deficiency ought to have been discovered under the provisions of s. 14A of the *Limitation Act* 1980, so as to allow the limitation clock to start ticking. The extra time and costs involved are likely to be substantial, particularly because in the light of such uncertainties, disputes and litigation on limitation are likely to increase considerably. This is, to say the least, worrying.

Nor, it might be added, can much comfort be taken, in this connection, from the Law Commission's recent suggestions for reform of the law of limitation of actions (*Consultation Paper on Limitation*, No. 151 (1997)). For, although the commission rightly suggests that the date of accrual of a cause of action, with all its messiness and arbitrary character, should be downgraded in favour of a standard limitation period of three years from the date of discoverability, the date of accrual will nevertheless remain very relevant. For the matters of which the plaintiff must have actual or constructive knowledge would include (as at present) not only the facts of negligence and the identity of the potential defendant, but also the fact that the damage which has been suffered is 'significant' (12.28ff.) and this throws the enquiry straight back to where it started – namely, when was loss first suffered. *Plus ça change* ...

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Taxation

Charges to stamp duty as consideration

by Janice B Shardlow

The imposition of a charge to taxation at a fixed point in time by reference to consideration inevitably causes complications where some of that consideration is contingent and accordingly may not eventually be paid. In the case of capital gains tax, a solution is found in s. 48 of the *Taxation of Chargeable Gains Act* 1992, which provides for an initial charge to capital gains tax on the basis that the contingent consideration will be paid, with a rebate of tax should the sum eventually prove to be irrecoverable.

on the internet

http://www.inlandrevenue.gov.uk

The Inland Revenue home page is a useful starting point for any research concerning taxation. The site provides access to press releases, copies of statements of practice and consultation documents.

In the case, however, of the somewhat 'archaic' charge to stamp duty, dependent on submission of a document to the Inland Revenue and assessment of the charge on the document at the point of submission with reference to the circumstances at the date of execution of the document (*Wm Cory & Son Ltd v IRC* [1965] AC 1088), the problem has been dealt with by the evolution of a principle generally known as 'the contingency principle'. In its simplest form this allows the Inland Revenue to charge ad valorem duty on an instrument:

'not only by reference to any sum which is conditionally payable but also by reference to any sum which is payable contingently or conditionally, that is to say on a sum which may become payable' (Coventry CC v IRC [1978] STC 151).

In other words to assume the contingency will occur and assess on that basis. Due to the 'one-off' nature of the tax there is no prospect of a rebate should the contingency not actually occur; on the other hand it also follows that no charge can be imposed by reference to consideration which is incapable of ascertainment at that date (*IRC v Littlewood Mail Order Stores Ltd* [1963] AC 135).

The contingency principle has gradually been extended over the years to deal with the situation where a contingent sum would appear to be unascertainable, in the sense that its precise amount cannot be fixed at execution, but it is nevertheless subject either to a maximum or minimum. In such an event the principle has been applied to levy a charge by reference to that maximum or minimum by taking it as a 'prima facie sum' or 'basic payment' (*Independent Television Authority v IRC* [1961] AC 427), contingently payable on the relevant contingency arising. A charge to tax has accordingly been levied, in effect on a double contingency, i.e. on the basis of two assumptions:

(1) that events will be such that a sum will be payable; and

(2) that events will be such that the sum will be equal to the stated maximum/minimum.

The recent case of *L M Tenancies 1 plc v Commissioners of Inland Revenue* (Court of Appeal (Civil Division), 28 January 1998) would appear to have taken the principle one step further, applying a new permutation, which it was initially thought would apply only in the case of a charge on periodic payments, to a single payment on a conveyance on sale.

STAMP DUTY ON LEASES

The case centred on the application of stamp duty to the consideration to be paid on two leases granted by St John's College, Cambridge, on 14 August 1993. In each case the lease provided that the tenant should pay an annual rent and a premium, each of which was to be calculated in accordance with a formula. In the case of the rent this was to be determined with reference to the net letting income of the property for the year in question, and in the case of the premium the formula was expressed to be an amount equal to 'a' x 'b', where 'a' was a specified figure and 'b' was the price of 13.75% Treasury loan stock at the close of business on the 25th business day following the execution of the lease. It was not disputed that the formula had in each case been adopted in an attempt to avoid stamp duty.

The Revenue, in assessing the stamp duty to be charged under para. 3 of the head of charge 'lease or tack' on the leases, agreed with the appellant that no charge could be levied by reference to the annual rent, since it was impossible to ascertain any letting value as at the date of the lease. However they took the view that the contingency principle could be applied to the premium and assessed the premium to stamp duty by taking the closing price of the Treasury loan stock at 13 August, i.e. the last working day prior to the date of execution, 14 August, which was a Saturday.

DETERMINATION OF PAYMENT

At first instance Carnwath J dismissed the appeal against the assessment. He held that the contingency principle was applicable not only where the instrument in question referred to a specific sum as contingently payable, but also where the money payable contingently under the instrument was to be determined by reference to an external factor and at a date after the execution of the instrument, provided that an amount of consideration could be ascertained in the circumstances existing at the date of the instrument by applying the formula as at that date. It followed that the amount chargeable in this case was the figure produced by applying the formula in the leases at the date of their execution.

In making his decision, Carnwath J accepted the appellant's argument that the principle stated by Lord Radcliffe in *Independent Television*, was correct:

> *'What is necessary is that it should be possible to ascertain from the agreement that there is some specified sum agreed upon as the subject of payment which may perhaps fairly be called the prima facie sum or basic payment.'*

However, by applying the House of Lords decision in *Underground Electric Railways Co of London v IRC* [1906] AC 21, he found that this was possible on the facts. The *Underground* case concerned the assessment under s. 56 of the *Stamp Act* 1891 of a periodical payment which was to be determined by reference to a formula. This was to be paid by the purchaser of certain assets as additional consideration and was to be determined each year with reference to the profits of the purchaser in that year. The stampable document stated that such profits were to be applied first to paying a 5% dividend to shareholders on the paid-up share capital of the purchasing company at the relevant time and then, to the extent that there were profits left, to paying as further consideration for the sale, such sum as was equal to a dividend of 3% on such of the original ordinary share capital issued by the purchasing company as was, at that time, paid up. The House of Lords approved an assessment based on the minimum sum which would be payable, should there be sufficient profits at the relevant time, and on the assumption that the amount of the original issued ordinary share capital paid up at the time of the execution of the document would be the minimum amount issued and paid up at that time. Carnwath J stated:

> *'The importance of this case ... is that the so called minimum sum or specified sum was ascertained not simply from the terms of the agreement but by reference to an external factor namely the amount of capital actually paid up at the date of the instrument.'*

In the Court of Appeal, Morritt LJ gave judgment for the respondents (Waller LJ and Sir John Balcombe concurring) and clearly rejected the appellant's contention that the contingency principle had been applied incorrectly on the basis that instead of identifying an ascertained and specified sum which the parties had agreed to pay on a contingency, the Inland Revenue had merely made an estimate of the operation of the formula by determining how it would operate immediately rather than in the future. Although accepting the fact that the immediate case concerned the charge under the heading 'lease or tack' (*Stamp Act* 1891, sch. 1) on the premium as a single payment, whereas the *Underground* case concerned a charge on consideration payable over a period pursuant to s. 56 of the *Stamp Act* 1891, Morritt LJ declined to accept attempts to distinguish the *Underground* case on the basis that:

(1) the value of the relevant Treasury stock at the time of contract was not, unlike the new company's existing paid up capital in the *Underground* case, an element in the future calculation required by the formula;

(2) the value of the relevant Treasury stock on any particular day was not affected by the acts of the parties to the agreement, whereas, in part at least, the amount of the company's paid up capital was.

His lordship accepted that these two differences existed, but did not feel that they were of such significance as to entitle him to refrain from applying the principle established by *Underground*. It could not be said that the value of the stock on the date of the lease was totally unconnected with its value on the valuation date, and any fluctuations were likely to be within a narrow band. In neither case was there any formula so there was no importance in the statements made in *Independent Television* and by Brightman J in *Coventry CC v IRC* that:

> *'If, per contra, the form of the instrument is such that a sum is payable but does not name what that sum is, or what it may be, so that the sum could in theory be any figure, subject to due quantification by reference to some formula, then there is nothing by reference to which ad valorem duty can be calculated ... Accordingly the present issue was not for consideration.'*

Leave to appeal to the House of Lords was refused.

Third contingency level

The case takes the contingency principle one step further by applying the 'third contingency' level employed in the *Underground* case to a single payment, hence making it clear that the principle established in that case is of general application. Accordingly it would now appear appropriate for the Inland Revenue to levy a charge to stamp duty on the basis of three contingencies, i.e. by making three assumptions:

(1) that events will be such that a sum will be payable;

(2) that events will be such that the sum will be equal to a maximum/minimum amount;

(3) that events existing at the date of execution of the instrument in question will remain the same, and accordingly the maximum/minimum can be ascertained at the date of execution of the instrument.

Whether the third assumption can be said to involve a greater leap of faith than assumptions one and two is debatable. Lord Lindley, in the *Underground* case, was happy to reject arguments that such a calculation was merely an 'accident':

> *'The fact that the minimum sum is payable on more contingencies than one is in my opinion quite immaterial.'*

The true import of the general application of this principle becomes clear when one starts to look at its application to particular factual circumstances.

TRANSACTIONS IN LAND

The *L M Tenancies* case preceded the coming into force of s. 242 of the *Finance Act* 1994 which attempts to deal with the issue of unascertainable consideration in land transactions by providing that:

'Where ... the consideration, or any part of the consideration, for

(a) the transfer or vesting of any estate or interest in land; or

(b) the grant of any lease or tack,

cannot apart from this subsection be ascertained at the time the instrument in question is executed, the consideration for the transfer, vesting or grant shall for these purposes be taken to be the market value immediately before the instrument is executed of the estate or interest transferred or vested or, as the case may be, the lease or tack granted.'

The concept of unascertainabilty is itself defined for these purposes by s. 242(3):

'For the purposes of this section

(i) the cases where consideration or rent cannot be ascertained at any time do not include cases where the consideration or rent could be ascertained on the assumption that any future event mentioned in the instrument in question were or were not to occur...'

Or, put another way, consideration is not unascertainable for these purposes where the contingency principle applies. Accordingly:

'the issues on this appeal remain of importance in the case of instruments executed after 7 December 1993 , as well as those executed before that date, in determining whether, for the purposes of that section, the consideration cannot, apart from that section, be ascertained' (L M Tenancies case).

The Inland Revenue's view, expressed in their *Tax Bulletin* No. 30, August 1997, following the judgment at first instance, was that the principle in *L M Tenancies* would apply to other 'reference values' unknown at the date of execution of a document. In the context of rent this meant, for instance, that if the rent was subject to increase based on the RPI, then in stamping the document the Inland Revenue would apply the published increase in the RPI over the twelve months prior to the execution of the lease or agreement for lease, to calculate the average annual rent.

It would appear therefore that, in their opinion, s. 242 will have a much more limited role than first envisaged, since the ability to make a third contingent assumption based on a reference value available should mean that it is rare that such consideration is 'unascertainable'. Only rent fixed by reference to a completely new factor, such as the rent in *L M Tenancies* itself, would appear to fall within the section. It is interesting to note that, since part of the consideration being unascertainable is sufficient to ensure that s. 242 applies, should a document in the form of that used in *L M Tenancies* be executed today, the entire charge would be based on market value.

Earn-outs

In the context of company sales, the increasing trend to defer some, if not all, of the consideration and to make that consideration dependent, at least to some extent, on the future value of the target company – such consideration being usually referred to as an 'earn-out' – will ensure that what appears to be 'unascertainable consideration' will continue to be employed. From a capital gains tax point of view, such consideration cannot be charged to tax under s. 48 *Taxation of Chargeable Gains Act* 1992, since it cannot be ascertained.

However, the case of *Marren (Inspector of Taxes) v Ingles* [1980] 1 WLR 983 determined that a charge to tax could be imposed on the basis that the vendor was receiving a chargeable asset, namely a chose in action which was not a debt and, accordingly, a charge could be imposed on receipt of this asset and again at the point when a capital sum was derived from the asset on the realisation of the earn-out consideration. In practice this charge has rarely arisen since vendors have been able to structure their earn-outs to fall within the terms of Extra - statutory Concession D27, which has now been enshrined in statutory form in s. 138A of the *Taxation of Chargeable Gains Act* 1992, and enables the reliefs in s. 132 and 135 to be employed to avoid any charge until the shares or debentures, the subject of the earn-out, are themselves sold. The section applies where the consideration is such that 'the value or quantity of the shares or debentures is unascertainable at the time when the right is conferred' and s. 138A now provides a definition of 'unascertainable' for these purposes: *' if, and only if*

(a) it is made referable to matters relating to any business or assets of one or more relevant companies; and

(b) those matters are uncertain at that time on account of future business of future assets being included in the business or assets to which they relate.'

Should the consideration not be ascertainable within this definition, for example, if the unascertainable element is referable to a matter unrelated to the business or assets of a relevant company, the relief is not available and one has to resort to *Marren v Ingles* in order to determine the charge. In a large number of cases the vendor seeking to structure the transaction to fall within s. 138A will refer to businesses or assets which in fact exist at the date of the execution of the document, and in doing so may well find himself in disagreement with the purchaser who will inevitably seek to relate the consideration to a formula which has no current day reference value.

In the stamp duty context it has, in the past, been possible, in certain circumstances, to convince the Revenue that the contingency principle should not apply to the unascertainable earn-out consideration, on the somewhat unusual basis that the House of Lords made it clear in *Marren v Ingles* that the right to that unascertainable consideration itself constituted a chose in action, not a debt. Accordingly it did not fall within the restricted definition of stampable consideration provided by the *Stamp Act* 1891, namely it did not consist of cash or foreign currency, stock or marketable securities and did not fall within s. 57. The success of this argument did not appear to depend on the absence of a maximum or minimum, since its essence lay in the nature of the consideration being provided and it was accepted that such a maximum or minimum did not prevent the application of the *Marren v Ingles* charge. Presumably this argument will continue to be accepted and accordingly may serve to resolve the perceived tension between the interests of the vendor and the purchaser, until, that is, some enterprising person attempts to apply the *L M Tenancies* contingency approach within the context of capital gains tax itself.

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