IN THE HIGH COURT OF JUSTICE **HC 1999 02905**
CHANCERY DIVISION
(REVENUE)

Royal Courts of Justice
Strand
London WC2A 2LL

23 February 2000

B E F O R E:

MR JUSTICE LIGHTMAN

B E T W E E N:

A PARDOE
(HM INSPECTOR OF TAXES)

Appellant

- and -

ENTERGY POWER DEVELOPMENT CORPORATION

Respondent

Mr Christopher Tidmarsh (Instructed by Solicitor for Inland Revenue, Somerset House, Strand, London WC2R 1LB) appeared on behalf of the Appellant.

Mrs Felicity Cullen (Instructed by Messrs Herbert Smith, Exchange House, Primrose Street, London EC2A 2HS) appeared on behalf of the Respondents.

Introduction

1. This is an appeal by HM Inspector of Taxes ("HMIT") from a decision of the Special Commissioners made on 10 May 1999. At issue is the validity of a direction dated 28 July 1997 ("the Direction") given by the Commissioners for Inland Revenue ("CIR") under section 777(9) of the Income and Corporation Taxes Act 1988 ("the Act") to Entergy Power Development Corporation ("Entergy"). The issue turns on the construction of s.777(9). A provision in the terms of this section has been in the statute book since 1969, but (besides the seven directions relating to the transaction in question in this case) only twelve directions have been given since that date and there has been no previous judicial consideration of the section or its statutory predecessors. The Special Commissioners upheld the contention of Entergy that the Direction was invalid. HMIT appealed against that decision. A second issue arises if the validity of the Direction is upheld. In the light of its decision that the Direction was invalid the Special Commissioners declined to express any views on this second question, and the parties agreed that I should do likewise if I held that the Direction was invalid.

2. The agreed facts can be shortly set out as follows:

(1) Entergy is incorporated in and generally resident for tax purposes in the USA;

(2) a Cypriot Company non-resident in the United Kingdom, Citrucy, owned at the relevant time the entire issued share capital of a United Kingdom company, Kingsnorth Power Ltd ("KPL"), which owned a power station in the United Kingdom;

(3) in June 1997 Entergy (and some six other prospective purchasers) entered into negotiations with Citrucy for the purchase of the entire issued share capital of KPL;

(4) on learning of these negotiations the CIR served the Direction on Entergy requiring Entergy to deduct tax and account to the CIR for tax on the price paid to Citrucy. At about the same time the CIR served like directions on the other prospective purchasers;

(5) the Direction was served on Entergy at an address in London on the 28 July 1997 and its receipt was acknowledged the same day;

(6) a contract for the purchase governed by English law between Entergy and Citrucy was concluded in Cyprus on 28 July 1997 and the purchase was completed the same day;

(7) in compliance with the Direction on completion Entergy deducted tax from the purchase money paid to Citrucy;

(8) on 30 September 1997 Entergy was assessed in the sum of £8,621,968 and on 28 October 1997 Entergy appealed against the assessment on the ground that the Direction was invalid.

3. The Direction was in the following terms:

"The Commissioners direct that, by virtue of s.777(9) Income and Corporation Taxes Act 1988, s.349 of that Act shall apply to any payment forming part of the said amount and paid at any time after the delivery of this Notice to the Registered Office of Entergy Power Development Corporation as if it were an annual payment charged with tax under Case III of Schedule D."

In a word, the Direction required Entergy to withhold tax from any purchase consideration paid by Entergy for shares in KPL to Citrucy.

4. The relevant statutory provisions for the purposes of this appeal are sections 349(1) and 350(1) and sections 775, 776 and 777 of the Act. Section 349(1) provides as follows:

"(1) Where —

(a) any annuity or other annual payment charged with tax under Case III of Schedule D, not being interest …

…

is not payable or not wholly payable out of profits or gains brought in to charge to

> income tax, the person by or through whom any payment thereof is made shall, on making the payment, deduct out of it a sum representing the amount of income tax thereon."

Section 350(1) provides:

> "where any payment within Section 349 is made by or through any person, that person shall forthwith deliver to the inspector an account of the payment, and shall be assessable and chargeable with income tax at the applicable rate on the payment …"

5. Section 775 is a provision directed at preventing individuals from avoiding income tax by selling the profits of their occupation for a capital sum. Section 776 is aimed at preventing persons concerned with land or the development of land from avoiding income tax where a gain of a capital nature is realized on the disposal of land or of property deriving value from land (e.g. shares in a land owning company) and the land or property was acquired with the sole or main object of realizing a gain from disposing of it or the land is held as trading stock or is developed with the sole or main object of realising a gain from disposing of it when developed. The CIR in this case had in mind s.776, for Citrucy was selling the shares in KPL, a company owning land (the power station) in the United Kingdom.

6. Section 777 (so far as material) provides as follows:

> "(1) This section has effect to supplement sections 775 and 776
> …
> (9) If it appears to the Board that any person entitled to any consideration or other amount taxable under section 775 or 776 is not resident in the United Kingdom, the Board may direct that section 349(1) shall apply to any payment forming part of that amount as if it were an annual payment charged with tax under Case III of Schedule D, but without prejudice to the final determination of the liability of that person …"

7. At the date of the Direction Citrucy was the beneficial owner of the issued share capital of KPL: there was no contract for sale and accordingly Citrucy did not have any present entitlement to any consideration for those shares. But at the date of the Direction a sale was imminent and so was a future entitlement to the consideration on such a sale. The question raised is whether in these circumstances s.777(9) authorized the CIR to serve the Direction. Entergy contends that s.777(9) only authorised service of a direction where a person is presently entitled to consideration and a present entitlement could only arise once a contract for sale had come into existence. The CIR contend that s.777(9) authorised them: (1) to serve a direction not merely where a person is presently entitled under an existing contract, but also where a person will or may be entitled in the future if and when a contract is entered into; and (2) (if the first contention is wrong) to serve a direction which only takes effect if and when a contract is concluded and the person becomes presently entitled.

8. There can be no dispute as to the proper approach to the construction of s.777(9). The subsection must be construed in its statutory context and most particularly in the context of s.775 and 776 to which s.777(9) is supplementary. Further as Lord Steyn said in IRC v. McGuckian 69 TC 1 at 78:

> "where there is no obvious meaning to a statutory provision, the modern emphasis is on a contextual approach designed to identify the purpose of a statute and give effect to it."

9. I turn now to s.777(9) and the critical words namely: "If it appears to the Board that any person entitled to any consideration or other amount under s.775 and 776 is not resident in the United Kingdom". In my judgment the following propositions may be stated:

(1) Section 777(9) is supplementary to section 775 and 776 and designed to provide machinery to safeguard and protect CIR's entitlement (so far as it supplements s.776) to tax on disposals falling within that section. Section 777(9) confers on the CIR the power as in interim measure to give a direction to persons paying taxable consideration to a non-resident (pending and without the prejudice to the final determination of the liability to tax of the person entitled to receive the same) freezing the tax element in any consideration in the hands of the payer;

(2) the formula "if it appears to the Board" makes the criterion the subjective judgment of the CIR. The subjective judgment can only be challenged in judicial review proceedings on established public law grounds;

(3) three conditions have to be satisfied before a direction is given, namely "entitlement", "non-residence" and the existence of sufficient reason to make a direction. It is clear beyond question that the non-residence and existence of sufficient reason to make a direction are matters for the subjective judgment of the CIR, but there is a dispute whether "entitlement" is likewise a matter for their subjective judgment. I have no doubt that (subject to one qualification) the answer is in the affirmative. The Scheme of s.777(9) is that the CIR have to form a judgment whether the three conditions are satisfied. The judgment on all three conditions may have to be based on imperfect and incomplete information and difficult issues of law and fact may arise. But nonetheless if the CIR form the necessary judgment, the interim protection afforded by a direction is available. The interests of the person adversely affected by the direction are protected in two ways: (a) explicitly the section provides that the direction does not prejudice the final determination of the issue of liability; and (b) implicitly the section provides that the CIR is duly bound to withdraw the direction if at any date after it is made, consequent upon receipt of further information, representations or otherwise, it ceases to appear to the CIR that the three conditions are satisfied. The one qualification to which I have referred is that the CIR must correctly direct themselves as to the meaning of the section and in particular of the word "entitled". It is common ground that, if they misdirect themselves, the direction is invalid;

(4) the phrase "any person entitled" in ordinary usage means "any person presently entitled£ and does not embrace a person prospectively entitled if some event happens in the future. As Hodge J said in In the Estate of Borger Deceased [1912] VLR 310 at 313:

> "… in my opinion "entitled" usually means 'entitled in possession' 'entitled to have the thing', not merely that you will be entitled or may be entitled to get something at some future date."

The learned judge advisedly used the word "usually" and not "invariably". The context and the purpose of the transaction or statute in question may require or justify a wider meaning;

(5) as regards context, I can find nothing in sections 775 and 776 or indeed in the Act as a whole which is supportive of any wider meaning. Indeed the indications are rather to the contrary effect. In particular s.776 only "bites" where there has been a disposal giving rise to the relevant entitlement and the natural implication is that the

statutory protection of a direction is intended to be available only once s.776 "bites" and there has accordingly been a disposal; and the Act is replete with sections which use express language to this effect when it is intended to provide for cases where the person in question is, will or may become entitled (see e.g. Sections 188G(6)(a), Section 431D(6)(b) and Section 482(5A)(a));

(6) as regards purpose, I do not think that this is a case where there is occasion to identify the purpose of s.777(9), for the meaning as set out above is obvious. But if and so far as it is appropriate to identify the purpose, the purpose behind s.777(9) is (as I have already indicated) to provide some measure of protection to the CIR where an entitlement has arisen to a taxable receipt: the CIR are given power to intervene between the dates of entitlement to payment and of actual payment. On this construction it is true to say that the power to intervene is precluded if there is no, or no sufficient, gap in time (as in this case) between contract and completion for the making of a direction or if the parties proceed immediately to completion bye-passing the contract stage altogether. HMIT contends that the legislature cannot have intended that there should be any such gap in the protection available to the CIR; that the statutory purpose must extend to providing protection in such situations; and that such protection can be afforded by adopting one or other of their proposed constructions. Whilst I fully accept that there is a such a gap in the protection afforded to the CIR, I do not think that a contextual approach identifies this extended purpose as the statutory purpose and that the legislature intended the CIR to be able to give directions ahead of transactions which will or may give rise to entitlement to taxable receipts. If Parliament had any such intention, it would surely in s.777(9) have used (as it used in other sections of the Act) the formula "person who is, will or may become entitled".

10. Having had the benefit of clear, concise and helpful submissions from both Counsel, I am quite clear that as a matter of construction of s.777(9) the CIR can give a direction if, and only if, at the time that they give the direction they are satisfied that there is a present entitlement. They cannot give a direction where there is only a prospect (however imminent) of future entitlement nor can they give a direction intended to take effect in the future when an entitlement arises. This may leave a yawning gap in the protection available to the CIR which ought to be filled, but whether the gap ought to be filled and how it should be filled are matters for the legislature, and not the Court.

11. Accordingly I respectfully agree with the Decision and reasoning of the Special Commissioners and dismiss this appeal.