

The importance of a contract (Lecture P1317 – 6.07 minutes)

During 2013/14, two taxpayers (Michelle McEnroe and Miranda Newman) sold their respective 50% shareholdings in Kingly Care Partnership Ltd (KCPL). The sale and purchase agreement stated that the consideration for the sale of these shares was £8,000,000.

At the time of the sale, KCPL owed its bankers an amount of just under £1,100,000.

On the day of the sale, the buyer's solicitors transferred £8,000,000 to the bank's solicitors. The latter then passed sufficient funds over to the bank to redeem the loan owed by KCPL. The balance was then paid to the vendors' solicitors.

In due course, the two former shareholders submitted tax returns which showed the consideration for the sale of each of their shareholdings to be 50% of approximately £6,900,000.

HMRC enquired into the tax returns and eventually issued closure notices, confirming that the consideration in each case should be 50% of £8,000,000. The taxpayers asked for an independent review of this disagreement and, when the response of the review was to concur with HMRC's position, they appealed to the First-Tier Tribunal.

The only point of dispute in this case (McEnroe v HMRC (2022)) was whether the consideration for the shares should be:

£8,000,000; or

£8,000,000 less the bank debt.

The grounds of the taxpayers' appeal is set out in the case report as follows:

(i) The consideration of £8,000,000 was a payment for the sale of the shares and the discharge of the bank debt. This must be properly apportioned and, under such an apportionment, £1,100,000 should be apportioned to the bank debt.

(ii) The agreement, properly construed, is that the buyer paid some £6,900,000 for the shares and circa £1,100,000 to repay the bank debt.

The sellers never received £8,000,000. The amount of £1,100,000 moved directly from the account of the buyer to the bank to discharge the debt. The sellers did not receive any value for this, as there was no personal guarantee given by either seller (this appears to be contradicted by the sale and purchase agreement which says there was a personal guarantee – a point confirmed by the taxpayers' evidence before the First-Tier Tribunal).

The appellants' treatment of the transaction in their returns also accords with the buyer's treatment of the transaction.

The contract interpretation needs to consider the whole aspect of the transaction, and not just the literal interpretation of the contract.

There is evidence that the amount of the bank debt was not intended to be treated as consideration for the shares.'

Judge Sarah Allatt opened her judgment by examining the law surrounding the calculation of chargeable gains, in particular Ss38 and 52 TCGA 1992. She then made reference to several cases, including the High Court's decision in Spectros International plc v Madden (1997) which also involved payment of a bank loan in addition to payment for shares. However, she did not agree with the vendors that the contract was for the sale of their shares and the discharge of the debt (see (g)(i) and (ii) above). She stated:

'The contract alludes to the fact that the debt will be discharged, but it does not say anything about how this is to be done and does not refer to the £8,000,000 being anything other than consideration for the shares.'

The judge also pointed out that, although there was testimony that the sale and purchase agreement did, in both the heads of terms and in earlier drafts, refer to the fact that the sale price was for the acquisition of KCPL on a debt-free basis, this statement did not make it into the final sale and purchase agreement. As she remarked:

'It does not follow that what was discussed beforehand is necessarily what the final agreement needed to reflect, as naturally a draft is for discussion and is not a final document.'

Given that the final version of the contract was not ambiguous, the judge dismissed the taxpayers' appeal. They had not discharged the burden of proof to demonstrate that their assertion about the lower quantum of the sale consideration was correct.

This all goes to emphasise the importance of ensuring that the terms of a contract properly reflect all the parties' intentions.

Contributed by Robert Jamieson