit from that freedom. Such a risk does not exist in a situation such as that at issue in the main proceedings. The legislation of the member state in question does not relate to the conditions for access of a company from that member state to the market in a third country or of a company from a third country to the market in that member state. It concerns only the tax treatment of dividends which derive from investments which their recipient has made in a company established in a third country.

101. It should be added that the line of argument of the United Kingdom, German, French and Netherlands Governments that the freedom applicable to the tax treatment of dividends originating in third countries depends not only on the purpose of the national legislation at issue in the main proceedings but also on the particular circumstances of the case in those proceedings would produce effects incompatible with article 64(1) TFEU.

102. It is apparent from that provision that article 63 TFEU on the free movement of capital covers, in principle, capital movements involving establishment or direct investment. The latter terms relate to a form of participation in an undertaking through the holding of shares which confers the possibility of effectively participating in its management and control: see *Glaxo Wellcome GmbH & Co KG v Finanzamt München II* (Case C-182/08) [2009] ECR I-8591, para 40 and *Idrima Tipou AE v Ipourgos Tipou kai Meson Mazikis Enimerosis* (Case C-81/09) [2010] ECR I-10161, para 48.

> 103. According to the case law, the restrictions on capital movements involving establishment or direct investment within the meaning of article 64(1) TFEU extend not only to national measures which, in their application to capital movements to or from third countries, restrict establishment or investment, but also to those which restrict payments of dividends deriving from them: see FII (No 1), para 183 and *Holböck's* case, para 36."

83. In *Kronos International Inc v Finanzamt Leverkusan* (Case C-47/12) [2015] STC 351 the CJEU stated, under the sub-heading 'The freedom at issue':

> 29. It is apparent from the court's settled case law that the tax treatment of dividends may fall within art 49 TFEU on freedom of establishment and art 63 TFEU on the free movement of capital (judgments in *Haribo Lakritzen Hans Riegel BetriebsgmbH v Finanzamt Linz* (Joined cases C-436/08 and C-437/08) [2011] STC 917, [2011] ECR I-305, para 33; *Ministre du Budget, des Comptes publics et de la Fonction publique v Accor SA* (Case C-310/09) [2012] STC 438, [2011] ECR I-8115, para 30; and *Test Claimants in the FII Group Litigation v Revenue and Customs Comrs* (Case C-35/11) [2013] STC 612, [2013] Ch 431, para 89).
>
> 30. As regards the question whether national legislation falls within the scope of one or other of the freedoms of movement, it is clear from well-established case law that the purpose of the legislation concerned must be taken into consideration (judgment in *Test Claimants in the FII Group Litigation*, para 90 and the case law cited).
>
> 31. National legislation intended to apply only to those shareholdings which enable the holder to exert a definite influence on a company's decisions and to determine its activities falls within the scope of art 49 TFEU on freedom of establishment (see judgments in *Test Claimants in the FII Group Litigation*, C-446/04, para 37; *Idrima Tipou AE v Ipourgos Tipou kai Meson Mazikis Enimerosis* (Case C-81/09) [2010] ECR I-10161, para 47; *Accor*, para 32; *Scheunemann v Finanzamt Bremerhaven* (Case C-31/11) [2012] 3 CMLR 1228, para 23; and *Test Claimants in the FII Group Litigation*, para 91).
>
> 32. On the other hand, national provisions which apply to shareholdings acquired solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking must be examined exclusively in light of the free movement of capital (judgments in *Haribo Lakritzen Hans Riegel and Österreichische Salinen*, para 35; *Accor*, para 32; *Scheunemann*, para 23; and *Test Claimants in the FII Group Litigation*, para 92).
>
> 33. In the main proceedings, it follows from the double taxation conventions concluded by the Federal Republic of Germany with the Kingdom of Denmark, the French Republic and—so far as concerns the 2001 tax year—Canada, and from application of para 8b(5) of the KStG 1994 in conjunction with the double taxation conventions concluded by the Federal Republic of Germany with the United Kingdom and with Canada, so far as concerns the 2000 tax year, that dividends paid to companies resident in Germany by companies

resident in those other states are exempt from German corporation tax when the shareholding of the company receiving the dividend in the company distributing it reaches the threshold of 10%.

34. Such a threshold admittedly serves to exclude from the scope of the exemption shareholdings acquired solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking.

35. However, contrary to the German government's submissions, such a threshold does not in itself make the exemption applicable only to those shareholdings which enable the holder to exert a definite influence on a company's decisions and to determine its activities. The court has already held that a holding of such a size does not necessarily mean that the holder exerts a definite influence on the decisions of the company of which it is a shareholder (see, to this effect, judgment in *Itelcar – Automoveis de Aluguer Lda v Fazenda Publica* (Case C-282/12) [2013] All ER (D) 114 (Oct), para 22).

36. Consequently, the national rules at issue in the main proceedings apply not only to dividends received by a resident company on the basis of a shareholding that confers definite influence over the decisions of the company distributing the dividends and enables its activities to be determined, but also to dividends received on the basis of a shareholding not conferring such influence.

37. In the case of legislation from whose purpose it cannot be determined whether it falls predominantly within the scope of art 49 TFEU or art 63 TFEU, the court has already held that, in so far as the national legislation relates to dividends which originate in a member state, account should be taken of the facts of the case in point in order to determine whether the situation to which the dispute in the main proceedings relates falls within the scope of art 49 TFEU or of art 63 TFEU (see, to this effect, judgments in *Test Claimants in the FII Group Litigation*, paras 93 and 94 and the case law cited; *Beker v Finanzamt Heilbronn* (Case C-168/11) [2013] STC 1334, paras 27 and 28; and *Bouanich v Directeur des services fiscaux de la Drome* (Case C-375/12) [2014] SWTI 1575, para 30).

38. As regards, on the other hand, the tax treatment of dividends originating in a third country, the court has held that it is sufficient to examine the purpose of national legislation in order to determine whether the tax treatment of such dividends falls within the scope of the provisions of the FEU Treaty on the free movement of capital, as national legislation relating to the tax treatment of dividends originating in third countries is not capable of falling within the scope of art 49 TFEU (see, to this effect, judgment in *Test Claimants in the FII Group Litigation*, paras 96 and 97).

It went on to note:

"53. … that the court has held that, since the Treaty does not extend freedom of establishment to third countries, it is important to ensure that the interpretation of art 63(1) TFEU as regards relations with third countries does not enable economic operators who do not fall within

> the limits of the territorial scope of freedom of establishment to profit from that freedom (judgment in *Test Claimants in the FII Group Litigation*, para 100).
>
> 54. However, as the Advocate General has, in essence, observed in point 64 of his opinion, such a risk does not exist in a situation such as that at issue in the main proceedings. The German rules do not relate to the conditions for access of a company from that member state to the market in a third country or of a company from a third country to the market in that member state. Those rules concern only the tax treatment of dividends which derive from investments made by the recipient of the dividends in a company resident in another member state or in a third country."

84. Mr Yates relies on *DMC* and *Glaxo Wellcome GmbH & Co KG v Finanzamt München II*, to which the CJEU referred in *DMC* (at [29] of its decision, see paragraph 81, above) to contend that it is the free movement of capital rather than freedom of establishment that is engaged. Ms Abram referred to the decision of the CJEU in *Marianne Scheunemann v Finanzamt Bremerhaven* (Case-31/11) [2012] EUECJ C-31/11 where the Court stated:

> "30 It should therefore be held that the legislation at issue in the main proceedings primarily affects freedom of establishment and that, in accordance with the case-law of the Court, it falls solely within the scope of the Treaty provisions concerning that freedom. If it were to be found that such a national measure has restrictive effects on the free movement of capital, those effects would have to be seen as an unavoidable consequence of a restriction on freedom of establishment and would not justify an independent examination of that measure in the light of the Treaty provisions on the free movement of capital (see, to that effect, Case C-464/05 *Geurts and Vogten* [2007] ECR I-9325, paragraph 16 and the case-law cited).
>
> 31 In any event, as regards the facts in the case before the referring court, it is established that the testator had a 100% holding in the capital of the company concerned and, accordingly, it cannot be denied that he was able to exert a definite influence over its decisions and to determine its activities."

85. Although she accepts that s 167 TCGA could apply to both freedoms Ms Abram contends that, on the basis of *Scheunemann,* it is possible to consider the facts of the case to determine which freedom applies. In the present case Mr Reeves established himself in the UK as a partner in BlueCrest to carry out his trade, which she says, is a paradigm example of the exercise of freedom of establishment. As a secondary part of that activity he moved assets to WHL and in doing so was able to continue to exercise the same trade or profession as before albeit through the "wrapper" of a company, WHL. Accordingly, she submits, the applicable freedom is the freedom of establishment.

86. However, as is clear from Mr Goy's description of s 167(2) TCGA as an anti-avoidance provision preventing a UK resident person being able to give chargeable assets to a UK resident company owned by a non-resident connected person who

could then sell his interest free from CGT (see paragraph 11, above), the legislation in dispute in the present case, like that in *DMC*, has less bearing on the procedure for establishment than on the procedure for the transfer of assets. In *DMC* it was between a limited partnership and a capital company and in the present case and individual, Mr Reeves, and a company, WHL.

87. As in *DMC* it follows that the legislation at issue must be examined solely in the light of free movement of capital, enshrined in Article 63 TFEU.

Article 64 TFEU

88. It is clear from *Yvon Velte v Finanzant Velbert* (Case C-181/12) [2013] EUECJ C-181/12, at [29] and [36], that article 64 TFEU (see paragraph 77, above), as a derogation from the free movement of capital, is to be interpreted strictly. However, it is common ground that the relevant restriction to hold-over relief, s 167(2) TCGA has been in place since at least 31 December 1993 and that it applies to third countries, ie to those resident anywhere outside the UK. The issue between the parties is whether s 167(2) TCGA relates to "direct investments".

89. Although not defined in the TFEU "direct investments" are included in the Nomenclature in Annex I to Council Directive 88/361/EEC (see paragraph 78, above). This has been recognised by the CJEU as having an indicative value for the purposes of defining the notion of capital movements (see eg *Trummer and Mayer* [1999] ECR I-1661 at [20] – [21]). Paragraph 2 of the Nomenclature section on the subject states that direct investments includes:

> Participation in new or existing undertaking with a view to establishing or maintaining lasting economic links.

90. It is clear from the Explanatory Note to the Directive that the concept of direct investments must be understood in its "widest sense" and that it covers:

> Investments of all kinds by natural persons or commercial, industrial or financial undertakings, and which serve to establish or to maintain lasting and direct links between the person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity.

The Explanatory Note continues with regard to:

> … companies limited by shares, there is participation in the nature of direct investment where the block of shares held by a natural person of another undertaking or any other holder enables the shareholder, either pursuant to the provisions of national laws relating to companies limited by shares or otherwise, to participate effectively in the management of the company or in its control.

91. In *Holböck v Finanzamt Salzburg-Land* (Case C-156/05) [2008] STC 92 the CJEU observed, at [35] that:

> "As regards shareholdings in new or existing undertakings, as the explanatory notes confirm, the objective of establishing or maintaining lasting economic links presupposes that the shares held by the shareholder enable him … to participate effectively in the management of that company or in its control (*Test Claimants in the FII Group Litigation*, para 182)."

92. In *Kronos* at [34] to [36] the CJEU indicated that a 10% holding in a company would be insufficient to be regarded as being held with any intention to influence its management and control restriction (see paragraph 83, above). Similarly, in *Haribo Lakritzen Hans Riegel BetriebsgmbH and another v Finanzamt Linz* (Case C-436/08 and C-237/08) [2011] STC 917 the CJEU stated at [137]:

> "135. Under Article 64(1) TFEU, the provisions of Article 63 TFEU are to be without prejudice to the application to non-member States of any restrictions which existed on 31 December 1993 under national or European Union law adopted in respect of the movement of capital to or from non'member States involving direct investment.
>
> 136 It follows that where, before 31 December 1993, a Member State has adopted legislation which contains restrictions on capital movements to or from non'member States which are prohibited by Article 63 TFEU and, after that date, adopts measures which, while also constituting a restriction on such movements, are essentially identical to the previous legislation or do no more than restrict or abolish an obstacle to the exercise of the European Union rights and freedoms arising under that previous legislation, Article 63 TFEU does not preclude the application of those measures to non'member States when they apply to capital movements involving direct investment (*Test Claimants in the FII Group Litigation*, paragraph 196).
>
> 137 It has already been held that holdings in a company which are not acquired with a view to the establishment or maintenance of lasting and direct economic links between the shareholder and that company and do not allow the shareholder to participate effectively in the management of that company or in its control cannot be regarded as direct investments (*Test Claimants in the FII Group Litigation*, paragraph 196). Since the legislation under examination in the context of the present question concerns only holdings of less than 10% of the share capital of the company making the distribution, it must be held not to fall within the scope *ratione materiae* of Article 64(1) TFEU."

93. Although it is accepted that Mr Reeves had a 7.4% stake in BlueCrest Ms Abram argues that the transfer of that interest to WHL, in which he was a 100% shareholder and sole director, involved a direct investment as it served to establish a direct link between Mr Reeves and WHL and that this enabled him to participate effectively in the management and control of the company, accordingly article 64(1) TFEU applies to preclude reliance on article 63 TFEU. Alternatively, she contends that even if the relevant investment for the purposes of article 64(1) TFEU was that in BlueCrest it would still amount to a direct investment in a business within the scope of article 64 because Mr Reeves was one of the founders of the BlueCrest and one of three members of the partnership board and, as such he participated effectively in its management and control.

94. However, as Mr Yates submits, the transfer by Mr Reeves to WHL was by way of a gift. He did not receive anything from WHL in return – if he had done he would not be seeking to rely on hold-over relief under s 165 TCGA. Therefore, he could not have made that transfer to WHL to establish or to maintain lasting and direct links between himself and WHL even if WHL had been an "entrepreneur" as envisaged by the explanatory note to the Directive.

95. Although Mr Reeves had a 7.4% interest in BlueCrest and did participate in its management and control, it does not follow that was because of the 7.4% interest. In that his position is analogous with a Chief Executive Officer of a company who has, say, a 5% non-voting shares in it but whose participation in its management and control can hardly be said to be because he holds shares in the company. In any event the 7.4% interest in BlueCrest that was held by Mr Reeves is clearly below the 10% interest which was held not to be within the scope *ratione materiae* of Article 64(1) TFEU in *Haribo* which is also consistent with the observations of the CJEU in *Kronos* at [34] to [36].

96. For these reasons I find that article 64(1) TFEU cannot apply.

Whether s 167(2) TCGA restricts free movement of capital

97. Mr Yates contends that s 167(2) TCGA restricts the free movement of capital because it discriminates against non-UK residents, as compared to UK resident transferors, as non-UK resident transferors are more likely to have non-resident relatives than someone who is resident in the UK. However, Ms Abram says that there is simply no discrimination because Mr Reeves, as a non-UK resident, is charged to tax on the disposal in exactly the same way and subject to exactly the same conditions as a UK resident would be.

98. In *O'Flynn v Adjudication Officer* (Case C-237/94) [1996] All ER (EC) 541 the CJEU considered the case of an Irish national resident in the UK whose son had died in the UK. Although there had been a religious ceremony in the UK the burial took place at a family grave in Ireland. The father applied for a means tested "funeral payment" which was refused because the burial not taken place in the UK. Having considered the relevant authorities, the CJEU stated:

> "20. It follows from all the foregoing case law that, unless objectively justified and proportionate in its aim, a provision of national law must be regarded as indirectly discriminatory if it is intrinsically liable to affect migrant workers more than national workers and if there is a consequent risk that it will place the former at a particular disadvantage.
>
> 21. It is not necessary at this respect that the provision in question does in practice affect a substantially higher proportion of migrant workers. It is sufficient that it is liable to have such an effect. Further the reason why a migrant worker chooses to make use of his freedom of movement within the Community are not to be taken into account in assessing whether a national provision is discriminatory. The possibility of exercising so fundamental a freedom as the freedom of

> movement of persons cannot be limited by such considerations, which are purely subjective."

99. Although Mr Yates sought to argue that if "funeral abroad" in *O'Flynn* was read "non-resident family member" Mr Reeves would have been subject to exactly the same discrimination as Mr Flynn I agree with Ms Abram that *O'Flynn* can be distinguished on the basis that Mr Reeves has not suffered any difference in treatment and has been taxed in the same way as any other person resident in the UK. As Mummery LJ (with whom Sullivan and Tomlinson LJJ agreed) noted in *Shiner v HMRC* [2011] STC 1878 at [41]:

> "Once one becomes immersed in the strategies of this litigation it is not difficult to see the EU destinations the claimants want this court and the Court of Justice, if a reference is made, to travel to: but the court is a judicial review court in this case. It has to adjudicate on the lawfulness of the actions of HMRC in their treatment of the claimants' tax affairs on the particular facts of this case. A prudent court will be cautious about being led off into unnecessary detours and must be alert as to whether it should even contemplate setting off in this case for some of the distant destinations opened up by the issues raised."

100. Therefore, the relevant question to ask in this case is whether the refusal of hold-over relief to Mr Reeves was discriminatory against him on the particular facts of this case. The answer, in my judgment, is no. Mr Reeves was treated in exactly the same way as a UK resident with a non-resident wife (or other relative).

Justification and proportionality

101. Given my conclusion in relation to discrimination it is not therefore necessary to consider whether s 167 TCGA can be justified and is proportionate but, had it been, I would have found that it can and that, on the particular facts of the case, it was proportionate.

102. As Mr Yates recognised there is no dispute that the balanced allocation of taxing rights is capable of being invoked as a justification. As the CJEU noted at [56] in *DMC*.

> "However, the objective of preserving the balanced allocation of the powers to impose taxes between Member States can justify legislation such as that at issue in the main proceedings where, in particular, the Member State in whose territory the income was generated is actually prevented from exercising its power of taxation in respect of such income."

103. Although WHL was UK-resident, and therefore subject to UK tax, because of his non-resident status Mr Reeves would, if entitled to hold-over relief, have been in a placed in a position to dispose of his interest in WHL outside the scope of UK CGT. However, I agree with Mr Yates the fact the Mr Reeves did subsequently do just that is neither here nor there.

Conclusion

104. For the above reasons the appeal is dismissed.

Appeal Rights

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

JOHN BROOKS
TRIBUNAL JUDGE

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