Michaelmas Term
[2024] UKSC 40
On appeal from: [2022] EWCA Civ 1422

JUDGMENT

R (on the application of Cobalt Data Centre 2 LLP and another) (Appellants) v Commissioners for His Majesty's Revenue and Customs (Respondent)

before

Lord Briggs
Lord Sales
Lord Burrows
Lady Rose
Lord Richards

JUDGMENT GIVEN ON
20 November 2024

Heard on 24 and 25 January 2024

Appellants
Laurence Rabinowitz KC
Niranjan Venkatesan
(Instructed by Macfarlanes LLP)

Respondent
David Ewart KC
Stephen Kosmin
Edward Waldegrave
Laura Ruxandu
(Instructed by HMRC Solicitor's Office and Legal Services (Stratford))

LORD BRIGGS AND LORD SALES (with whom Lord Burrows, Lady Rose and Lord Richards agree):

Introduction – the Issues

1. This appeal concerns the conditions for the availability of the initial 100% capital allowances ("EZA") regime arising from expenditure incurred in the construction of buildings in an enterprise zone under the Capital Allowances Act 2001 ("the 2001 Act"). Section 298 of the 2001 Act provides that:

> "(1) For the purposes of sections 299 to 304, the time limit for expenditure on the construction of a building on a site in an enterprise zone is-
>
> (a) 10 years after the site was first included in the zone, or
>
> (b) If the expenditure is incurred under a contract entered into within those 10 years, 20 years after the site was first included in the zone."

2. In the present case the relevant expenditure was incurred more than 10 years but less than 20 years after the site was first included in the zone, so that the taxpayer was required to show that the expenditure was incurred "under a contract entered into within those 10 years" within the meaning of section 298(1)(b). We will refer to years 1 to 10 as the first period and to years 11 to 20 as the second period.

3. The contract upon which the taxpayers rely for this purpose in the present case is a type of building contract which has come to be known as a golden contract, and it has been labelled "the Golden Contract" in these proceedings. The distinguishing feature of a golden contract in this context is that, rather than prescribe one or more construction projects which the contractor undertakes to carry out, it sets out a range of alternative construction projects, each described in detail, between which the developer is entitled to (and must) choose, by service of a specified notice upon the contractor. The contract consists of more than a series of mere options (although that is how the specified alternatives were labelled in this Golden Contract), because the developer is required to choose one within a specified time frame, so that the contractor has a contractual right from the outset that one of the specified building projects will be commissioned. A golden contract creates a regime according to which the developer's obligation to proceed with a development is matched by the developer's right to select between specified projects, rather than granting an option or set of options leaving the developer free to do nothing. There is therefore a commitment from the outset to the carrying out of a building project

on a site within the enterprise zone, but the developer retains the right to decide which one.

4. The Golden Contract in the present case specified six alternative projects, each for different buildings on different sites (although many of the sites overlapped) within the same enterprise zone, each identified by a description of the type of building, the site on which it was to be constructed, and by reference to an appendix setting out the agreed specification in great detail. It is common ground that the Golden Contract, as originally made and as it remained at the end of the first period, required the developer to select one of the alternative projects. For ease of reference, whilst it should be emphasised that it imposed an obligation on the developer to make a selection, we will call it the developer's right to select.

5. Building contracts commonly contain a right for the developer to insist on changes to be made in the specification of the project as it goes along, usually with a right conferred on the building contractor to refuse to accept unreasonable changes, and provision for payment of the resulting extra cost (if any). The Golden Contract included such provision. We will call it the developer's right to change.

6. The combination of the developer's right to select and the developer's right to change provided the developer under the Golden Contract with valuable flexibility to make significant choices and adjustments to the projects and therefore to the expenditure to be incurred during the second period (ie between the tenth and twentieth anniversaries of the relevant site being included in the enterprise zone), without losing the benefit of the EZA regime. This is because both the right to select and the right to change are unilateral rights conferred on the developer by the Golden Contract in its original form. Expenditure incurred by reason of the exercise of either of those rights is, as the respondents ("HMRC") accept, expenditure incurred "under" the Golden Contract. Because the Golden Contract was made during the first period, any expenditure incurred in the second period as a result of the exercise of those rights would satisfy the composite time limit in section 298(1)(b).

7. Under the common law which regulates the legal relationship between contracting parties, there is of course freedom to make almost any alteration to this relationship by a further agreement. This may be achieved (broadly speaking) by one or other of two mechanisms. The first is to vary the existing contract by altering one or more of its terms. The second is to put an end to the existing contract and replace it with a new one. We will call the first mechanism variation and the second replacement. The second has tended to be called rescission during argument, but this is a word with a variety of meanings, only one of which is to put an end to a contract by a further agreement. Furthermore rescission says nothing about any continuing contractual relationship, whereas replacement does. It is again common ground that both variation and replacement require a further agreement

which satisfies the common law requirements of a binding contract, including fresh consideration.

8. The facts which have given rise to the issues to be determined on this appeal may, in a nutshell, be summarised as follows. The Tyne Riverside Enterprise Zone was established on 19 February 1996. On 17 February 2006 two wholly owned and controlled special purpose subsidiaries of the same corporate parent made the Golden Contract for the construction of a building in that enterprise zone just two days before the expiry of the first 10 year period. The parties were Highbridge North Tyneside Developer One Limited (called the Developer) and Highbridge North Tyneside Contractor One Limited (called the Contractor). The appellant taxpayers are successors in title to the rights of the Developer. The Golden Contract gave the Developer the right of selection of one out of six specified projects, called Works Option 1 to Works Option 6. By clause 12 of the JCT Standard Form as incorporated in and amended by the Golden Contract ("clause 12"), the Developer was given a right to change the design, quality or quantity of "the Works" (as defined) included in the detailed specifications within each Works Option, subject to a requirement that the Contractor consent to a change to design, such consent not to be unreasonably withheld or delayed, and with provision for extra payment to the Contractor where changes necessitated extra work.

9. At various times during the second period the Developer purported to exercise both the right to select and the right to change. The Developer and the Contractor also purported during the second period to vary the Golden Contract so as, inter alia, to enable the Developer to select more than one of the specified Works Options. Thereafter the Contractor built and the Developer and the taxpayers (the Developer's successors) paid for three buildings, called DC1, DC2 and DC3. The present appeal is concerned with a claim for EZAs in respect of buildings DC2 and DC3. Those buildings differ in significant respects from the subject matter of any of the Works Options set out in the Golden Contract in its original form. The expenditure incurred by the Developer and the taxpayers on DC2 and DC3 within the second period ("the Relevant Expenditure") constitutes the basis of the claim to 100% capital allowances in issue on this appeal.

10. The primary case of the taxpayers is that the Relevant Expenditure was all incurred under the Golden Contract and hence fell within the scope of section 298, because it was all commissioned by the unilateral exercise by the Developer of the right to select and the right to change set out in clause 12 conferred by the Golden Contract in its original form, ie as made during the first period. HMRC say that those rights, on the true construction of the Golden Contract, were insufficiently wide to enable the Developer to require the Contractor to build DC2 or DC3, which could only be contracted for by a new agreement, made after the end of the first period, and therefore falling foul of the time limits in section 298. The taxpayers reply by claiming, in the alternative to their primary case, that if the Relevant Expenditure was incurred as the result of a new agreement enabling the Developer to select additional Works Options, it was one which varied rather than replaced the Golden Contract, so that it was still incurred "under" the Golden Contract as

varied. To that alternative case HMRC makes two responses. First (in logic though not in time), section 298 does not on its true construction permit expenditure required or allowed by the content of a variation made during the second period of a contract made during the first period (or at least a variation which changed the type of building or the site on which it was to be built) to be treated as expenditure incurred "under" the earlier contract. Secondly, the alterations (to use a neutral word) necessary to provide for the construction of DC2 and DC3 amounted to a replacement of the Golden Contract rather than a variation of it, so that on no construction of section 298 could the replacement contract be said to have been made during the first period.

11. Thus the issues which emerge for decision by this court may be summarised as follows:

(i) Was the Relevant Expenditure triggered by the exercise of the Developer's unilateral rights to select and to change conferred by the Golden Contract in its original form? ("The Clause 12 Issue")

(ii) If not, does section 298 on its true construction enable expenditure, incurred by reason of a variation during the second period of a contract originally made in the first period, to be treated as expenditure incurred under the original contract? ("The section 298 Issue")

(iii) If it does, was the Relevant Expenditure triggered by a variation or by a replacement of the Golden Contract? ("The Variation Issue")

12. The Clause 12 Issue raises questions of construction of the Golden Contract, mainly in relation to clause 12, and its application to agreed facts, although the issues of construction go a little wider than that. If the question as framed is given an affirmative answer then HMRC accept that the appeal should be allowed. We deal with this issue at paras 108-124 below.

13. The section 298 Issue raises an important question of construction of section 298, in its statutory context. If it is answered in the negative, then the appeal must fail, and the Variation Issue becomes largely academic. But the taxpayers raise the threshold question whether it is open to HMRC to raise the section 298 Issue at all, having, it is said, declined to do so in the courts below in circumstances where permission to raise it now would cause the taxpayers prejudice. We deal with this issue at paras 58-107 below.

14. The Variation Issue is said to raise an important unresolved question of pure common law, namely whether and if so to what extent the characterisation of a contractual alteration to a contractual relationship as either a variation or a replacement (or, if one

wishes to use the word, rescission) of the original contract depends upon the common intention of the parties, objectively ascertained. We will call it the Variation Issue. This is a point upon which the courts below disagreed, and in relation to which the judgments of the members of the Court of Appeal do not deliver entirely uniform reasoning. But it only arises if this court answers the Clause 12 Issue "no" and either refuses to entertain the section 298 Issue or answers it "yes". We deal with this issue at paras 125-161 below.

15. For reasons which will in due course appear, we would answer the Clause 12 Issue in the negative. We consider that the court should entertain the section 298 Issue and we would also answer it in the negative. We would therefore dismiss the appeal, albeit for different reasons than those given by the Court of Appeal for the same outcome. While the Variation Issue is therefore in our view largely academic, it was the basis for the Court of Appeal's decision and the subject of extensive reasoning in that court. It has been fully argued on this appeal, and we consider it to be of sufficient public importance to address it in any event. It does not in our view admit of a simple yes or no answer. Because the section 298 Issue is also of general importance and because a proper understanding of the time limits in section 298 forms part of the context in which the other issues fall to be decided, we propose to consider it first, after a fuller deployment of the facts, the terms of the Golden Contract and a summary of the decisions of the courts below.

The Facts

16. In 1996, an Order was made to designate an enterprise zone in North Tyneside to include the Cobalt Business Park ("the Site") during the period 19 February 1996 to 18 February 2006: the Tyne Riverside Enterprise Zones (North Tyneside) (Designation) (No. 1) Order 1996 (SI 1996/106).

17. Prior to 2006, part of the Site had been used by Siemens, the well-known manufacturing company, for a facility to make semiconductors. However, following a downturn in the price for computer memory chips, Siemens ceased production and sold the Site to the Atmel group ("Atmel"). In 2006, realising that the enterprise zone would soon be coming to an end, Atmel took steps to preserve the ability to claim EZAs in respect of future construction work at the Site. It incorporated the Developer and the Contractor as special purpose vehicles with a view to achieving this.

18. On 17 February 2006 – as noted above, two days before the deadline specified in section 298(1) of 10 years after 19 February 1996 - the Developer and the Contractor entered into the Golden Contract for the construction of a building at the Site. In doing this, the intention of both the Developer and the Contractor was that the Developer would have the tax benefit of being able to claim EZAs in relation to the construction costs, pursuant to section 298(1)(b), for whichever building was chosen for construction under the Golden Contract.

19. The Golden Contract incorporated the conditions of the JCT Standard Form of Building Contract with Contractor's Design 1998 Edition ("the JCT Standard Form") with certain specified amendments agreed by the parties. In the JCT Standard Form clauses the Developer is called "the Employer", and both terms are used in this judgment.

20. The JCT Standard Form provides that the Employer is entitled (and obliged) to require the Contractor to undertake a single building project. But by amendment of that form, the Golden Contract provided from the outset that the Developer was entitled (and obliged) to require the Contractor to undertake any one (but not more than one) of six specified building projects. The alternative projects were called "Works Option 1" to "Works Option 6" and definitions were provided for each of these terms which referred to very detailed documentation specifying the Developer's instructions for that option (called "the Works Option 1 Employer's Requirements", "the Works Option 2 Employer's Requirements" and so on, respectively). The six Works Options defined in the Golden Contract differed significantly in size and scope, provided for works to be undertaken on different parts of the Site (on areas described as Sites A, B or C, depending on the Works Option) and provided in each case for a different specified "Contract Sum" payable by the Developer.

21. Works Option 1 was defined as follows:

> "… the design, construction and commissioning work comprising an industrial unit to accommodate the manufacture of an eight inch board on Site C for which works the Employer has issued to the Contractor its requirements (hereinafter referred to as the 'Works Option 1 Employer's Requirements')."

Works Option 3 was defined as follows:

> "… the design and construction works comprising an office business park on Site A for which works the Employer has issued to the Contractor its requirements (hereinafter referred to as the 'Works Option 3 Employer's Requirements')."

22. Clause 23A of the Golden Contract obliged the Developer to serve a Notice to Proceed on the Contractor which was to state "which Works Option the Contractor shall carry out and complete".

23. In February 2009 (that is, outside the first 10 year period specified in section 298) the parties agreed to vary the Golden Contract to permit the Developer to submit a Notice

to Proceed in respect of a combination of specified Works Options, stating that notwithstanding the giving of a Notice to Proceed in respect of Works Option 2, the Employer could also give a Notice to Proceed in respect of Works Option 3 ("Variation 1"). In April 2009 a further variation was agreed to replace Variation 1 to permit the Developer to choose to proceed with a different combination of Works Options, being Works Option 1 and Works Option 3 ("Variation 2"). Clause 23A was amended accordingly, to say that notwithstanding the giving of a Notice to Proceed as respects Works Option 1 the Developer could also give a Notice to Proceed as respects Works Option 3. As is clear, these variations effected significant substantive alterations in the rights and obligations of the Developer and the Contractor as they had originally been specified in the Golden Contract.

24. Clause 12 of the JCT Standard Form, as incorporated in and amended by the Golden Contract, headed "Changes in the Employer's Requirements and provisional sums", provided in relevant part as follows:

> "12.1 The term 'Change in the Employer's Requirements' or 'Change' means:
>
> 12.1.1. a change in the Employer's Requirements which makes necessary the alteration or modification of the design, quality or quantity of the Works, otherwise than such as may be reasonably necessary for the purposes of rectification pursuant to clause 8.4, including
>
> .1.1 the addition, omission or substitution of any work,
>
> .1.2 the alteration of the kind or standard of any of the materials or goods to be used in the Works,
>
> .1.3 the removal from the site of any work executed or materials or goods brought thereon by the Contractor for the purposes of the Works other than work materials or goods which are not in accordance with this Contract;
>
> 12.1.2 the imposition by the Employer of any obligations or restrictions in regard to the matters set out in clause 12.1.2.1 to 12.1.2.4 or the addition to or alteration or omission of any such obligations or restrictions so imposed or imposed by the Employer in the Employer's Requirements in regard to:

> .2.1 access to the site or use of any specific parts of the site,
>
> .2.2 limitations of working space,
>
> .2.3. limitations of working hours …,
>
> .2.4 the execution or completion of the work in any specific order.
>
> 12.2.1 The Employer may subject to the proviso hereto and to clause 12.2.2 issue instructions effecting a Change in the Employer's Requirements. No Change effected by the Employer shall vitiate this Contract. Provided that the Employer may not effect a Change which is, or which makes necessary, an alteration or modification in the design of the Works without the consent of the Contract which consent shall not be unreasonably delayed or withheld."

25. The expression "the Employer's Requirements" used in clause 12.1.1 was defined to mean:

> "The document referred to in Appendix 14 Appendix 15 Appendix 16 Appendix 17 Appendix 18 Appendix 19 (as the case may be) setting out the requirements of the Employer in relation to the relevant Works Option."

Each Appendix corresponded to a particular Works Option, in the same order. Hence "Works Option 1 Employer's Requirements" was defined to mean "the documents referred to in Appendix 14 as Ref: ER WO1", and the other Works Option Employer's Requirements were defined in a similar way by reference to the other Appendices, respectively. We address the terms relevant to the operation of clause 12 in more detail in the section below on the Clause 12 Issue.

26. Clause 13 of the JCT Standard Form, as incorporated into the Golden Contract, provided that the Contract Sum could not be adjusted or altered in any way whatsoever otherwise than in accordance with the express provisions of the JCT Standard Form.

27. On 20 November 2009 the Developer issued Change Order 1, expressed to be made relying on clause 12, with reference to Works Option 1 and Works Option 3 (that is, invoking the Contractor's obligations under the Golden Contract as varied by Variation 2), to instruct the Contractor to undertake the design and construction of a data centre referred to as "DC1" on Site C (which had been the site allocated to Works Option 1 under the Golden Contract in its original form). Change Order 1 also stated that "[f]urther Change Orders may be issued in respect of the buildings within Works Option 3 or otherwise in accordance with the contract to the extent that they relate to that part of the land [meaning, the Site] not affected by this Change Order". Pursuant to Change Order 1, DC1 was constructed on Site C with practical completion of the shell and core being achieved in 2011. The position in relation to DC1 and the capital allowance regime under the 2001 Act is not in issue in this appeal.

28. On 1 April 2011, again expressly relying on clause 12, the Developer issued Change Order 2, referring to Works Option 1 and requiring the Contractor to undertake the design, construction and commissioning of another data centre, DC2, "totalling 3,360 square metres net technical space", in accordance with the detailed specification in a new set of Employer's Requirements, for the sum of £54,845,150. The Developer paid the Contractor this sum on the same date. This amount contrasts with the original specified Contract Sum of £102,500,000 for Works Option 1. DC2 was to be constructed on Site A.

29. On 4 April 2011, once more relying on clause 12 and again referring to Works Option 1, the Developer issued Change Order 3, requiring the Contractor to undertake the design, construction and commissioning of another data centre, DC3, "totalling 2,400 square metres net technical space", in accordance with the detailed specification in a further new set of Employer's Requirements, for the sum of £42,284,000. The Developer paid the Contractor this sum on the same date. DC3 was to be constructed on Site B.

30. Following the service of Change Order 2 and Change Order 3, the Developer served Notices to Proceed with DC2 and DC3. The Contractor kept the sums it had been paid and proceeded to build the shell and core of both data centres. Although these were constructed on sites different from that allocated to Works Option 1 under the Golden Contract (ie Site C), they were built close by and the Upper Tribunal found that the change in location was not material.

31. Also in April 2011, the Developer, acting in combination with the Contractor, transferred the DC2 and DC3 development projects to the taxpayers. On 4 April 2011, the Developer and the Contractor entered into a sale and development agreement ("SDA") in relation to DC2 with Cobalt Data Centre 2 LLP ("the DC2 LLP"), the first appellant. The price paid by the DC2 LLP was £153,709,750. On 5 April 2011, the Developer and the Contractor entered into an SDA in relation to DC3 with Cobalt Data Centre 3 LLP ("the DC3 LLP"), the second appellant. The price paid by the DC3 LLP was

£109,754,500. On those dates, pursuant to the SDAs, the Developer assigned to the DC2 LLP and the DC3 LLP, respectively, the benefit of its rights under the Golden Contract concerning DC2 and DC3. In this judgment, we refer to the DC2 LLP and the DC3 LLP together as "the taxpayers".

32. The issues of principle which arise in relation to the claims for EZAs by the DC2 LLP and the DC3 LLP are the same, so throughout the proceedings and on this appeal, for convenience, the arguments and analysis have proceeded by reference to DC2 alone.

33. Other parties to the SDA of 4 April 2011 in relation to DC2 were Highbridge Business Park Limited ("HBPL") and Highbridge Properties plc. HBPL was the owner of the relevant superior lease of the Site and had granted a lease of the land for DC2 to the Developer.

34. Under the SDA the Developer assigned its lease and the benefit of its rights relating to DC2 under the Golden Contract (as varied) to the DC2 LLP. Clause 2.3 of the SDA recorded that the Developer agreed to procure the construction of DC2 for the DC2 LLP on the terms recorded in the SDA. Clause 2.4 provided that the DC2 LLP undertook certain obligations in consideration of the obligations on the part of the Developer and the Contractor to carry out and complete the building works in the manner set out in the SDA. Clause 2.5 stated that the Developer had already paid the Contractor the sum due pursuant to the Golden Contract (as varied). The SDA provided for distinct sets of obligations in relation to the construction of the shell and core of DC2 and its fitting out. In both cases, it was contemplated that the Contractor would engage sub-contractors to carry out the work. The person to whom DC2 was let would be entitled to specify how it should be fitted out.

35. In due course the shell and core elements of DC2 and DC3 were constructed at the Site in the enterprise zone, with completion dates of 28 January 2013 and 17 December 2012, respectively. However, the taxpayers have not succeeded in finding tenants for the data centres.

36. An issue has arisen as to the basis on which the Contractor proceeded to carry out the construction of DC2 (and DC3). The Contractor and the Developer believed that this was done pursuant to a valid notice given under clause 12 and hence pursuant to obligations contained in the Golden Contract as earlier varied by Variation 1 and Variation 2, that is to say that the issue of Change Order 2 did not itself constitute a variation of the Golden Contract. However, as the Upper Tribunal and the Court of Appeal held, and as we agree, they were mistaken about this. The Upper Tribunal held that the Golden Contract was varied by an agreement between the Developer and the Contractor reflecting the terms of Change Order 2, but was not precise about how the Contractor expressed its agreement in that regard. That may have been because HMRC did not

dispute that an agreement arose between the Developer and the Contractor as a result of Change Order 2. In the Court of Appeal the taxpayers contended that the Contractor's agreement could be inferred from the fact that the Contractor accepted payment from the Developer and proceeded to build DC2 on the footing it was contractually bound to do so in accordance with the specification in Change Order 2 and, having regard to the position adopted by HMRC in the Upper Tribunal, the Court of Appeal proceeded on that basis: paras 70 (Lewison LJ) and 139 (Newey LJ).

37. In this court, however, HMRC submitted that on proper analysis the Contractor carried out the work to construct DC2 not under the Golden Contract but under a separate agreement constituted by the SDA. We discuss this in paras 152-156 below. In the event, the outcome of this appeal does not depend upon a precise analysis of the contractual position between the Developer and the Contractor in the period after April 2011 when DC2 was under construction, going beyond our conclusion that DC2 was not required to be constructed by the exercise of any Developer's unilateral right in the Golden Contract in its original form as at the expiry of the first 10 year period.

The Taxpayers' Capital Allowance Claims and the Proceedings in the Upper Tribunal

38. In their tax returns for the year 2010-2011, the taxpayers claimed for EZAs which they contend arose on the expenditure which they incurred in acquiring by assignment their rights under the Golden Contract (as varied) in respect of DC2 and DC3. The taxpayers relied on section 296 of the 2001 Act, which allows a person who purchases from a developer a relevant interest in a building constructed in an enterprise zone before it has been used to treat the capital sum paid for that interest as "qualifying expenditure" for which an EZA may be claimed. Using DC2 for illustration, the DC2 LLP claimed an EZA in the sum of £153,709,750.

39. By closure notices issued on 28 July 2016 HMRC denied the taxpayers' EZA claims.

40. The taxpayers appealed against the closure notices to the First-tier Tax Tribunal. On 27 October 2016 they also issued a claim for judicial review, in which they maintained that, in denying the EZAs which had been claimed, HMRC had acted contrary to their published statement of practice which gave the taxpayers a legitimate expectation that EZAs would be available. The tax appeals and the judicial review claim were transferred to the Upper Tribunal, to be heard together.

41. A number of issues arose in the tax appeals, including whether the full capital sum in respect of which EZAs were claimed was paid for the relevant interest referred to in section 296. In due course, most of the issues were resolved by the Upper Tribunal,

including by a significant reduction in the amount of the EZAs, in ways which do not call for consideration in this appeal. The relevant issue in this appeal depends upon the nature of the expenditure incurred by the Developer, since under the 2001 Act the taxpayers' claims for EZAs in respect of their own expenditure on acquiring their interests in the respective development projects depend upon them showing that the Developer's own expenditure on the projects would have qualified for EZAs had the Developer retained ownership of them. The issue was defined in the Upper Tribunal as whether the Developer incurred the expenditure "under a contract" which had been entered into before 19 February 2006 (the relevant 10 year cut-off date, as explained above) for the purposes of section 298 of the 2001 Act.

42. As regards that issue, by its decision the Upper Tribunal allowed the taxpayers' appeal, holding that the Developer's expenditure on each of DC2 and DC3 was incurred under the Golden Contract, which had been entered into before 19 February 2006.

43. In reaching that decision the Upper Tribunal rejected the principal submission of the taxpayers that Change Order 2 (in relation to DC2) and Change Order 3 (in relation to DC3) had been validly issued pursuant to clause 12. However, the tribunal proceeded on the basis that, in one way or another, the Contractor had agreed to build DC2 and DC3 in accordance with the Change Orders.

44. The Upper Tribunal then rejected the principal submission of HMRC, that by one or other of the Change Orders issued on 20 November 2009, 1 April 2011 or 4 April 2011 (paras 27-29 above) the Developer had rescinded – that is, replaced – the Golden Contract with a new contract with the Contractor on new terms after the relevant cut-off date under section 298 (including by incorporating many terms which had originally been set out in the Golden Contract). (In the course of the hearing in the Upper Tribunal, HMRC abandoned a further argument, that Variation 1 or Variation 2 had operated to rescind and replace the Golden Contract). Instead, the Upper Tribunal found that the Golden Contract, as a contract made before the relevant cut-off date, had remained in place, albeit it had been varied by agreement of the parties pursuant to (so far as was relevant) Change Order 2 and Change Order 3, so that expenditure incurred under that contract as so varied qualified as "expenditure incurred under a contract entered into" within the first period as required by section 298(1)(b). In other words, using our terminology, the Upper Tribunal concluded that the Golden Contract had been varied but not replaced.

45. In the view of the Upper Tribunal, the decision whether there had been a variation or a replacement was to be determined by the general law of contract. In the course of the hearing in the tribunal, subject to certain qualifications, HMRC had indicated their broad agreement that the application of the relevant phrase in section 298(1)(b) ("incurred under a contract entered into" within the first 10 year period) depended on general principles of the common law of contract. The tribunal rejected HMRC's argument that, according to the general law, whether there is a variation or a replacement depends upon the magnitude

of the changes and that in this case the changes made by the Change Orders to the Golden Contract, as it existed before those Change Orders were issued, were so great that they had to be analysed as effecting a replacement rather than a variation of the Golden Contract. The tribunal accepted instead the taxpayers' opposing argument that, according to the general law, the choice between the two mechanisms was to be resolved by identifying, in the usual objective manner, the intention of the parties to the Golden Contract. The context in which the Change Orders came to be given was one where all the parties involved (including, in particular, the Developer and the Contractor) were aware of the critical feature of the tax background for the transactions and of the need for EZAs to be available in respect of the Developer's costs, in order to promote the financial viability of the developments and to maximise their commercial value. Accordingly, it was clear that the parties intended that the changes should take effect by way of variation of the Golden Contract, to preserve the right to claim EZAs under section 298, rather than by way of replacement of that contract.

46. HMRC also argued that, even if the Golden Contract had been varied by the Change Orders rather than replaced, the Change Orders had created a new contract separate from the Golden Contract and that the relevant expenditure had been incurred "under" that new contract for the purposes of section 298. The Upper Tribunal rejected this contention for similar reasons, holding that the question, under which contract was expenditure incurred, depended on the intention of the parties.

47. The Upper Tribunal also rejected a contention of HMRC, which was introduced for the first time at the hearing, that for the purposes of section 298 (although not for the purposes of the common law) the Golden Contract was to be regarded as a mere unenforceable agreement to agree so that the relevant expenditure of the Developer could not be regarded as having been made "under" a contract within the meaning of that provision. The Upper Tribunal concluded that there were binding obligations on both the Developer and the Contractor from the time when the Golden Contract was entered into, which were then varied as the parties intended; performance and payment had been rendered pursuant to those obligations; and this was all that was required by section 298.

48. As well as rejecting this argument on its merits, the Upper Tribunal said that it did not consider that it was open to HMRC to introduce it, because it was "an argument about the proper construction of section 298" and so was contrary to an agreement between the parties that the issue regarding application of that provision turned on ordinary common law principles of contract. However, in their appeal to the Court of Appeal, HMRC made detailed submissions to explain that they had not in fact agreed that the application of section 298 turned solely on the general law of contract, but had always maintained a distinct argument that (whether or not the Golden Contract was varied according to the general law), the relevant expenditure by the Developer was not "under" a contract which satisfied the requirements set out in section 298 according to its proper construction. In the Court of Appeal, the taxpayers reserved their position in relation to this in their

skeleton argument, but did not present detailed argument either in writing or orally to contest the point made by HMRC: see paras 61–63 below.

49. The taxpayers' claim for judicial review on the basis of alleged infringement of a legitimate expectation related only to the debate in the Upper Tribunal about the extent of the EZAs which the taxpayers were entitled to claim, should they fail in their submission (as they did) that pursuant to section 296 they were entitled to claim EZAs in the full amount which they paid to acquire the DC2 and DC3 developments. The basis for the legitimate expectation claim was the contention that in 1994 HMRC had given assurances regarding the extent to which EZAs could be claimed in respect of the cost of providing forms of rental support for incoming tenants where there was a qualifying investment by third party investors such as the taxpayers and that subsequently, down to and including 2011 (when the relevant events in this case occurred), HMRC had confirmed those assurances by their unvarying practice in allowing claims for EZAs in relation to such arrangements. The Upper Tribunal found that HMRC had made a representation that was "clear, unambiguous and devoid of relevant qualification" (being the applicable test for a legitimate expectation to arise: see *R v Inland Revenue Comrs, Ex p MFK Underwriting Agents Ltd* [1990] 1 WLR 1545) in relation to accepting claims for EZAs in relation to such rental support arrangements. The Upper Tribunal accordingly upheld the taxpayers' claim in relation to a legitimate expectation that sums paid by them in respect of such arrangements could be the subject of EZAs. The effect of this was that HMRC was precluded from denying the taxpayers' claim for EZAs in relation to their expenditure on such arrangements, to the extent that on true construction of the statutory provisions they would not have been entitled to EZAs in relation to it. The tribunal noted that the taxpayers' argument was that the relevant representation relied upon did not extend beyond this.

The Court of Appeal

50. HMRC appealed to the Court of Appeal, with permission granted by Asplin LJ, on the ground that the Upper Tribunal erred in finding that the Relevant Expenditure was incurred under "a statutorily relevant contract" entered into within the first 10 year period referred to in section 298(1)(b). (The taxpayers cross-appealed in relation to the extent of the EZAs which the Upper Tribunal had found they could claim, but it is not necessary to say more about this). In their skeleton argument for the appeal, HMRC advanced the submission (among others) that the contractual arrangements between the Developer and the Contractor did not satisfy the requirements of section 298 according to its proper construction, since neither when the Golden Contract was entered into nor otherwise in the first 10 year period was the construction of DC2 or DC3 provided for under that contract. HMRC submitted that the Upper Tribunal had erred in law in failing to consider the proper construction of section 298 and apply it correctly to the facts.

51. In the taxpayers' skeleton argument for the appeal they responded to this submission by maintaining that it was a new argument and saying merely that they reserved their position as to: whether it fell within the scope of the permission to appeal granted by Asplin LJ, whether it was open to HMRC "in the light of concessions made by them below" and whether the necessary findings of fact to support it had been made. They did not condescend to particulars and advanced no detailed submissions in response to HMRC's written case that the point had in fact been raised before the Upper Tribunal. The taxpayers then set out their substantive submissions to answer HMRC's submission as to the construction of section 298, on its merits.

52. In the event, the Court of Appeal held that this submission fell within the scope of the permission to appeal which had been granted to HMRC. This is not now in dispute. Nor is it said that there is any uncertainty in the findings of fact by the Upper Tribunal which precluded examination of the submission by HMRC in the Court of Appeal or precludes it in this court. The relevant facts have been found and it is a pure matter of law whether section 298 is satisfied, according to its true construction.

53. The Court of Appeal nonetheless rejected HMRC's submission on the proper construction of section 298 on its merits: paras 38-46, per Lewison LJ. The court therefore proceeded to examine three remaining issues to determine whether the Relevant Expenditure was incurred under the same contract as had been entered into within the first 10 year period referred to in section 298: (i) whether, as the taxpayers submitted, Change Orders 2 and 3 were validly given under clause 12 of the Golden Contract; (ii) whether, as HMRC submitted, the Change Orders were so radically different from the Golden Contract as to lead to the conclusion that the Golden Contract had been replaced (or rescinded, in the words of HMRC and adopted by the Court of Appeal) rather than varied; and (iii) whether, as HMRC further submitted, even if the Golden Contract was not replaced but remained in effect, nevertheless a new separate contract came into existence as a result of the Change Orders and it was under that new contract, not the Golden Contract, that the Relevant Expenditure was incurred.

54. The Court of Appeal unanimously rejected the taxpayers' submission under (i) above and held, in common with the Upper Tribunal, that the giving of Change Orders 2 and 3 was not within the scope of the Developer's rights under clause 12.

55. There was a degree of divergence of reasoning in the Court of Appeal in relation to issues (ii) and (iii). Lewison LJ considered that the Golden Contract gave the Developer a right to proceed with only one project, which right had been extended by Variation 2 to allow a choice to proceed with both Works Option 1 and Works Option 3; either way, this was a right to choose only once, and that right had been exercised and used up by the Developer issuing Change Order 1 (leading to the construction of DC1); therefore, focusing on DC2, Change Order 2 and the Contractor's agreement to carry out the work it described amounted to a different contract: para 69. He then addressed the question

whether the making of that contract constituted a variation or a replacement of the Golden Contract. In his view, the Upper Tribunal had erred by equating the desire of the Developer and the Contractor to preserve the ability to claim EZAs with an intention, on an objective assessment, to do so and hence to treat Change Order 2 and the agreement resulting from it as a variation of the Golden Contract. Instead, their intention, so assessed, was that the arrangement pursuant to Change Order 2 and the SDA which followed, and not the Golden Contract, was to be the basis for the construction of DC2. Thus the Relevant Expenditure was not incurred under a contract made within the first 10 year period as required by section 298 and it did not matter whether this involved replacement (or as he said, rescission) of the Golden Contract. See paras 115-121. The same reasoning led Lewison LJ to uphold HMRC's further submission referred to in para 53 above, and it did not matter whether the new contract under which the Relevant Expenditure was incurred was the SDA or a separate contract formed by the Contractor's acceptance of the price and performance of the work specified in Change Order 2: paras 122-124. Andrews LJ agreed with Lewison LJ and gave a short judgment of her own.

56. Newey LJ agreed that HMRC's appeal should be allowed but for somewhat different reasons. He summarised the principles to be applied at para 136: to a great extent the question whether a subsequent agreement operates by way of replacement or variation depends on the intention of the parties, as objectively assessed; the background circumstances in which the parties were acting have a significant role to play in determining their objective intention and this can include the tax position in the light of which they negotiate with each other; if the parties have stated their intentions in terms in the later agreement, that will be determinative, subject to certain limits (citing a dictum by Lord Sumption in *Plevin v Paragon Personal Finance Ltd (No 2)* [2017] UKSC 23; [2017] 1 WLR 1249 ("*Plevin*"), para 13); if the parties have not stated their intention as to replacement or variation in terms, the earlier agreement will normally be taken to have been replaced (rescinded, in his words) rather than varied if the new one is, in its essential character, substantially inconsistent with it (citing statements in *Morris v Baron & Co* [1918] AC 1 and *British and Beningtons Ltd v North Western Cachar Tea Co Ltd* [1923] AC 48 ("*British and Beningtons*")). In Newey LJ's view, the new agreement made pursuant to the Contractor's acceptance of Change Order 2 involved a major departure from what had been agreed in the Golden Contract and did not constitute a variation of it, even though it was possible that it incorporated some of the terms found in the Golden Contract: paras 140-142. He did not regard the tax considerations as irrelevant in determining the intention of the parties on an objective basis (para 144); but those considerations were not of such significance as to outweigh other indications regarding their intention, including in particular that the Developer, by issuing Change Order 1, had already used up its entitlement under the Golden Contract to choose a project to be constructed: paras 144-145. The Golden Contract had not been rescinded (in the sense of set aside in its entirety), but that did not matter; the correct inference was that the Developer and the Contractor entered into fresh contractual arrangements which did not involve either variation or rescission of the Golden Contract, and it was under those fresh arrangements, made outside the first 10 year period specified by section 298, that the Relevant Expenditure was incurred: para 146.

57. The taxpayers now appeal to this court.

The Section 298 Issue

58. As we have explained, the Court of Appeal approached this case on the basis of their decision that section 298 did treat expenditure incurred under a contractual variation (during the second period) of a contract originally made during the first period as expenditure incurred under the original contract. That is why, having rejected the taxpayers' case on the Clause 12 Issue, they considered it essential to decide whether the alterations to the Golden Contract which provided for the building of DC2 and DC3, and therefore the Relevant Expenditure, amounted to a variation or replacement of the Golden Contract.

Is There a Procedural Objection to HMRC Raising the Section 298 Issue?

59. The taxpayers submit that it is too late now, and would be an abuse of process, for HMRC to put forward a construction of section 298 which excludes (from qualifying under section 298) expenditure incurred pursuant to a contractual variation in the second 10 year period of a contract made during the first 10 year period. They submit that this court should decline to hear such an argument.

60. We do not accept this submission.

61. Going into the hearing in the Court of Appeal there was an issue between the parties whether in the Upper Tribunal HMRC had advanced a construction of section 298 along the lines now relied upon. HMRC in their skeleton argument gave a detailed account to explain that they had (para 50 above); the taxpayers merely reserved their position (para 51 above). Lewison LJ recorded in his judgment that at the hearing in the Court of Appeal counsel for the taxpayers raised no objection to HMRC presenting their submission based on the construction of section 298 on their appeal. One might think that would put an end to any procedural objection to the point being taken, but Mr Rabinowitz KC for the taxpayers says that Lewison LJ's statement was incorrect. Mr Rabinowitz showed us a short passage in the transcript of the hearing in the Court of Appeal where counsel for the taxpayers (at that stage, Adrian Williamson KC), having presented all his substantive arguments in reply to HMRC's submission regarding the proper interpretation of section 298, at the very close of his case said that, if the submission had been raised by HMRC at an earlier stage in the proceedings, "then we would certainly have considered judicial review proceedings in relation to that". But no distinct submission was made that it was an abuse of process for HMRC to raise the issue on the appeal or that there was a determinative procedural objection to them doing so which should prevent the Court of Appeal from considering the full arguments which it had just heard about the proper construction of section 298. Clearly, neither Lewison LJ nor the other members of the

court understood what Mr Williamson said to amount to a sustained objection on the part of the taxpayers to this submission of HMRC being made, whether it was new or not. When the Court of Appeal's judgment was circulated to the parties in draft, no correction was suggested by the taxpayers.

62. If the taxpayers wished to argue in the Court of Appeal that it was an abuse of process for HMRC to raise this issue on the appeal to that court, or that there was any procedural objection to them doing so, when HMRC had asserted in its skeleton argument that it was not a new issue and set out its submissions on the substantive merits, it was incumbent on them to explain and make good that contention. They did not do so. In their skeleton argument the taxpayers made no positive submission that there was a procedural objection or that it was an abuse of process for HMRC to raise the issue. Nor did they develop any substantive submission orally to support such a contention. It was not enough to say merely that they would have considered judicial review proceedings in relation to this question. The court was not in a position from that statement to know whether the point was truly new or, as HMRC contended in detail in its skeleton argument, one which had been taken in the Upper Tribunal. Nor was the court told what the grounds for judicial review might have been (it being left to infer that perhaps there might have been a new and different legitimate expectation claim), still less was the court taken to any material to allow it to assess whether there would have been any merit at all in such a claim so as to know whether the alleged prejudice was real or not. The court was merely referred to correspondence in 1994 set out in the judgment of the Upper Tribunal at paras 320-322.

63. In our view, the taxpayers did not raise a procedural or abuse of process objection in a distinct and proper form in the Court of Appeal. Even if, contrary to this view, it could be said that they did enough to raise such an objection, they did not make it good and the Court of Appeal was right to admit into the proceedings the issue of the proper construction of section 298 and to rule upon it. We would add that, in so far as the taxpayers sought to suggest that statements in the correspondence set out by the Upper Tribunal gave rise to a valid legitimate expectation claim that any variation of a golden contract after the first 10 year period would be treated in the same way as a variation of a golden contract within that period, so as to prevent HMRC from raising the section 298 issue, the argument was without merit: as regards that point, the statements referred to did not satisfy the demanding test referred to in para 49 above.

64. Since the section 298 Issue was properly raised by HMRC with the permission of the Court of Appeal on the appeal to that court and is the subject of a determination by that court against which HMRC now appeals, in our view it is not open to the taxpayers to object to it being determined on the merits in this court.

65. In their written case in this court, the taxpayers seek to make factual points to support their argument that HMRC's appeal on the question of the proper construction of section 298 should be dismissed on procedural grounds, regardless of the merits.

However, in our judgment it is not open to the taxpayers to seek to introduce this procedural objection in this way, for three reasons.

66. First, it is too late. If the point was to be taken, it should have been taken in the Court of Appeal. But it was not raised in that court as a distinct substantive answer to HMRC's submission regarding the proper construction of section 298. The submission is in reality a new point raised by the taxpayers for the first time in this court, for which no permission has been sought or given.

67. Secondly, even if it could be said that the procedural objection was raised in the Court of Appeal, that court was clearly right to proceed despite this, since on the arguments then presented by the taxpayers there was only one possible outcome, that their submission should be dismissed. There has been no material error of law on the basis of which it would be appropriate to go behind the decision of the Court of Appeal to determine this issue on the merits.

68. Thirdly, in so far as the taxpayers wished to advance a procedural objection to the section 298 Issue being raised in this court, they should have ensured that the relevant facts were set out in the Agreed Statement of Facts and Issues. But there is nothing there which would allow this court to decide the matter. Instead, the taxpayers make new factual assertions in their written case which are not agreed and have not been the subject of any factual findings below. It is not this court's function to find facts relevant to the taxpayers' submission and this was not an appropriate way to introduce such a submission at this level. Nor is the court in a position to do so, as it has not been provided with the materials which it would be necessary to examine if it were to find the relevant facts and decide this issue for itself.

69. In the event, the point on the proper construction of section 298 has been fully argued in this court (albeit de bene esse) both in the parties' written cases and orally, without either side being under any procedural impediment, and without the need to deploy or test any additional evidence. Since the point was both argued and determined in the Court of Appeal, there is now a Court of Appeal decision, forming part of its ratio, which will bind both it and every other court apart from this one, and therefore all persons with similar issues between them, unless and until addressed by this court. As we will explain, we consider that the decision on that point was wrong, so it is appropriate in the public interest that it should be overruled by this court. We therefore turn to the merits of the point.

The Section 298 Issue: the Merits

70. Construction of statutes, and taxing statutes in particular, requires close attention to the purpose of the provision in issue, and a realistic view of the transaction or other

matter to which it is alleged to apply. The relevant authorities were recently reviewed by this court in *Rossendale Borough Council v Hurstwood Properties (A) Ltd* [2021] UKSC 16; [2022] AC 690, paras 9-17. Two well-known dicta from those cases will suffice. The first, from *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51; [2005] 1 AC 684, para 32, by Lord Nicholls of Birkenhead, giving the joint opinion of the appellate committee of the House of Lords, is that the essence of the correct 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."

The second, from Ribiero PJ in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46, para 35, approved in *Barclays Mercantile*, is that:

> "The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."

71. This is not, however, to downplay the importance of the language of the provision to be construed. As Lord Hodge said in *R (O) v Secretary of State for the Home Department* [2022] UKSC 3; [2023] AC 255, para 29, "they are the words which Parliament has chosen to enact as an expression of the purpose of the legislation and are therefore the primary source by which their meaning is ascertained". That said, a "phrase or passage must be read in the context of the section as a whole and in the wider context of a relevant group of sections" (*ibid,* para 29) and "sources, such as Law Commission reports, reports of Royal Commissions and advisory committees, and Government White papers may disclose the background to a statute and assist the court to identify not only the mischief which it addresses but also the purpose of the legislation, thereby assisting a purposive interpretation of a particular statutory provision" (*ibid,* para 30).

72. As will be seen, there is limited, but nonetheless significant, external material but, beyond that, it is the words of section 298, read in their statutory context, from which the purpose of the section must be derived.

73. Section 298(1), with which this appeal is concerned, introduces important temporal limits on the availability of capital allowances. There are no other provisions which have a direct bearing on this, save for section 5 referred to below. We have already set out section 298 at the beginning of this judgment, but it may be helpful to repeat it here:

> "(1) For the purposes of sections 299 to 304, the time limit for expenditure on the construction of a building on a site in an enterprise zone is-
>
> (a) 10 years after the site was first included in the zone, or
>
> (b) if the expenditure is incurred under a contract entered into within those 10 years, 20 years after the site was first included in the zone."

74. Section 5 of the 2001 Act provides a general rule which, if applicable, explains the meaning of the phrase "the expenditure is incurred" in section 298(1)(b). By section 5(1):

> "… the general rule is that an amount of capital expenditure is treated as incurred as soon as there is an unconditional obligation to pay it."

By section 5(2) and (5) a gap in time between the arising of the unconditional obligation and the contractual date for payment does not postpone the time when it is incurred, unless that gap is more than 4 months, in which case the obligation is incurred on the contractual date for payment.

75. The rival interpretations of section 298(1) may be summarised as follows. The taxpayers submit that the requirement that the relevant expenditure incurred in the second period must be "incurred under a contract entered into within" the first period is satisfied if the provision for such expenditure is to be found in the contract, even if such provision was not present in the contract as originally made but was added by a variation of it made in the second period. Notwithstanding that the variation was not made until the second period, it is accurate to describe the expenditure as having been incurred "under the contract" originally made in the first period. Although varied, it remains the same contract.

76. By contrast, HMRC submit that the language of section 298(1) requires expenditure incurred in the second period to have been made pursuant to a contractual commitment entered into in the first period. While the taxpayers' construction may be literally permissible, HMRC submit that this construction fails to give effect to the evident purpose of section 298(1). Mr David Ewart KC, for HMRC, submits that this purpose is to be implemented by restricting the introduction of alterations into the original contract by later variation after the end of the first period to alterations which make no change to the nature of the building prescribed by the contract, or to the site upon which it is to be

built. Any alterations which impose obligations to construct a different building, or a building (whether or not different) on a different site, do not give rise to the incurring of expenditure under the contract. HMRC's written case puts it thus:

> "HMRC's position is that the effect of section 298 is that EZAs are available (assuming other requirements to be satisfied) in respect of expenditure incurred in the second ten-year period on the construction of a building in an enterprise zone only if the expenditure is incurred pursuant to a contractual commitment (which arose in the initial ten-year period) to incur that expenditure on the construction of <u>that</u> building on its site." (*original underlining*)

77. As a matter of language, both submissions advance possible interpretations of section 298(1), if read in isolation. However, both the taxpayers and HMRC recognise the need to read section 298(1) in context and to identify the purpose of the time limits imposed by section 298.

78. As to context, enterprise zones with their special features, including the availability of 100% capital allowances for expenditure on the construction of buildings in an enterprise zone in the year when the expenditure was incurred, were introduced in order to promote the regeneration of economically deprived areas. The regime was introduced in 1980, with the provisions for capital allowances included in the Finance Act 1980. A Treasury press statement accompanying the budget statement in that year set out clearly the underlying purpose of the regime:

> "The Chancellor of the Exchequer has announced proposals for setting up, on an experimental basis, about half-a-dozen 'enterprise zones'.
>
> Within small sites of up to 500 acres, private enterprise will be positively encouraged by reducing the burden of government supervision and fiscal demands.
>
> The sites chosen will be in areas of physical and economic decay where conventional government policies have not succeeded in regenerating self-sustaining economic activity.
>
> …

Measures

The Enterprise Zones will be designated for an initial period of ten years, subject to renewal. Both the new and existing firms in the zones will benefit from the following measures:

1. Exemption from development land tax.

2. 100 per cent. capital allowances (for income and corporation tax purposes) on industrial and commercial property.

3. Exemption from general rates on industrial and commercial property.

4. Simplification of planning procedures…

The aim is to stimulate economic activity by removing the hand of government as far as possible."

79. Given the purpose of creating enterprise zones and conferring tax and other advantages, it would be surprising if they were not subject to time limits. Such limits are imposed by section 298(1) which represents a central part of the whole regime. The original predecessor to section 298(1) was section 74(1) of the Finance Act 1980 which imposed a single time limit: the expenditure had to be incurred, or incurred under a contract entered into, not more than 10 years after the site of the building was first included in an enterprise zone. There was at that time no long stop period of 20 years for the expenditure to be incurred, provided it was incurred under a contract made in the 10 year period. The Treasury press statement said this about the time limit:

"4…Since the aim of setting up an Enterprise Zone is to achieve a significant impact by way of new development, improvement of existing property, or increased economic activity within a reasonable timescale, the Government proposes that the designation orders for Enterprise Zones should run for a period of ten years. Designation will bring into effect the fiscal and other measures listed below.

> 5. During the ten year period both new and existing firms within the Enterprise Zone will benefit from the following measures…"

80. The long stop date of 20 years in section 298(1) was first introduced by the Finance Act (No 2) 1992. It is clear that both the 10 year and the 20 year limits serve real purposes. For the present case, it is the 10 year limit which is of prime importance.

81. For the taxpayers Mr Rabinowitz submitted that the relevant purpose is that of the whole of the statutory regime for enhanced capital allowances for expenditure on buildings in enterprise zones, namely to encourage the development of relevant buildings within the zone, by offering a tax incentive to developers. Thus, he said, any construction of a particular provision which enhanced that incentive was to be preferred to one which reduced it.

82. We have no doubt that this is the purpose of the regime for enhanced capital allowances, viewed as a whole. But in our view that purpose is identified at too high a level of generality. Section 298 imposes a formulaic statutory time limit within which steps have to be taken in order to gain the relevant tax incentive. Identifying the relevant purpose requires an understanding why that time limit was imposed. In the present context the question is, what is the purpose of the requirement that expenditure within the 20 year period should have been incurred under a contract made within the 10 year period? In short, why should that matter?

83. The point that emerges from the Treasury press statement is that the government conceived that the need to kick-start industrial development within enterprise zones was to be attempted by a package of measures, including both tax reliefs and reduced interference from planning and other regulatory controls, over a 10 year period. We were told that indeed the relaxed planning regime was limited to 10 years. Once the 10 years were up, the hope presumably was, not that all necessary or desirable development would have been completed, but that a sufficient time-limited incentive would have been provided so that by the end of 10 years development would have occurred (or contracts would be in place for it to occur) to provide a good basis for economic revitalisation of the area which would then encourage further development of the zone thereafter, but without the need for continuing incentives. Both from the terms of section 298(1), read in context, and from the Treasury press statement, the purpose that clearly emerges is that the construction of buildings attracting 100% capital allowances should have occurred, or been the subject of contractual commitment, within the 10 year period. In this way, "the aim of setting up an Enterprise Zone... to achieve a significant impact by way new development, improvement of existing property, or increased economic activity *within a reasonable timescale*" (emphasis added), as stated in the Treasury press statement, would be realised. The fact that there was for some 24 years no 20-year limit serves to emphasise

that the applicable contractual commitment had to be in place by the end of the 10 year period for 100% capital allowances to be available.

84. In our view, the taxpayers' construction of section 298(1) entirely fails to implement the statutory purpose of the 10 year time limit in a case such as the present, and all the more so if the taxpayers' case about the common law meaning of variation (as depending purely upon the parties' intention) is correct. If the taxpayers are right, then a developer could by a contractual variation made in the second period commit itself for the very first time to incurring expenditure on the construction of something entirely different (in terms of type, cost, quality, purpose, size and location) from anything to which the parties had committed during the first 10 year period, but still obtain 100% capital allowances for the expenditure, provided only that the parties to the original contract chose the mechanism of variation rather than replacement to make that fundamental change to their contractual relationship. That cannot be right.

85. An example will suffice to demonstrate why that must be so. HMRC chose the example of a variation to an original contract for the sale of goods to make it a construction contract for a building in an enterprise zone, but we think that goes too far, and might even exceed the generous ambit within which the common law permits parties to choose the mechanism of variation rather than replacement, when altering their contractual relationship (see paras 143-149 below). But suppose that in a contract made during the first period the parties agree upon the construction of a modest industrial building in one corner of the enterprise zone, and then well into the second period agree by variation (rather than replacement) to substitute a large power station on an extensive central part of the zone, at a cost greater by several orders of magnitude than that originally contracted for. On the taxpayers' construction they would recover 100% capital allowances for the whole of that expenditure, although the parties had contractually committed to none of it by the end of the first period, but just to a small sum on something completely different.

86. That example reveals three basic problems with the taxpayers' construction. The first is that the basic purpose of the 10 year time limit for the first period, to secure a commitment <u>by then</u> to incur in substance the expenditure on a qualifying development within the zone as the quid pro quo for the incentive of 100% allowances, will have been wholly undermined. Secondly, that undermining will have been achieved largely by the form by which the parties have chosen to substitute their original commitment with their new, later one. The operation of this tax regime and the generous allowances for which it provides would, on this view, be available to those parties who happen to have made a contract in the first period but not to others, even though there would be no difference in the terms of their respective commitments. It is highly unlikely that that was the purpose of the regime. Thirdly, for those parties with an existing contract at the end of the first period, the availability of the 100% capital allowances would depend on whether the parties chose to agree the new commitment by means of a variation of the contract or by means of making a completely new contract. Such a degree of taxpayer choice for no

discernible reason is also highly unlikely to further the purpose of the provision. As the history of the regime for incentivisation of development within enterprise zones makes clear, it is the 10 year rather than 20 year time limit which lies at the heart of the statutory scheme.

87. While this critique is we think fatal to the taxpayer's proffered construction, this does not automatically mean that the alternative proffered by HMRC must therefore be correct. It was criticised by the taxpayers on three main grounds. The first is that there is no warrant in the language of section 298 for introducing the "same building, same site" restriction which lies at the heart of HMRC's construction. The second is that both those supposed conditions, and in particular the "same building" condition, introduce inappropriate uncertainty into a regime for tax incentives which ought to be clear and predictable if they are to achieve their purpose of encouraging large-scale investment. Thirdly, the two conditions introduce unnecessary rigidity into a scheme where flexibility in the choice of development in what may be a fast-changing market is a valuable objective, over the whole 20 year period.

88. None of these criticisms, especially the first, is entirely without substance, and they deserve to be appraised both separately and in combination. HMRC sought to meet the first criticism by pointing to the language not so much of section 298 itself, but of its statutory predecessors, backed up by the submission that the reformulation of the language in the 2001 Act was just a modernisation of language unaccompanied by any intended change in underlying meaning. There are warnings in well-known authorities about the general undesirability of becoming bogged down in statutory pre-history. Generally, a deliberate change in language implies some change in meaning, and the public is in principle entitled to understand the meaning of legislation by reading it in its current form, rather than by having to undertake a historical study of antecedent legislation now repealed and, in the modern world, usually struck out of the on-line publications of statutory law. See *R (Derry) v Revenue and Customs Comrs* [2019] UKSC 19; [2019] 1 WLR 2754, paras 7-10 (Lord Carnwath), comparing the approach to be adopted to the interpretation of consolidation statutes as explained in *Farrell v Alexander* [1977] AC 59; *Urenco Chemplants Ltd v Revenue and Customs Comrs* [2022] EWCA Civ 1587; [2023] STC 54, para 148 (Henderson LJ); and *NCL Investments Ltd v Revenue and Customs Comrs* [2022] UKSC 9; [2022] 1 WLR 1829, paras 44-47 (Lord Hamblen and Lady Rose).

89. In the present case HMRC were allowed to take the court through the antecedents to section 298 to see if they added anything usefully supportive of the suggested "same building, same site" condition. In our view they did not. While it may be said that some of the antecedent versions of the section 298 time limit made more reference to "a building" or "the building" than does section 298, this was not done in a way which would support a specific "same building" condition in the manner for which HMRC contend. All versions of the time limit, including section 298, assume that the relevant expenditure has been incurred on the construction of a building on a site in an enterprise zone, and

then go on to set both the 10 year and 20 year time limits by reference to the date when "the site" was first included within the zone. Thus the drafting purpose of the reference to the site is to define the start date of the relevant time-limiting periods. It may well have been assumed both by the drafter and by Parliament that the contract referred to in section 298(1)(b) would be making provision for expenditure on the construction of a building on the same site as is used to set the time limits, but that seems to us to be as far as the use of the words "building" and "site" goes, as a matter of language.

90. As regards the taxpayers' second criticism, it cannot be doubted that HMRC's construction introduces questions, about what "same site" means and about what variations give rise to a different building, which the taxpayers' construction elegantly avoids. But legislation, and in particular tax legislation, frequently makes liability or relief dependent upon questions of classification which call for an evaluation of fact and law. This is the daily task of the tax tribunals, and of the courts on appeal. Those tasks are the very embodiment of the requirement to take a realistic view of the transaction to which it is said that the relevant statutory provision applies. So we do not attribute much weight to this criticism.

91. The taxpayers' third criticism that HMRC's construction hampers building development by being over-rigid and preventing alterations to meet changing conditions might have been a significant one, but for HMRC's concession (already recorded) that alterations in obligation triggered by the exercise of unilateral rights to select and to change contained in the original contract do occur "under" that contract, because they do not amount to a variation of it. Taken together those rights in the Golden Contract create a very substantial amount of choice, both as to buildings and sites, within which the developer can later decide how to deploy its expenditure within the zone. It is indeed a telling feature of this case that the Developer purported to be using no more than those unilateral rights in altering the obligations under the Golden Contract which led to the incurring of the Relevant Expenditure on DC2 and DC3. The parties to the Golden Contract chose no less than six alternative Works Options, on different sites, for different types of building and at a wide range of different prices between £183 million (Works Option 2) and £13,672,116 (Works Option 6). The Developer had a right and obligation to select any one of them during the second period. It also had a right to make further changes under clause 12 during the second period, without falling foul of section 298 (according to HMRC's construction, with that concession built into it). That flexibility does not undermine the purpose of the provision since it is the early commitment to investment on construction on the enterprise zone that, it is hoped, will spur other businesses to locate there and bring much needed new employment to the area even after the EZA regime has expired. A commitment to build a large power station, if it had been made within the 10 year period, may have prompted many more businesses to choose to locate to that zone than would the modest industrial building. The much later commitment to the bigger project does not therefore fulfil the statutory purpose and does not justify the valuable tax relief granted under the regime.

92. If the purpose of the 10 year time limit in section 298 is, as we have concluded, to obtain within the first period a commitment to qualifying development, then some limitation of the developer's freedom of action during the second period seems to us to be a necessary price to pay. Of course, if the only recognisable purpose of section 298 was to incentivise development expenditure within 20 years, then a construction which imposed more limits upon the developer's freedom during the second period would be, for that reason viewed alone, less attractive than a construction which imposed fewer limits. But, as we have explained, that would be to adopt an identification of statutory purpose at too high a level of generality and one which pays no regard to the 10 year time limit imposed by section 298(1).

93. Taken together, the taxpayers' second and third main criticisms of HMRC's construction add little to the first. The second is a typical feature of tax legislation, while the third is based upon a misidentification of the purpose behind the 10 year time limit. But the first has independent vigour, and HMRC's attempted answer to it did not really meet it. There is real difficulty in conjuring a "same building, same site" condition out of the language of section 298(1).

94. In this case there is we think a construction, lying between the rivals presented by the parties, which fulfils the purpose of the 10 year time limit in section 298 without departing from the language used, or inserting language which is not there. It requires the court first to identify the expenditure, the incurring of which gives rise to the claimed initial allowances. That expenditure will necessarily be "on" the construction of a building on a site in an enterprise zone: see section 298(1). The date or dates upon which the expenditure was incurred will have to be ascertained. If the date falls within what we have called the first period, then the 10 year time limit in section 298(1)(a) is satisfied, and it does not matter what contract it was incurred "under", or when that contract was made. If the expenditure is incurred outside the 20 year period, then it fails the 20 year time limit in section 298(1)(b), again without any need to identify the date of the contract under which it was incurred. But if the expenditure was incurred during what we have called the second period, then it is necessary to ask "under" what contract it was incurred and whether that contract was made during the first period. Thus far we are treading no new or contentious ground.

95. Where that question arises, we consider that section 298(1)(b) requires the court to look back to the end of the first period: ie the tenth anniversary of the date when the site upon the development of which the relevant expenditure was actually incurred was first included within an enterprise zone ("the tenth anniversary"), and ask this question: Was there by the tenth anniversary a contractual relationship under which the relevant expenditure had either been agreed upon in terms, or which arose from building work on that site which, as at the tenth anniversary, the developer by then had a contractual right of the type described in para 4 above to require (by the exercise, at a later date, of rights in a golden contract to select) and/or the right to change (under clause 12)? If, and only

if, the answer to that question is "yes" was the expenditure incurred "under a contract entered into within those 10 years" as required by section 298(1)(b).

96. A number of points need to be made about the way in which that question should be asked, and the reason why it is framed in those terms. The first is that, to serve the statutory purpose, it is a question of substance rather than of form. The purpose is to ascertain whether there was a contractual commitment to the relevant expenditure by the tenth anniversary. That might arise in a particular case from a much earlier original contract, altered by one or more variations before the tenth anniversary, or from the replacement of an original contract by a new contract, again by that date. In neither case would it matter whether, as a matter of form, the parties had used the mechanism of variation or replacement. The only question of substance would be whether by the tenth anniversary their contractual relationship included the necessary commitment.

97. This approach is permissible linguistically because the phrase "under a contract" does not command the identification of a single contract. In statutory language the general rule is that the singular includes the plural. The requisite commitment could be identified in a contractual relationship constituted by more than one contract, or by an original contract varied later by a further agreement made by the tenth anniversary. However it may have come to pass, there will only be a single relevant contractual relationship on the tenth anniversary, which either will or will not contain the requisite commitment to the incurring of the relevant expenditure.

98. The next point is that the question whether the expenditure is incurred "under" a contract entered into by the tenth anniversary is also a question of substance rather than form. For the reasons already given, including the HMRC concession about the admissibility of unilateral rights to select and to change, the question is whether by the tenth anniversary the commitment to the relevant expenditure has reached a stage which does not require any further bargaining before it becomes, or can unilaterally be made, unconditional within the contemplation of section 5. Two points flow from this. The first, perhaps obvious, point is that the expenditure does not cease to be incurred under the contract(s) made by the tenth anniversary merely because the precise specification is later altered by the exercise of rights to select and to change contained in the original contract(s) in place by that date. Thus the expenditure committed to by the tenth anniversary may include payment for wooden windows but have been replaced under a right to change, existing as at the tenth anniversary and exercised after it, by a specification for pvc windows.

99. The second point may be less obvious, but it is equally important. The parties to a pre-tenth anniversary contractual relationship may after that date make alterations to the project by further agreement (ie by contractual variation) rather than by the exercise of a unilateral right to change, without it necessarily meaning that there was not the requisite commitment to the relevant expenditure as at the tenth anniversary. For example the

parties may have chosen to make by a contractual variation an alteration which could have been made by the exercise of a unilateral right to change, perhaps to avoid any possible argument about the scope of that right. On its proper construction, section 298(1)(b) looks to the substance of the contractual commitments in place at the first 10 year anniversary and compares that to what was done within the second 10 year period. The relevant question is not the form or mechanism which the parties later chose to use, but whether the change detracted in substance from the existence of the requisite commitment to the relevant expenditure as at the tenth anniversary. (We leave aside the more difficult question whether expenditure under a replacement contract agreed in substitution for the original contract and in substance replicating the commitments in that original contract would be sufficiently related to the original contract as to qualify as expenditure "under" that original contract).

100. In our judgment, this approach to the interpretation of section 298(1)(b) is justified by a realistic assessment of two aspects of the overall statutory purpose. The object of the section 298 regime is to incentivise certain behaviour in relation to the enterprise zone within the specified first 10 year period with a view to achieving a practical result, namely a commitment to the construction of buildings within the zone which will promote the economic revitalisation of the area.

101. The behaviour to be incentivised in the first period is whatever is required for a sufficient commitment to pay the capital expenditure to arise in that period, which may be the construction of a relevant building (if the payment obligation was conditional on that being done) or by entering into an unconditional obligation to pay the construction costs in advance (section 298(1)(a) read with section 5), or the making of a contractual commitment to construct such a building at a later stage (section 298(1)(b)). On a proper reading of the words "under a contract" in this context, the relevant contractual commitment need not be unconditional, but it has to be one which binds both the developer and the contractor. The developer has to have accepted an obligation by the tenth anniversary date to proceed with some form of relevant development, even if it has a right to select which one. In this case, the Developer assumed such an obligation under clause 23A of the Golden Contract. By the same date, the contractor has to have engaged to carry out at least some qualifying work.

102. On the other hand, the intended practical result of the regime is the construction of buildings in the enterprise zone. As is well known, and as Parliament must be taken to have been aware, major construction projects often involve the need to adapt to unforeseen circumstances as they proceed. Construction contracts are usually drafted to accommodate this to some extent, but further adaptation may be required by variation beyond those contractual parameters while still directed to completion of what is in substance the same building. If the valuable EZAs available in relation to the building were lost by reason of such adaptation by variation of the original contract, the risk would arise that the building contemplated by that contract might be abandoned and not finished, for commercial reasons. That outcome too would defeat the purpose of the regime. So it

is reasonable to construe section 298(1)(b) as allowing EZAs to be claimed so long as, and to the extent that, the building project upon which the relevant expenditure is incurred in the enterprise zone is in substance the same as that contracted for under the original contract. In a practical regime of this kind, this minor extension of the object of section 298(1)(b) from its focus on the substance of the contractual commitments in place at the first 10 year anniversary to include a focus on the substance of the building project contemplated by the contractual arrangements in place at that anniversary is justified because the substance of the building project and the substance of the financial commitments in relation to it will be very closely aligned.

103. The construction of section 298(1) does not depend upon a rigid "same building, same site" test as is proposed by HMRC. Nonetheless the question whether in substance the relevant expenditure had been contractually committed to by the tenth anniversary will often produce the same answer as HMRC's suggested test. But not always. One building may not be regarded or described as the same as another because of differences in its design but the contractual commitment to the relevant expenditure may be unchanged in substance. Similarly, a building may be described as to be built on a differently labelled site, but it may turn out that the new site lies entirely within the boundaries of the larger permitted site of the originally agreed project. In such a case there may be a contractual commitment to the building expenditure on the tenth anniversary which has not in substance changed.

104. A realistic appraisal of the dealings between the parties which led to there being an unconditional commitment to the Relevant Expenditure in the present case (the expenditure for which the 100% allowances are claimed) plainly fails to satisfy the requirements of section 298, unless it was validly achieved by the exercise by the Developer of its rights to select and to change. The Relevant Expenditure was incurred in the building of DC2 and DC3. However liberally that expenditure may be viewed as a package or two packages, there was not on the tenth anniversary date (19 February 2006) a contractual commitment in terms to incur that expenditure, or anything like it. The Golden Contract had been made only two days previously, and it constituted the whole of the relevant contractual relationship between the parties.

105. It has never been part of the taxpayers' case that the Relevant Expenditure had been committed to in the Golden Contract without the need to rely either upon the exercise of unilateral rights to select and change, or without the relevant commitment being introduced into the Golden Contract by a contractual variation made after the tenth anniversary date. The taxpayers lost before the Upper Tribunal on their primary case that the Relevant Expenditure was incurred pursuant to the exercise by the Developer of its unilateral rights under the Golden Contract to select and to change. But the taxpayers succeeded before the Upper Tribunal because they persuaded the tribunal, first, that section 298 treated expenditure incurred under contractual variations made in the second period to a contract entered into in the first period as if incurred under the original contract and, secondly, because the relevant alterations were made (pursuant to the parties'

common intention) by way of variation of the Golden Contract rather than by replacement of it. The taxpayers lost in the Court of Appeal because, having again lost on their primary case, they also lost on the issue as between variation and replacement.

106. But the taxpayers won before both the courts below on the question whether, in principle, a variation made in the second period is for the purposes of section 298 to be treated as contained in the original contract made in the first period, so that expenditure incurred under those varied provisions is to be regarded as having been incurred under the original contract. The point went almost by default before the Upper Tribunal but was argued and won by the taxpayers before the Court of Appeal, really on the basis of a linguistic approach to section 298 which the Court of Appeal thought admitted of no other interpretation.

107. For the reasons given above, we disagree with that conclusion. While we acknowledge that the language of section 298 will readily accommodate the interpretation placed upon it by the Court of Appeal, that interpretation wholly fails to implement the evident purpose of the 10 year time limit. Rather it renders it devoid of any rational purpose, other than a desire to encourage parties to structure alterations to their contractual relationship after the tenth anniversary date by using a particular drafting mechanism, namely variation rather than replacement. That cannot be a purpose sensibly to be attributed to the legislature. By contrast we consider that our preferred interpretation of section 298, as set out in paras 95 and 102 above, does fulfil its statutory purpose, and represents the more natural reading of the provision in its context.

The Clause 12 Issue

108. The question arising under this heading is whether DC2 and DC3 were buildings which the Contractor was bound to construct, and therefore the Developer bound to pay for, by reason of the unilateral exercise of the right to change conferred on the Developer by clause 12 of the Golden Contract, so that the taxpayers' expenditure upon their construction was incurred by them as Developer under the Golden Contract within the meaning of section 298(1)(b). As already noted, nothing in the differences of detail between the relevant facts about the commissioning of DC2 and DC3 lead to any difference in outcome, so that the questions arising under this heading may conveniently be answered with reference to the facts about DC2 alone.

109. Both the Upper Tribunal and the Court of Appeal answered this question in the negative. In their view, although for slightly different but overlapping reasons, clause 12 was, as a matter of its true construction, insufficiently wide in scope to enable the Developer to impose the content of Change Order 2 upon the Contractor by way of the exercise of a unilateral contractual right. In summary, the Upper Tribunal reached that conclusion by a careful analysis of the language of clause 12, read in its context. While

largely in agreement with that analysis, the Court of Appeal added that the wide construction of clause 12 for which the taxpayers had to contend went beyond the inherent limits of unilateral rights to change to be found in building contracts generally, as laid down in a succession of well-known authorities beginning with *Sir Lindsay Parkinson & Co Ltd v Comrs of His Majesty's Works and Public Buildings* [1949] 2 KB 632, and exemplified by this quotation from *Wilmot-Smith on Construction Contracts*, 4th ed (2021), para 14-07:

> "it is a matter of fact and degree as to whether the instruction for a variation goes beyond a change envisaged by the contract and instructs something over and above that which was expected and contracted for. … As with all matters of fact and degree it is easier to demonstrate at the extremes than it is at the margin. So, for example, a contract to build a beach house will have implicit within the variations clause a right to change the colour of the external paintwork. It will not extend to the right to order that the contractor build a lighthouse alongside."

110. We have already set out the main parts of clause 12 (para 24 above). The sub-clause creating the right to change relied upon by the taxpayers is clause 12.2.1. It is helpful to set it out again here. It provides that:

> "The Employer may subject to the proviso hereto and to clause 12.2.2 issue instructions effecting a Change in the Employer's Requirements. No Change effected by the Employer shall vitiate this Contract. Provided that the Employer may not effect a Change which is, or which makes necessary, an alteration or modification in the design of the Works without the consent of the Contractor which consent shall not be unreasonably delayed or withheld."

111. The defined terms need quite a bit of unwrapping. For present purposes the relevant part of the definition of "Change in the Employer's Requirements" is in clause 12.1, as follows:

> "The term 'Change in the Employer's Requirements' or 'Change' means:
>
> 12.1.1. a change in the Employer's Requirements which makes necessary the alteration or modification of the design, quality or quantity of the Works, otherwise than such as may be

reasonably necessary for the purposes of rectification pursuant to clause 8.4, including

> 1.1 the addition, omission or substitution of any work,
>
> 1.2 the alteration of the kind or standard of any of the materials or goods to be used in the Works,
>
> 1.3 the removal from the site of any work executed or materials or goods brought thereon by the Contractor for the purposes of the Works other than work materials or goods which are not in accordance with this Contract;"

The "Employer's Requirements" is defined in clause 1.3 of the Conditions as follows:

> "'Employer's Requirements' means the document referred to in Appendix 14 Appendix 15 Appendix 16 Appendix 17 Appendix 18 Appendix 19 (as the case may be) setting out the requirements of the Employer in relation to the relevant Works Option."

"Works Option" is defined, also in clause 1.3, as follows:

> "'Works Option' means Works Option 1 or Works Option 2 or Works Options 3 or Works Option 4 or Works Option 5 or Works Option 6 (as the case may be)."

Each of Works Option 1 to 6 are separately defined. We are currently concerned with Works Option 1, for which clause 1.3 provides this definition:

> "'Works Option 1' means the design, construction and commissioning work comprising an industrial unit to accommodate the manufacture of an eight inch board on Site C for which works the Employer has issued to the Contractor its requirements (hereinafter referred to as the Works Option 1 Employer's Requirements)."

The "Works Option 1 Employer's Requirements" is also separately defined, as follows:

> "'Works Option 1 Employer's Requirements' means the documents referred to in Appendix 14 as Ref: ER WOl."

Finally, the term "Works" is defined by clause 3.1 as follows:

> "'Works' means the design, construction and commissioning the Employer wishes to obtain for the Works Option *stated in the Notice to Proceed* which for the avoidance of doubt shall either be Works Option 1 Works Option 2 Works Option 3 Works Option 4 Works Option 5 or Works Option 6 and referred to in the Employer's Requirements and the Contractor's Proposals for that Works Option and including any work needed to ensure that the Tests on Completion and the Performance Tests are passed *and any changes made to these works in accordance with this Contract*" (our italics).

112. The two italicised passages in the definition of Works give rise to an apparent assumption that there will have been the selection of a particular Works Option by a Notice to Proceed by the time it becomes necessary to understand what "Works" means in clause 12, on the making of a Change. This is a point made by the Upper Tribunal at para 79.

113. It is we think clear, and not in dispute, that the very concept of a right to give instructions "effecting a Change in the Employer's Requirements" (which for brevity we will label "Change") requires one to ask: change from what? The detailed definitions set out above show that the relevant Employer's Requirements are these contained generally in the appendices that provide the detail of each of Works Options 1 to 6, and specifically in the particular Works Option in respect of which the Employer has given Notice to Proceed. In the case of Change Order 2 that was Works Option 1, and the Employer's Requirements were those set out in Appendix 14.

114. The taxpayers' case is that, subject only to the qualifications expressed in clause 12.2.1, the Employer can instruct any Change, of any breadth or magnitude, to the Appendix 14 specification for Works Option 1, provided only that the Employer's desire to make that change necessitated "the alteration or modification of the design, quality or quantity of the Works" within the meaning of clause 12.1.1. The desire of the Developer to have constructed DC2 is said to have satisfied that proviso, because of the very large disparity in terms of (at least) design and quantity between Appendix 14 and the specification for DC2 set out in detail in Change Order 2, and because it called for the "substitution of any work" within the meaning of clause 12.1.1.1.

115. Mr Rabinowitz submitted that there could be no basis for narrowing that expressly broad liberty to effect Change under clause 12 for the following reasons. First, there were no express words of limitation. Secondly, none should be implied, because (a) generous provisions for change were common in building contracts and served the sensible commercial purpose of preventing contractors holding employers to ransom; (b) the right of the Contractor to withhold consent, coupled with a right to extra payment, sufficiently protected the Contractor from unfair prejudice or commercial harm; and (c) the overriding desire of the parties to the Golden Contract to obtain 100% capital allowances meant that the right to change should be liberally construed as a matter of common intention.

116. While those submissions might have been of some force against the identification of limitations on the right to change by a purely implied term, we consider that the taxpayers' case (and Mr Rabinowitz's submissions) fall at the first hurdle. There is an express limit on the changes which may be made under clause 12. They may only be made within the confines of "alteration or modification of the design, quality or quantity of the Works" where, in this context, "the Works" means Works Option 1 which, by definition, means "the design, construction and commissioning work comprising an industrial unit to accommodate the manufacture of an eight inch board on Site C". The detail of the design, quality and quantities involved in the execution of the building described (by purpose and location) in Works Option 1 is no doubt contained in the Employer's Requirements in Appendix 14, and all those may be subject to Change under clause 12, but only to the extent that what is sought to be substituted by the requested Change are still design, quality and quantities of what is substantially the same building (ie in this case an industrial unit to accommodate the manufacture of an eight inch board on Site C).

117. A naval example may illustrate the point. A shipbuilding contract for the construction of an aircraft carrier may contain a right to alter or modify aspects of its design, quality or quantities. But if the Admiralty decides instead that it wants a nuclear submarine, this will not be a matter of alteration or modification to the design, quality or qualities of the specification for the aircraft carrier. That specification will have to be abandoned and completely replaced.

118. Interpreting those words in context leads to a conclusion that this is the correct construction. The basic structure of the Golden Contract was to give the Developer a right to select one of six different buildings, identified in each Works Option by reference to purpose and location, each for a different price, across what was cumulatively a very wide price range. Upon selection of one of them by a Notice to Proceed, the Golden Contract then became a much more standard type of building contract, for the construction of the particular building selected, but with the usual right of the employer to require changes (ie alterations or modifications) in design, quality and quantity, attributable to that building, subject to the Contractor's consent (not to be unreasonably withheld) and to consequential increases (but not reductions) in price attributable to the need to give effect to those alterations. The right to require a Change plainly did not extend to changing from one (already selected) building to that specified in a different Works Option, still less to

choosing, by way of a supposed Change, some completely different type of building, on a different site, outwith the confines of any of the six Works Options. Yet both of those alternatives would fall within the right enjoyed by the Developer, on the taxpayers' construction.

119. Mr Rabinowitz submitted that, whatever the apparent confines of the definition of Change in the main part of clause 12.1.1, the immediately following words: "including … the addition, omission or substitution of any work" overrode those confines by deeming the addition (etc) of "any work" to be comprised within the definition of Change, relying (inter alia) upon *Dilworth v Comr of Stamps* [1899] AC 99, 105-106, a decision of the Privy Council on appeal from New Zealand. That was a case about statutory construction, in which the Board acknowledged that the use of the word "include" might either widen or more precisely define an earlier definition. It was followed, again by the Privy Council, in *Reynolds v Comr of Income Tax* [1967] 1 AC 1, 10. We do not consider that in either of those cases the Board was seeking to lay down an immutable or exclusive pair of alternative meanings of the word "include" in statute, still less in contractual usage with which we are here concerned.

120. If the phrase "any work" in clause 12.1.1.1 had indeed been included either by way of overriding enlargement or more precise definition of the meaning of "Change", then the apparently limitless potential meaning of "work" might have got the taxpayers home. But the question whether the word "including" was used in clause 12 for either of those purposes is itself a question of construction of this particular contract. In context we consider that it does no more than explain by way of examples items of types which may be changed. The list, which follows "including", specifies work, standards of materials of goods and the removal of work, materials or goods from site. The word "work" is not used by way of expansion of the careful definition of "Change" which precedes it, and which for that purpose incorporates the precisely defined term "Works" in the way which we have described.

121. Nor does the protection undoubtedly afforded to the Contractor of being entitled (if acting reasonably) to refuse consent to a Change involving an alteration or modification to the design of the Works, and to be paid for consequential extras, lead to the adoption of a wider meaning of "Change" than that which clause 12.1.1 otherwise allows. The question is, to what regime for Change is that right reasonably to refuse consent attached? The Golden Contract is remarkable in giving the developer an extraordinarily wide right of selection between different Works Options. To construe clause 12 as enabling the Developer, without even going through the selection process, to demand the construction of almost any other building whatever, regardless of location, subject only to a right of refusal if exercised reasonably, leads to an outcome in terms of the breadth of the Developer's unilateral rights which departs fundamentally from the structure of the agreement. The protection for the Contractor afforded by the right of reasonable refusal of consent is clearly less than the protection inherent in the specification of a limited obligation under clause 12 in the first place. Furthermore the

Contractor's qualified right to refuse to consent to a Change is limited to one which involves an alteration or modification to the design of the works, whereas the right to change extends also to alteration or modification to quality and quantities, in relation to which there is no right to refuse at all.

122. Mr Rabinowitz also submitted that the Upper Tribunal had found, as a matter of fact, that the building requested by Change Order 2 was not all that different in type of building from that specified in Works Option 1, and that its site was no great distance away either. That may be so, but the parties have by the language of clause 12, read with the definitions of the words and phrases which it incorporates, chosen to use purpose and site as the defining characteristics of the building comprised in each of the Works Options. Faced with those contractual boundaries, a miss is as good as a mile.

123. There is an additional contextual point which bears upon the breadth of the right of Change under clause 12, although only briefly mentioned in submissions. It is that neither in clause 12 nor anywhere else in the Golden Contract does the Developer have a right to reduce the price for any Works Option, once selected by Notice to Proceed. We have noted that the working out of the definitions embedded or adopted in clause 12 assumes that in relation to any Change, there will be a "change from what" benchmark already established by the prior selection of a specific Works Option by the issue of a Notice to Proceed. Where a Change causes the Contractor to have to undertake extra work, there is a formula for ensuring that it is paid for in addition to the price specified for that Works Option. But there is no mechanism for price reduction where, as here, a purported Change greatly reduces the scope and specification for the necessary works.

124. For those reasons, which do not differ substantially from those of the Upper Tribunal, endorsed by the Court of Appeal, we would decide this issue against the taxpayers. We should add, though it forms no part of the ratio of our judgment, that even if the taxpayers had been successful as to the meaning of the right of change in clause 12, we are in some doubt whether this would have brought expenditure incurred on DC2 (or a fortiori DC3) within section 298. They were both purportedly demanded under clause 12 as Changes to Works Option 1, but only to that Option as amended by a contractual variation (Variation 2) agreed upon after the tenth anniversary to permit multiple selections of buildings under a single Works Option, or group of Works Options. DC1 had already been selected in part under Works Option 1, and the instruction to build DC2 was not issued by way of replacement to or modification of DC1. If, but for Variation 2, this would not have been permitted under the Golden Contract in its original form, we find it difficult to see how DC2 can be said to have been built, and the relevant expenditure incurred, by way of the exercise of any unilateral right to change contained in the Golden Contract as it was at the tenth anniversary, whatever the true construction of clause 12. (It may be that HMRC abandoned this as a separate point in the courts below, but we mention it lest silence about it might otherwise have cast doubt upon the consistency of our views, taken as a whole.)

The Variation Issue

125. The Variation Issue arises only on the footing, contrary to our opinion, that the phrase "incurred under a contract entered into [etc]" in section 298(1)(b) refers to the general law of contract and does not import any distinct statutory standard of its own. According to the general law of contract it may be possible to say (at least, for some purposes) that a contract which has been varied continues to be, in some sense, the same contract as it was at the outset, in that a contract may be varied without terminating it. On that view, expenditure incurred under an original contract which has been varied can be regarded as having been incurred under that original contract (in this case, the Golden Contract). By contrast, if the original contract has been replaced rather than varied, and expenditure is incurred under the replacement contract, then ex hypothesi it has not been incurred under the original contract. It should be emphasised, however, that the result of our discussion of the section 298 issue is that section 298 does import a distinct statutory standard and does not refer in a simple and exclusive way to the general law of contract. Accordingly, what follows does not bear upon the outcome of the appeal.

126. The debate in relation to the Variation Issue proceeded in a rather abstract way, at the level of contract theory, as to where exactly the boundary lies between variation and replacement of a contract. The taxpayers submit that, by reason of the principle of freedom of contract as recognised in the common law, it is open to the parties to a contract to choose whether to achieve an alteration in their contractual rights and obligations by variation or by replacement. They contend that (if they lose on the Clause 12 issue), on an objective assessment of the intention of the Developer and the Contractor in the present case in light of the tax background to their contractual arrangements, the alteration in those arrangements consequent on the Developer issuing Change Order 2 and Change Order 3 was intended by them to take effect by variation of the Golden Contract and not by way of replacement of it by a new contract made outside that period. Therefore, as a matter of common law contractual analysis, the Relevant Expenditure had been incurred "under" the Golden Contract (that is, under a contract entered into within the first 10 year period). On that basis, subject to the issue regarding the interpretation of section 298 which we have addressed above, the taxpayers say they are entitled to claim EZAs in relation to the Relevant Expenditure.

127. Contrary to this, HMRC deny that the choice or characterisation of an alteration in contractual rights and obligations as a variation or a replacement is a matter primarily governed by the intention of the parties. Instead, they submit that a two-stage process applies. First, one has to identify what alteration in contractual rights and obligations has been agreed by the parties. For that purpose the parties' common intention plays its usual role, objectively ascertained. But at the second stage, one has to assess that alteration against an objective standard of classification to see whether it is so fundamental that the new set of rights and obligations has to be regarded as constituting the replacement rather than a variation of the original contract. HMRC say that this approach is supported by, in particular, *Morris v Baron* and *British and Beningtons*. Adopting this approach, HMRC

submit that the alteration in the contractual arrangements between the Developer and the Contractor consequent upon Change Order 2 and Change Order 3 was so extensive that it falls to be characterised as a replacement of the Golden Contract. The Relevant Expenditure was incurred under the new contract which had replaced the Golden Contract and which was entered into after the end of the first 10 year period specified in section 298. According to this analysis, the taxpayers would not be entitled to claim EZAs in relation to the Relevant Expenditure.

128. Alongside this debate about the importance in this context of common intention in contract theory, there was also discussion about the particular and rather unusual facts of this case. The issue here arises because the Developer issued Change Order 2 and Change Order 3 and the Contractor accepted and complied with them while both labouring under two erroneous beliefs. The first was the erroneous belief that they were valid instructions given pursuant to clause 12 of the Golden Contract with which the Contractor was obliged to comply by virtue of the Golden Contract itself (at least, as it had been varied according to Variation 2). The second was that by achieving desired alterations to the Golden Contract by variation rather than replacement they would not fall foul of the time limit imposed under section 298 (as evidenced by their agreeing Variation 1 and Variation 2). A difficulty therefore arises as to how to identify any relevant common intention (ie to vary or to replace) in connection with the alterations in the contractual arrangements consequent upon Change Order 2 and Change Order 3, in circumstances where (i) the parties thought they were operating according to the terms of the original contract and were therefore neither varying those terms nor replacing them and (ii) the parties' probable belief that varying rather than replacing the Golden Contract was effective under section 298 was itself wrong in law. It is one thing to attribute a common intention to parties which they never actually had, on the generous basis that they would have had it if they had correctly understood the law. It is quite another to apply that generous approach when the replacement assumption about the law is itself wrong.

Variation vs Replacement

129. Where parties to an original contract later agree to make alterations to their rights and obligations they do not usually care whether those alterations are characterised as variations of the original contract or as a replacement of it. As a practical matter, nothing normally turns on that. All that matters is that the parties have moved from one set of contractual rights and obligations to another. On any view, they need a second contract after the original contract to achieve that alteration. A variation of the original contract has to take place by means of a later binding and valid contract, just as does a replacement of the original contract. Both need fresh consideration. Since, typically, neither the choice nor the characterisation of the mechanism for the alteration is significant for the parties, it may be difficult to infer with any confidence that they had any particular common intention as to its choice, one way or the other. As Toulson LJ observed in *Samuel v Wadlow* [2007] EWCA Civ 155, para 39, it may not be easy to tell whether their intention was that the original contract should continue in varied form or that it should be replaced,

"since the distinction is one of legal theory which might have little commercial meaning for the parties".

130. An exceptional case where it matters whether the parties have chosen to bring about an alteration to their contractual relationship by the mechanism of variation or of replacement is where the interposition of some statutory regime in effect hangs upon that outcome. If the parties are aware of that statutory regime then they may well mind very much which mechanism is chosen to effect their desired alteration. Sometimes their interests in choosing one mechanism rather than the other may coincide, and it may be easy in such a case to infer a common intention as to the mechanism which they desired to use. For example, on the assumption (with which we disagree) that expenditure incurred after a variation (but not replacement) of a qualifying contract is incurred "under" the original contract for the purposes of section 298, it may easily be inferred that well-advised parties to the Golden Contract would have much preferred to achieve an alteration in their relationship by variation rather than replacement. Sometimes, however, the parties' interests may be diametrically opposed. In such cases they are unlikely to have shared a common intention as to the choice of mechanism. Sometimes the parties may have been entirely ignorant of the existence of the relevant statutory regime, in which case they may be supposed not to have had any more significant intention as to mechanism than parties to a contract where the choice makes no difference at all. In all those cases it is likely that a three-stage test will be required. The first is to ascertain what is the alteration to their contractual relationship upon which they agreed. The second is to ask whether they did so by using the mechanism of variation or replacement, having regard to such common intention about that choice as may properly be ascertained or inferred. The third stage is to apply (or not, as the case may be) the statutory consequences.

131. *Morris v Baron* was a case where the parties must have been ignorant of the relevant statutory regime. It was concerned with the operation of section 4 of the Sale of Goods Act 1893, which provided that a contract for the sale of goods above £10 in value would be unenforceable unless evidenced in writing. A contract for the sale of goods above that value was agreed and duly evidenced in writing. The seller brought an action to recover the price of goods supplied under the contract and the buyer counterclaimed for damages for the non-delivery of other goods in breach of the contract. The legal proceedings were settled by an oral agreement, which as part of the settlement terms also provided for a sale of goods, presumably in ignorance of section 4. Later, the seller again sued for the price of the goods supplied under the original contract, maintaining that the oral agreement was not enforceable by reason of section 4 of the 1893 Act, with the result that the parties were relegated to their rights under the original contract; and the buyer counterclaimed under that contract, as in the previous litigation. The buyer was successful in the Court of Appeal, which held that a written agreement made in compliance with section 4 could not be rescinded except by an agreement in writing. The House of Lords reversed this decision, holding in the relevant part of its decision that the original written contract could be, and had been, impliedly brought to an end by the later unenforceable oral contract, since the later contract evinced an intention to "rescind" the original contract

(that is, bring it to an end and put another arrangement in its place) as distinct from an intention to vary it (that is, leave it in place, subject to such change as might validly be achieved by the later contract). As a matter of law, writing was not required by section 4 to bring to an end a contract for the sale of goods evidenced in writing pursuant to the 1893 Act, so to that extent it did not matter that the later agreement was oral only (though it could not be enforced as a contract for the sale of goods).

132. This authority does not support HMRC's case, namely that once the content of the alteration has been established, intention no longer has any role to play in resolving the variation or replacement question. It is against them. In applying the relevant distinction which the statute required to be made, all of the law lords held that the question whether the original contract was varied or "rescinded" depended on the parties' common intention. Lord Finlay LC said (p 12), "[t]he evidence in the present case points to the conclusion that the parties intended not merely to vary the original contract but to set it aside and substitute another for it …"; the question then arose (p 13), "[i]s the law such as to prevent effect being given to the intention of the parties to treat the original contract as rescinded?", and he held that it was not.

133. Viscount Haldane (pp 16-18) analysed *Noble v Ward* (1866) LR 1 Ex 117; (1867) LR 2 Ex 135, a case on the Statute of Frauds, which held that where the later invalid oral contract purports to vary, "and only to that extent to supersede or rescind", an earlier written contract, the oral contract does not operate validly; but he held that a later oral contract, though it cannot be sued upon, may be effective to rescind (that is, set aside) in its entirety a prior written contract: "[t]he question is whether there is an intention in any event to rescind, independent of any further intention which may exist to substitute a second contract"; see also p 19: "[w]hat is … essential is that there should have been made manifest the intention [sc of the parties] in any event of a complete extinction of the first and formal contract, and not merely the desire of an alteration, however sweeping, in terms which still leave it subsisting". In each case, the court has to determine the parties' common intention and then apply the statutory regime, which turns on a distinction between an intention to end the original contract (which can be achieved by oral agreement) and an intention to vary and give effect to the original contract as so varied (which cannot be achieved by oral agreement). On the facts, the case fell into the former category. The oral agreement was effective to bring the original contract to an end, which meant that the buyer could not sue upon it (nor could they sue upon the oral contract, because that was unenforceable).

134. Lord Dunedin concurred with the view of *Noble v Ward* taken by Lord Haldane: "The criterion [determining whether effect will be given to the later oral contract] is in the question whether what is intended to be effected by the second contract is rescission or variation" (p 26). It was a question of fact "whether the parties did intend to rescind" (p 27). On the facts it was established that they did so intend.

135. Lord Atkinson analysed the case in a similar way. The parties to a written agreement "may rescind that agreement by a parol agreement subsequently entered into by them with that specific intention", even if the later agreement could not be enforced because of the operation of statute, "provided the intention of the parties to rescind the first be clear" (p 30). By contrast, a contract which the law requires to be evidenced by writing cannot be varied orally, the reason being "that after the agreed variation the contract of the parties is not the original contract which had been reduced into writing, but that contract as varied, that of this latter in its entirety there is no written evidence, and it therefore cannot in its entirety be enforced" (p 31). On the facts in the case, the later oral contract evinced an intention of the parties wholly to set aside their original contract: the terms of the oral contract were "in conflict in all those material and fundamental provisions which go to the root of the each of them"; it was impossible to reach any conclusion "as to the meaning, aim and effect" of the oral contract other than "that it was the clear intention of both [parties] to put aside, in their future dealings, the original agreement, and to treat it thenceforth as abandoned or non-existent" (p 33). Similarly, Lord Parmoor stated (pp 36-37) that the determining factor was "the intention of the parties at the time when [the oral agreement] was made"; if it "expressed in clear language an intention to rescind [the previous written contract] it would … be decisive". He found that it did.

136. Mr Ewart sought to suggest that Lord Atkinson held that there was a rule of law to the effect that if there was a fundamental difference between the original contract and the later contract, the later contract had to be taken to "rescind" the original contract. We do not accept this. Lord Atkinson, like the other law lords, held that the question whether the later contract set aside the original contract depended on the intention of the parties, to be gathered from all the circumstances. The fact that the agreed alterations to their contractual relationship were fundamental was certainly relevant to the ascertainment of their common intention to rescind the original contract rather than to vary it, but that fundamentality did not operate as a separate rule of law, regardless of intention.

137. *British and Beningtons* is authority to the same effect. A buyer entered into written contracts to purchase tea, to be delivered to warehouses in London. Owing to congestion in London, the consignments of tea were delivered to other ports. The parties then made an oral agreement that the buyer would take delivery at those ports and would receive a reduction in the price. As in *Morris v Baron*, the oral agreement was unenforceable because it was not in writing and a critical issue was whether the original contracts remained in force. The House of Lords held that they did. Lord Sumner, with whom Lord Buckmaster, Lord Wrenbury and Lord Carson agreed, said (p 67) that the test to be applied, as derived from *Morris v Baron*, was whether "the common intention of the parties … was to 'abrogate', 'rescind', 'supersede' or 'extinguish' the old contracts by a 'substitution' of a 'completely new' and 'self-contained' or 'self-subsisting' agreement …". On the facts, he found that there was no such intention. It was not the case that any variation at all of an original contract meant that a new, varied contract governed and discharged (that is, set aside) the original contract: "The variation may be a new contract, so as to make writing … indispensable to its admissibility, for this is a matter of form and

of the words of the statute, but the discharge of the old contract must depend on intention …" (p 69). Lord Atkinson also determined the issue by referring to the intention of the parties (p 60): it had not been found that the parties intended to rescind the original contracts.

138. In *Morris v Baron* Lord Finlay cited (pp 11-12), and likewise in *British and Beningtons* Lord Atkinson cited (pp 60-62), the old case of *Stead v Dawber* (1839) 10 Ad & E 57; 113 ER 22 on the operation of the predecessor of section 4 of the 1893 Act in the Statute of Frauds, in which a small change to extend the date for delivery of goods under a contract of sale was held to constitute a new contract which was unenforceable and could not be sued upon. Lord Denman held (10 Ad & E 57, 64-65) that the case turned on a question of fact: "what … was the intention of the parties" in substituting a later date for delivery; "did they intend to substitute a new contract for the old one, the same in all other respects except those of the day of delivery [and another term which was changed] with the old one?". He explained, "Independently of the statute, there is nothing to prevent the total waiver, or the partial alteration, of a written contract not under seal by parol agreement; and in contemplation of law, such a contract so altered subsists between these parties: but the statute intervenes and, in the case of such a contract, takes away the remedy by action". The court therefore put "that construction on what passed between these parties which best effectuates their intention", determining that the agreement to extend time for delivery was part of the contract between them, and then applied the statute, holding that the contract so altered was not enforceable.

139. This authority, like *Morris v Baron* and *British and Beningtons*, shows that the common intention of the parties governs the nature of the contractual arrangements between them. If a statutory regime then has to be applied, it is applied to the state of the contractual relations between them as determined under the general law in accordance with their common intention. *Morris v Baron*, *British and Beningtons* and *Stead v Dawber* illustrate the sort of three-stage analysis we have referred to above, which is different from that contended for by HMRC.

140. Mr Ewart, pursuing his theme that there is a rule of law which says that if a later contract is fundamentally different from the original contract it will be taken to have rescinded (in the sense of set aside) and replaced the original contract, relied on the sort of analysis illustrated by *Street v Mountford* [1985] AC 809. The issue in that case was whether a particular contract constituted a licence, or a tenancy protected by the Rent Acts. The contract was labelled as a "licence agreement", but that was not determinative. The contract terms about the rights granted to the occupier satisfied the criteria for a tenancy under the common law, later codified in the Law of Property Act 1925, so that the Rent Acts, which applied to certain tenancies but not to licences, therefore gave the occupant security of tenure. The House of Lords was much pressed with the submission that the parties had by the words of the agreement evinced a clear common intention to create occupation rights by the grant of a licence rather than a tenancy, and that it would

derogate from their freedom of contract for the court to hold otherwise. In a memorable passage Lord Templeman said this:

> "Both parties enjoyed freedom to contract or not to contract and both parties exercised that freedom by contracting on the terms set forth in the written agreement and on no other terms. But the consequences in law of the agreement, once concluded, can only be determined by consideration of the effect of the agreement. If the agreement satisfied all the requirements of a tenancy, then the agreement produced a tenancy and the parties cannot alter the effect of the agreement by insisting that they only created a licence. The manufacture of a five pronged implement for manual digging results in a fork even if the manufacturer, unfamiliar with the English language, insists that he intended to make and has made a spade."

141. That was a case in which it was by no means in the common interests of both parties that the agreement created either a tenancy or for that matter a licence. The common law characterised the grant of rights of occupation as a tenancy or licence by reference to the substantive rights conferred. The difference between a tenancy and a licence was not (as here) a mere matter of choice between alternative mechanisms for the conferral of the rights granted. Once the nature of the rights granted had been ascertained there was indeed no room for a second stage of characterisation, dependent upon the parties' common intention. They either constituted a licence or a tenancy, and that was a matter of law. The same analysis applies to the characterisation of a security interest as a fixed or floating charge, in *Agnew v Comr of Inland Revenue* [2001] UKPC 28; [2001] 2 AC 710. In the present case, by contrast, the choice of the mechanism for the alteration of the parties' contractual relationship was a matter upon which the parties were free to choose, and it is by no means governed purely by the content of the alterations themselves. There will be many alterations which could be brought about either by variation or by replacement, and there is no reason why the question which method they actually chose should not be ascertained, at least in part, by reference to what may be inferred as to their common intention. Thus for example, describing the alteration as a variation (as was done for Variation 2) is a perfectly legitimate indicator of intention, whereas it was irrelevant in *Street v Mountford*.

142. We were taken to a number of cases concerned with the application of legislation to contracts of employment. These again show that the parties' intentions govern their contractual relationship, and that legislation applies in the light of the choices they have made. The point is well illustrated by *Cumbria County Council v Dow (No 2)* [2008] IRLR 109. Claims were brought against an employer under the equal pay legislation. The case concerned the application of the relevant statutory limitation period, which was six months from the day on which the relevant contract of employment came to an end. In the course of the claimants' employment changes had been made in their contracts, and

the question arose whether those changes constituted variations of the original contracts of employment or their replacement by new contracts of employment (which would have the result that the claimants were out of time to claim in relation to their employment under the earlier contracts). Elias J (President), giving judgment for the majority in the Employment Appeal Tribunal, treated the issue as one depending on the intention of the parties: paras 36-37. If the parties had expressly agreed which mechanism would be used, their choice would be determinative. Otherwise, their intention would have to be inferred. If the change was not fundamental, the inference would be that they intended there to be a variation. Again, the lack of fundamentality was a pointer to the parties' common intention as to mechanism, not a rule of law dictating the outcome.

143. Mr Rabinowitz made the powerful submission that HMRC's contention on the Variation Issue is contrary to the principle of party autonomy on which the common law of contract is founded. Statutes may impose a rule which operates regardless of the intention of the parties because Parliament may have reason to impose it. But the common law of contract facilitates rather than frustrates the intentions of the parties, except where what they seek to do is contrary to public policy; and it could not be suggested that an agreement that a particular alteration should operate as a variation rather than a replacement of an existing contract (or vice versa) is contrary to public policy.

144. In general terms, we agree with this. Freedom of contract is a basic principle of the common law. In *Morris v Baron*, if the parties had expressly stated that they were varying and not replacing the original contract, it is clear from the judgments in the case that their intention would have been determinative of that issue. That was the approach adopted in *Cumbria County Council v Dow.*

145. Mr Rabinowitz submitted that there was no limit in the common law to the ability of the parties to specify that a change in their contractual relations should take effect by way of variation rather than replacement of an original contract between them, subject only to the sham doctrine (*Snook v London and West Riding Investments Ltd* [1967] 2 QB 786; though we note that this is not really a limit at all, since that doctrine gives effect to the true intention of the parties and disregards the false appearance of a particular legal relationship which they have sought to present). This contention can be tested by extreme examples.

146. Suppose there is a contract for a holiday in Edinburgh which is implemented and completely exhausted at the time. If, fifteen years later, the parties want to make a contract for a different holiday in Paris, could they agree that this will be by way of a variation of the earlier contract? Or could they agree to change the contract for a holiday in Edinburgh into a contract to build a nuclear submarine and agree that this will be by way of variation of the holiday contract, including if that is done fifteen years later? If the parties tried to do this, one would be inclined to ask why. It might be an attempt to try to get some benefit under a statute or, say, a contract for holiday insurance. But then the statute or the

insurance contract with a third party, stating an external rule, would usually make it clear whether, according to that rule, the parties could obtain the hoped for benefit. That would still leave the question whether, as a matter of contract theory, the parties' intentions would be determinative of the question of variation or replacement so far as the general law of contract is concerned. At the other extreme, if the parties to a CiF contract agreed to extend by one hour the time by which the Bill of Lading had to be presented to the buyer's bank, while the relevant cargo was already at sea, one might expect short shrift to be given to an argument that this created an entirely new contract rather than a variation of that which was already partly performed, whatever the label which they chose to attach to the document creating the alteration in their contractual relationship.

147. It is difficult to answer such an abstract question without an understanding of what significance the choice of mechanism might have in the circumstances of a particular case. Nonetheless, we consider that Mr Rabinowitz's submission goes too far. At some point it would bring the law into disrepute if the parties specified that some change in their contractual relations should take effect as a variation rather than a replacement even though that was utterly absurd, yet the law still gave effect to that specification in some way which had effects in the real world. We do not think that the general law would give effect to the intentions of the parties to the extent that it brought itself into disrepute and damaged its legitimacy in the eyes of the public.

148. In *Plevin*, for the purposes of determining whether a statutory regime applied in relation to conditional fee arrangements made at a particular time, this court had to decide whether two deeds of variation in relation to an original conditional fee agreement, which were expressly agreed to be a variation of that agreement, took effect as variations of that agreement rather than as a replacement of it. At para 13, Lord Sumption (with whom the other Justices agreed) said "[w]hether a variation amends the principal agreement or discharges and replaces it depends on the intention of the parties" and referred to *Morris v Baron*. He concluded, "While the description given to the transactions by the parties would not necessarily be conclusive if the alleged variation substituted a different subject matter, that cannot be said of either of the deeds of variation". Therefore they took effect as variations of the original agreement. However, Lord Sumption's statement indicates that there is a limit to the ability of the parties to an agreement to specify that a change in their contractual rights and obligations constitutes a variation rather than a replacement of it. We agree that there is.

149. It has to be acknowledged that these are vague standards which, as purely abstract statements, are not very informative about where precisely the limits lie of the ability of the parties to specify that a change to a contract is a variation rather than a replacement and by doing so to bring about some substantive legal result. If it is borne in mind that the choice between variation and replacement is between alternative mechanisms for the alteration of contractual relations, rather than just a labelling exercise, it may not be too difficult to discern the probably rare cases where the chosen label simply does not match the mechanics actually deployed. We do not think we can usefully say more. This court

deals with practical legal questions and does not seek to provide exhaustive abstract statements of the law.

150. We revert briefly at this point to the section 298 Issue. The difficulties and uncertainties involved in applying the general common law as regards treatment of a change in contractual relations as a variation or a replacement of an original contract are further reasons why it is not plausible to think that the legislative regime as regards what happens in the second 10 year period was supposed to operate solely by reference to common law theory. That would make this tax legislation too uncertain in its effect and would improperly elevate taxpayer choice as to how it should operate above implementation of the policy purpose behind the 10 year time limit.

151. However, having heard argument on the point, we think it is appropriate to state our view that the centrality and force of the principle of freedom of contract means that, purely in terms of the general common law, parties to an agreement have a wide margin of choice in deciding whether an alteration in their contractual relationship should be achieved by the mechanism of variation or replacement. This is generally a matter to be determined according to their common intention, assessed in the usual objective way, within wide parameters and subject to limits only at the margins which we have attempted to describe.

152. Also, in view of the arguments we have heard and since there was a divergence of view in the Court of Appeal, we think it is appropriate to say something about the difference in the approaches adopted by Lewison LJ and Newey LJ. The difference between them is essentially about the proper approach to determining the intention of the parties to the Golden Contract when they made their subsequent agreements consequent upon the issuing of Change Order 2 and Change Order 3.

153. It is not necessary to be definitive, but it seems to us the most convincing contractual analysis is that, even though the Change Orders were not validly issued pursuant to clause 12, the Contractor accepted that it would be contractually bound to build DC2 and DC3 by keeping the money paid in conjunction with those orders and then proceeding to build in accordance with the specifications in them. Alternatively, it may be that the new contractual rights and obligations came into being with the SDA in each case. Either way, interpretation of the new contractual arrangements would have to proceed with reference to the context in which they were entered into.

154. According to Lewison LJ, the Developer and the Contractor had a mere subjective desire to avoid tax and this could not be taken to affect their intentions, as objectively assessed. With respect, we disagree. The tax context in which the Golden Contract was entered into and the later contractual arrangements were made was known to both parties and was a very important part of the factual background for the making of the Golden

Contract and those later arrangements. We agree with Newey LJ that the tax context in which an agreement or series of agreements is made can be part of the relevant background for assessing the intention of the parties. It often will be. This is all the more so where it may be said that the achievement of the relevant tax advantage was, as here, a shared goal.

155. When the parties confronted the question of altering the relationship constituted by the Golden Contract in terms of whether they wished to vary or replace it, as they did when agreeing Variation 1 and Variation 2, they clearly intended to make the alterations by way of variation rather than replacement. That is evident from the express label of "variation" which they gave to the new contracts which made those alterations. But even if they had not attached that label, we consider that in this tax context both parties understood the importance of maintaining a position that any subsequent expenditure could be taken to be incurred under the Golden Contract, so that EZAs could be claimed, and that their intention would have been assessed to be to vary the Golden Contract rather than replace it. It may not matter that they were mistaken in thinking that the use of the mechanism of variation was sufficient to secure the advantage of satisfying section 298. It is enough that they probably thought it was, or at least that its use gave them a better argument in any later dispute with HMRC than if they had opted for replacement.

156. Newey LJ addressed the difficult question whether the alterations in the contractual arrangements consequent on Change Order 2 and Change Order 3 were intended to be by way of variation or replacement. He considered that because the choice of building allowed by the Golden Contract, as varied by Variation 2, had already been exercised by the Developer issuing Change Order 1, the better view was that the later Change Orders took effect by way of replacement rather than variation. We are doubtful about that. If the parties had appreciated that they needed a new agreement to alter the Golden Contract in order to issue Change Order 2 and Change Order 3, and agreed to do so, we are by no means sure that in applying the common law it would have been right to assess their intention as being to replace rather than vary the Golden Contract. In view of the degree of respect afforded by the common law to party autonomy and the relevance of the tax context, we would incline to the view that such alterations would in such circumstances have been assessed to be by way of variation rather than replacement. But, as we explain below, the point does not arise for decision and it is not necessary or appropriate to say any more about this.

Characterisation of the Contractual Alterations on the Facts

157. In 2011 the Developer and the Contractor thought that there was no need to alter the Golden Contract. They believed that Change Order 2 and Change Order 3 were validly issued under clause 12 and that (presumably) Variation 2 had not already taken them out of the time-frame required by section 298, because it was a variation rather than a replacement of the Golden Contract. The test of party intention as regards variation or

replacement is difficult to apply where, as in this case, it is evident that the parties to a contract intended neither.

158. At this stage of the analysis, the taxpayers' submission implicitly gives priority to the statutory rule rather than the common law. It amounts to this: the statutory rule requires a choice to be made between variation and replacement, therefore what the parties to the Golden Contract did must be fitted into one or other of those categories even though to do so means departing from their objective common intention. The common law does not require such a choice to be made, but the statute does.

159. It is implicit in this contention that the taxpayers are not contending that section 298(1)(b) simply refers to the common law, without more. Mr Rabinowitz's submission was that we should decide whether there was a variation or a replacement of the Golden Contract by determining what the parties' intention would have been had they appreciated (i) that the Change Orders were not validly given under clause 12 and (ii) that only an alteration by way of variation would pass the time limit under section 298 (which is probably what they thought, even though they would have been wrong). In support of this he relied on *United Dominions Corpn (Jamaica) Ltd v Shoucair* [1969] 1 AC 340 (PC), 348-349.

160. For reasons we have already given, we disagree. We do not consider that, on its proper construction, section 298 requires such an artificial choice to be made. The question whether the expenditure on DC2 and DC3 was incurred under the Golden Contract does not depend upon whether the contractual effects consequent upon Change Order 2 and Change Order 3 were achieved by way of variation or replacement of the Golden Contract.

161. Since the statute does not pose the question whether the events after 2006 amounted to a variation or a replacement of the Golden Contract, there is no good reason for us to answer it.

Conclusion

162. We agree with the Upper Tribunal and the Court of Appeal that Change Order 2 and Change Order 3 were not validly issued under clause 12 of the Golden Contract. Our conclusion is that, on the proper interpretation of the 2001 Act, the Relevant Expenditure was not incurred under a contract made before the end of the first 10 year period, as required by section 298(1). Therefore, for reasons different from those given by the Court of Appeal, we would dismiss the appeal.