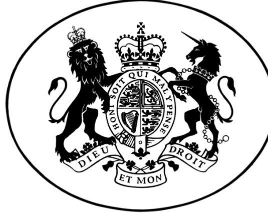
[2013] UKFTT 387 (TC)



TC02784

Appeal number TC/2009/10778

INCOME TAX - PAYE & NIC – Rule 18 lead cases – tax avoidance scheme – bonuses - restricted securities - liquidation distribution – Ch 2 Part 7 ITEPA 2003 - the Ramsay principle – appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

TOWER RADIO LTD
TOTAL PROPERTY SUPPORT SERVICES LTD **Appellants**

- and -

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

TRIBUNAL: JUDGE PETER KEMPSTER
JOHN WHITING OBE

Sitting in public at the Royal Courts of Justice, Strand, London WC2 on 18-20 September 2012

Giles Goodfellow QC and Oliver Connolly of counsel, instructed by Barnes Roffe LLP for the Appellants

Timothy Brennan QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

1. This case concerns two Appellants, Tower Radio Ltd ('Tower') and Total Property Support Services ('TPSS'). The two Appellants are the formal specified lead cases pursuant a Rule 18 Direction issued by Judge Kempster on 2 June 2011, which identified the common or related issues as:

> "Whether the sums or benefits received by officers or employees pursuant to arrangements registered as Disclosed Tax Scheme 54003391 and adopted by the Lead Case Appellants and others during the tax years 2003-04 and/or 2004-05 are:
>
> (a) chargeable to income tax as employment income, and, if so, as PAYE income; and/or
>
> (b) constitute earnings liable for National Insurance Contributions."

2. There is a number of related cases stayed or sisted behind the lead cases, all of whom participated in a tax planning scheme. The scheme was carried out in a consistent manner but with variations in a limited number of features. The scheme was devised by Barnes Roffe, a firm of accountants. It centred on the award of shares in a subsidiary company to certain employees of the employing company. Because of the way the shares were constituted and the scheme was effected, the taxpayers argue that the provisions of the Income Tax (Earnings and Pensions) Act 2003 ('ITEPA') apply in a certain way so as to mean that no income tax or national insurance contributions (NICs) apply.

3. The Respondents ('HMRC') in response contend, in short, that although shares were used, to all intents and purposes the employer gave money bonuses to the employees and so income tax and NICs should apply in the normal way.

Relevant Law

4. The relevant legislation is set out in the Appendix to this decision notice.

5. In this decision notice the following abbreviations are used for reference to some relevant case law:

Abbreviation	Court	Case	Citation
NMB	High Court	*NMB Holdings Ltd v SSSS*	(2000) 73 TC 85
DTE	Court of Appeal	*DTE Financial Services Ltd v Wilson*	[2001] STC 777
MacNiven	House of Lords	*MacNiven v Westmoreland Investments Ltd*	[2001] STC 637
Gray's Timber Products	House of Lords	*Gray's Timber Products Ltd v HMRC*	[2010] STC 782
Mayes	Court of Appeal	*Mayes v HMRC*	[2011] STC 1269

PA Holdings	Court of Appeal	*PA Holdings Ltd v HMRC*	[2012] STC 582
Aberdeen	Upper Tribunal	*Aberdeen Asset Management plc v HMRC*	[2012] STC 650
Sloane Robinson	First-tier Tribunal	*Sloane Robinson Investment Services Ltd v HMRC*	[2012] SFTD 1181
UBS	Upper Tribunal	*UBS AG and DB Group Services (UK) Ltd v HMRC*	[2013] STC 68

Evidence

6. There was a substantial volume of documentary evidence presented to the Tribunal. In addition, we heard oral evidence from Mr Bernard Litman, Managing Director of Tower; Mr Gareth Coombs, Director of TPSS; and Mr Stephen Wood, Tax Partner at Barnes Roffe. We were also to have heard from Mr Alexander Thorne, another Director of TPSS, but due to illness he was unable to give oral evidence.

Tower Radio Ltd

7. Tower is a trading company, retailing and wholesaling electrical appliances such as TVs, radios, white goods etc. It has operated since at least the 1970s and is based in Essex. The shareholders were at the relevant times:

Mr Bernard Litman (managing director) 23,330 ‘A’ Ordinary £1 shares

Mrs M Litman (mother of Mr B Litman) 11,667 ‘A’ Ordinary £1 shares

Mrs S Litman-Lanceron (sister of Mr B Litman) 11,667 ‘A’ Ordinary £1 shares

Mrs A Gallacher (wife of another director of Tower, Mr A Gallacher) 1 ‘B’ ordinary share

The ‘A’ shares are fully voting and participating; the ‘B’ shares are non-voting and have rights to repayment at par in a winding up.

8. The directors of Tower were at the relevant time:

Mr Bernard Litman (also Chairman)

Mrs M Litman (aged 83)

Mrs S Litman-Lanceron (resident in France)

Mr Adrian Gallacher (also the general manager of Tower)

9. The auditors and tax advisers to the company were Barnes Roffe.

Total Property Support Services Ltd

10. Total Property Support Services has been in business since 2001. Its trade is property maintenance and general construction. The shareholders at the relevant times were:

Mr G Coombs 250 'A' Ordinary £1 shares

Mr AW Thorne 250 'A' Ordinary £1 shares

Mrs Coombs (wife of Mr G Coombs) 250 'B' Ordinary £1 shares

Mrs Thorne (wife of Mr AW Thorne) 250 'B' Ordinary £1 shares

11. The directors of TPSS were Mr Coombs and Mr Thorne.

12. The auditors and tax advisers to the company were Barnes Roffe.

Barnes Roffe and the scheme

13. Barnes Roffe ("BR") is a firm of accountants, auditors and tax advisers, based in Leytonstone. The scheme in question was developed by BR and was used by them and some other accountancy firms.

14. In outline, the scheme involved the payment of remuneration by way of bonuses. This was done by making the employee an award of restricted shares in a special purpose vehicle company - in this decision notice we call them "SPVs". The value of the SPV was eventually realised by liquidating the SPV and distributing its assets to the employee shareholder. The idea was to take advantage of the way the provisions in the relevant legislation (ITEPA Part 7 Ch 2) make no immediate charge to income tax or NICs for an award of 'restricted securities', and then realise the value in the shares in a way that fell outside the subsequent charging mechanism in the legislation.

15. The shares in the SPV were made to be "restricted securities" by including a clause in the SPV's articles of association which would require the employee who was awarded the shares to sell them to the employer were they to leave (otherwise than by reason of death) the employer within a given period. In such a case, they would receive 95% of the market value of the shares.

16. The various schemes effected by BR all utilised SPVs named Efforsenrab Ltd, the companies being distinguished by being given numbers, for example Efforsenrab (1) Ltd was used by Tower.

17. We examine the scheme in more detail below through the evidence and the arguments of Counsel.

Mr Litman's evidence

18. Mr Litman adopted and confirmed a witness statement dated 29 December 2011.

19. Mr Litman had been employed full time by Tower since 1979 and had been managing director since 1985. The day-to-day running of the company was by Mr Litman and Mr Adrian Gallacher (also a director but not a shareholder).

20. Tower had been commercially successful and had built up reserves of over £1 million by 2003. Mr Litman said that he had no need of additional cash through dividends or bonuses so he did not see any need to pay out this money. That was because he had received substantial sums from Tower in the previous three years. His witness statement refers to these sums being paid jointly to Mr Litman and his then wife though in his oral evidence Mr Litman said that he could not recall if his wife was paid as a director. He was also asked if he was the highest paid director; he could not recall details but there seems little doubt from Tower's accounts that he was.

21. In late 2003 Mr Litman had a conversation with BR about ways of moving money off the company's balance sheet. A meeting with BR took place on 22 January 2004; at the meeting and in correspondence (particularly a letter of 10 February 2004) the scheme was explained to Mr Litman. He understood that the scheme was a tax efficient way for Tower to provide a valuable non-cash bonus to him and, if appropriate, other employees. He stated that it was always planned that decisions on whom among the directors would get this bonus would be made in a directors' meeting. The figure of £1 million that was in due course used in the scheme came from BR.

22. On 10 February 2004 BR sent Mr Litman a letter of engagement in relation to the scheme, which he signed on 3 March. The SPV (Efforsenrab (1) Ltd) was incorporated by London Law Services on the instructions of BR on 12 March 2004. It became a subsidiary of Tower. Mr Litman signed various documents relating to SPV, including some that he accepted bore incorrect dates.

23. On 30 March 2004 BR wrote to Mr Litman explaining the plan for the transfer of one million "A" shares in SPV to him by Tower. The letter enclosed documents ready for signature including board minutes, EGM minutes, stock transfer form and new share certificate in Mr Litman's name.

24. There was an EGM of Tower on 1 April 2004 with Mr Litman, his sister and his mother present. The discussion was about the destination of the shares in SPV. Mr Litman told us that he made it clear to the meeting that he felt he should be entitled to all the shares given his contribution to the Tower business. This was agreed to in principle by the shareholders but subject to the Board's final approval. The EGM agreed to the transfer of the 1,000,000 'A' £1 shares in SPV "to the directors [of Tower] as a discretionary reward for services performed in the accounting periods to 30 April 2003 and 30 April 2004". Tower itself would retain a single 'B' £1 ordinary share in SPV.

25. Two directors' meetings followed on 5 April and approved the transfer of 600,000 of the shares to Mr Litman "as a discretionary reward for the services performed by him" in the year to 30 April 2003, and the remaining 400,000 shares to Mr Litman "as a discretionary reward for the services performed by him" in the year to 30 April 2004. In each case it was minuted that "It was noted that the company had traded successfully in that period and continued to do so, and it was considered that the excellent trading result was due to the efforts of [Mr Litman] as a director of the company. … It was agreed that there would be no cash alternative to the aforementioned discretionary award". Mr Litman told us that the decision on the destination of the award was a decision for the directors.

26. There was a restriction on the "A" shares awarded to Mr Litman. Under Article 24 of the Articles of Association of SPV, on the occurrence of certain events, defined as 'forfeiture events', the holder of the 'A' shares was required to transfer them to such other shareholders of SPV as the directors determined. The holder would be paid 95% of the market value of the shares. The main forfeiture event was:

> "24(B)(ii) [Mr Litman] ceases to hold office or employment with Tower Radio Limited (otherwise than by reason of death) and does not continue or take up an office or employment with any other Group Company"

Mr Litman described the purpose of the restrictions as to prevent him from walking away from Tower.

27. Mr Litman told us that at the time it was envisaged that he would retain the shares in SPV for at least two years and run the company as a business in that period. That business was expected to be investing. That was not a problem as he did not need the cash immediately, and he had previous experience of investment business.

28. Mr Litman described the use of the funds by SPV as being the conduct of a trade in corporate bonds and Barclays treasury deposits, where he took advice from Barclays stockbrokers on the type of securities and also did some research himself at the time. In fact, between 31 March and 26 May 2004 the entire £1 million (plus accruals) was invested in consecutive seven-day Barclays treasury deposits; on 26 May £800,000 was redeposited with Barclays and £200,086.27 was used to purchase "General and Electric Floating Rate Notes"; on 2 June £500,000 was redeposited with Barclays and £305,841.93 was used to purchase "Bradford and Bingley Euro Medium Term Notes"; on 16 July the General and Electric Notes were sold for £198,901.66 plus interest of £2,166.71, and the Bradford and Bingley Notes were sold for £306,679.13; the Barclays deposit was then renewed on seven-day terms (including the sale proceeds of the above bonds) until 27 July 2004. As was mentioned by Mr Litman, the use of Barclays seven-day deposits was a continuation of the cash investment policy of Tower.

29. Mr Litman stated that the reason for the change from the intention of retaining SPV for two years or more was advice from BR. BR explained in a letter of 1 July 2004 that there was in their view a risk that changes would be made to relevant tax legislation which might give rise to further income tax and NIC charges in the

circumstances of SPV; the CGT rules might also change. In view of this advice, Mr Litman decided to set in train the winding up of SPV.

30. On 26 July 2004 shareholder and board meetings were held to resolve that SPV be wound up. The following day Mr Litman received £993,999 distribution from the liquidator in respect of his "A" shares and Tower received £1 distribution from the liquidator in respect of its "B" share. Further distributions were made on 29 July of £11,299.99 and £0.01 respectively; on 22 December of £15.92 to Mr Litman only; and on 30 March 2005 £10.14 to Mr Litman only.

31. In cross examination by Mr Brennan for HMRC:

(1) On the forfeiture provisions attached to the "A" shares, Mr Brennan questioned whether it was likely that Mr Litman would leave a company for which he had worked for 25 years. Mr Litman pointed out that he had two other companies, involved in property, and he could have used the money in expanding these. He suggested there '...could have been a bust up with the family...'. He conceded that the risk of losing 5% of the value of the shares was not a huge lock in. On being asked whether there really was a commercial underpinning to the restriction, Mr Litman referred to the loss of the 5%; he agreed he did not draw up the documents but insisted he had read through them and agreed he had signed and dated them in accordance with instructions he was given.

(2) Mr Brennan asked Mr Litman whether there was any intention of giving a bonus to Mr Gallagher. Mr Litman said that this was discussed with his mother and sister but 'they thought he was quite well paid' though the value in SPV 'could have gone to anyone'. Mr Litman explained on re-examination by Mr Goodfellow that Mr Gallagher received some £80,000 from another activity, a partnership Tower was involved in with Panorama Promotions. Mr Brennan suggested that it was always going to be the case that the award would be made to Mr Litman but Mr Litman insisted that was not the case.

(3) Mr Brennan suggested to Mr Litman that the two non-cash investments made by SPV had been undertaken just to try to make SPV look less like a money-box company before it was wound up. Mr Litman replied that Barclays stockbrokers had advised the investments when he expressed the wish for more interest income but still at a low risk. The use of Barclays seven-day deposits followed the way that had been used by Tower for that company's surplus funds.

Mr Coombs' evidence

32. Mr Coombs adopted and confirmed a witness statement dated 3 January 2012.

33. Both Mr Coombs and Mr Thorne had been directors of TPSS since May 2001.

34. In September 2004 Mr Coombs and Mr Thorne had a meeting with BR, at which BR explained a method to enable TPSS '...to provide valuable benefits to key employees in a tax efficient manner'. The details of the scheme were set out in a letter

to Messrs Coombs and Thorne dated 21 September 2004. Mr Coombs understood the scheme to be a way of providing value to himself and Mr Thorne in a tax-efficient way. On the same day, BR also sent TPSS a letter of engagement for the scheme which Mr Coombs signed on 23 September.

5 35. The scheme that involved TPSS moved very quickly. Two SPVs - Efforsenrab (147) Ltd and Efforsenrab (148) Ltd ('E147' and 'E148') - were incorporated on 22 September 2004 by London Law Services. E148 was the company destined for Mr Coombs, E147 for Mr Thorne. These companies were set up in a standard way:

- Share capital of £10,000,000 divided into 10,000,000 £1 shares
10
- 9,999,000 of these shares were to be 'A' ordinary voting shares
- 1,000 of these shares were to be 'B' ordinary shares
- The A and B shares had equal rights to dividends and a return of assets on liquidation but only the A shares had voting rights

36. The Articles of Association of the SPVs contained forfeiture provisions drafted in
15 the same way as that described at [26] above in relation to the Tower SPV.

37. BR sent various forms and instructions to Messrs Thorne and Coombs in a letter dated 28 September 2004. On that day, Mr Coombs signed relevant forms for E148 to allot 50,000 'A' shares, changed the accounting date of E148 and allocate 1 'B' share to TPSS. Mr Coombs referred to the various forms being pre-dated 21 September, and
20 accepted that date was even before E148 was formed.

38. The funds from TPSS to E148 were transferred on 28 September, although they may not have arrived in a bank account for E148 until the following day. Mr Coombs told us that the sum of £50,000 was decided on by discussion with Mr Thorne and in conjunction with BR at the September meeting. It was a mutual decision between
25 him and Mr Thorne and was based on the amount of cash that TPSS had available on its balance sheet.

39. A second letter of 28 September from BR to Messrs Coombs and Thorne set out the mechanics of transferring the shares in E148 to Mr Coombs and E147 to Mr Thorne. On that date an EGM of TPSS took place which approved the transfer of
30 shares in E148 to Mr Coombs in principle; this was subject to the approval of the directors which was given in a directors' meeting on the same day. Forms were duly signed and the 'A' shares in E148 transferred to Mr Coombs.

40. Mr Coombs stated that it was his intention, after receiving his shares in E148, to immediately place it into liquidation. He had been advised that there was a risk that
35 the law would change and the hoped-for beneficial tax treatment would not accrue. Accordingly, a directors' meeting of E148 took place on 29 September, then an EGM and resolutions were passed to effect the winding up of E148. The bulk of the value of E148 was paid out to Mr Coombs on 1 October and a final distribution paid at the end of January 2005.

41. In cross examination by Mr Brennan for HMRC:

(1) Mr Brennan asked what would have happened if Mr Thorne had wanted a cash bonus payment rather than using the shares route. Mr Coombs agreed that a bonus or dividend could have been paid but in collective discussion with BR the agreement was to use the bonus shares scheme. Mr Coombs agreed that no-one else's agreement was necessary in connection with the taking of £50,000 value from the company.

(2) Mr Brennan asked about the purpose of the restriction on the shares. Mr Coombs stated that it was there to protect the company (in effect the other director) in the event of a disagreement between him and Mr Thorne. Given the amounts involved in the forfeiture clause it was suggested to Mr Coombs that there was no real point to the clause; he conceded that '...in reality there was no advantage...'.

(3) Mr Coombs accepted that when he instructed the transfer of the money to the SPV on 28 September it was already his intention to wind-up the company the next day.

42. We were to have heard oral evidence from Mr Thorne, in support of his witness statement. Unfortunately Mr Thorne was ill, having recently had a heart attack, as evidenced by a medical certificate. As Mr Thorne's statement was very similar to Mr Coombs, with the substitution of E147 for E148, the Tribunal agreed with Counsel for the Appellants that there was nothing to be gained in requiring Mr Thorne to give oral evidence. We agreed that, given that the contents of Mr Thorne's witness statement were almost identical to those of Mr Coombs, any oral evidence from Mr Thorne was unlikely to be any different from that of Mr Coombs. In our deliberations we have borne in mind that this denied HMRC the opportunity to question Mr Thorne on his witness statement.

Mr Wood's evidence

43. Mr Stephen Wood adopted and confirmed a witness statement dated 3 January 2012.

44. Mr Wood is a tax partner in BR and was in practical terms the deviser and main promoter of the scheme. The scheme developed after he became aware at a conference in September 2003 of a possible arrangement whereby an employee might be awarded restricted shares in a special purpose vehicle. He developed the scheme, taking legal advice, and the resulting arrangement was in his view suitable for employers who wanted to reward key employees in a tax efficient manner but where the employees did not need to access the value immediately. The scheme had been licensed to two other local firms in exchange for a share of their fees charged to clients.

45. The employer would subscribe for shares in a newly incorporated SPV. The shares issued would be 'restricted securities' under s 423 ITEPA. The intention was that there would be forfeiture conditions attached to the shares in the SPVs so that they would fall within these provisions. The condition would be a requirement to sell

the shares at the direction of the company were the employee to leave, for which they would receive only 95% of the value of the shares. Because of the forfeiture condition, there would be no immediate charge as employment income to income tax nor NICs. This followed from s 425. The plan was that the company would trade for a year or more (preferably two). This was so that on the disposal of the restricted securities, CGT business asset taper relief would accrue. At the time, it was thought that a liquidation of the SPV would mean that the proceeds in a liquidation would not be subject to income tax or NICs. But it would be left up to the employee owner of the SPV whether their company was liquidated as they would hold the majority of the voting rights. It was this plan that was put to Tower and Mr Litman.

46. Legislative developments then affected the scheme. In the Budget of 17 March 2004, proposals for a system of disclosure of tax avoidance schemes (DOTAS) were announced. These came into force on 1 August 2004; existing reportable schemes would have to be disclosed by 31 October 2004. BR concluded that their scheme would be disclosable and duly notified it to HMRC on 29 October 2004.

47. BR felt that with disclosure there was an increased risk of the definition of chargeable event in s 427 being amended to cover the liquidation route. Also, changes were announced on 7 May 2004 which amended s 446E and s 429. Having considered the situation and taken further advice from Counsel, BR decided to alert clients to the risk of legislative change to affect the income tax/NIC position. As far as his own clients were concerned, Mr Wood concluded that the best course of action was to proceed to liquidation before further legislative changes were made and indeed before the BR DOTAS disclosure was made. This would mean sacrificing the chance of CGT taper relief. The substance of this advice was passed on to the two licensed local firms. Mr Litman was written to by BR on 1 July 2004 and was offered assistance with the liquidation process.

48. Clients were still introduced to the scheme after 13 May but were no longer advised to hold the shares in the SPV so as to qualify for CGT taper relief. This was the version of the scheme put to TPSS in the letter dated 21 September 2004. Mr Wood stressed that it remained up to the employees who acquired the shares in the SPV to decide what their company did and for how long it carried on any activities.

49. 212 Efforsenrab companies were incorporated, though not all were used for schemes. There were 111 scheme users, drawn from 30-40 BR clients and a smaller number from other advisers licensed by BR. More than one SPV would be utilised for a particular client if there were multiple directors.

50. In cross examination by Mr Brennan for HMRC Mr Wood was asked about the point of the restriction in the SPV shares. His answer was that it was twofold (a) to get within the provisions of section 425; and (b) to give a certain degree of comfort if the employees or directors fell out. He accepted that at 95% of the value the degree of comfort was pretty slight. He confirmed that the percentage was not geared to the circumstances of a particular client nor the amounts of money involved. Mr Wood was also asked whether BR had considered another percentage at all. His response was that the figure was influenced by CGT taper relief considerations; other

percentages had been considered but the conclusion was to leave the restriction ‘light’.

Schedule of scheme users

51. Prior to Mr Wood giving his oral evidence, HMRC sought to introduce a schedule which detailed for each Efforsenrab company the date of incorporation, date of award of shares, date of liquidation, and the number of days between award of shares and liquidation. Mr Goodfellow for the Appellants objected that this had not been listed for the bundle nor disclosed to the Appellants; it was unfair to ask Mr Wood questions on events from eight years earlier where insufficient detail was given to allow identification of who was involved in the various companies listed or the accuracy of the information. Mr Brennan for HMRC stated that there was clearly a marketed tax avoidance scheme and its use needed to be seen in context.

52. After consideration we decided that any questions to Mr Wood could refer to the scheme generally, but that questions on the detail of the schedule would not be fair.

Case for the Appellants

53. Mr Goodfellow for the Taxpayers submitted as follows.

54. The issue before the Tribunal was whether a transfer of shares by an employer company to one of its employees should be analysed as a transfer of restricted securities (as the Taxpayers contend) or instead as a payment of money (as HMRC contend). In both appeals there were two stages in common: the share transfer stage, and the liquidation stage. In the case of Tower, the relevant subsidiary also carried on business for some four months.

55. *The share transfer stage*

(1) The A shares in the relevant SPV were “restricted securities” because they were subject to forfeiture for 95% of their value in the event of certain forfeiture events defined in Article 24(b) of the SPV’s articles of association: s 423(2).

(2) The acquisition of those restricted securities by the employee from the employer was exempt from income tax: s 425. Thus the acquisition was “exempt income” under s 8 and did not constitute “general earnings” under s 7(3), nor “PAYE income” under s 683, nor “taxable earnings” under s 683(2) (see ss 10(2) and 15(2)).

56. *The liquidation stage*

(1) There was no “chargeable event” under s 427 when SPV was liquidated. The definition of chargeable events in s 427(3) did not include a liquidation of the company in which the restricted securities were held.

(2) In the absence of a chargeable event, there was no charge under s 426 and no “taxable amount” under s 428. There was no other charging provision in

Part 7 to impose an income tax charge on the employee shareholder of SPV in relation to sums received from the liquidator of SPV in respect of his shares on the liquidation. Thus there was no PAYE income.

57. HMRC had not identified any technical flaw in the tax planning undertaken. They had not offered any reasons countering the technical analysis given above. They seemed to accept (tacitly) that the planning worked on the then wording of Part 7. Indeed they subsequently amended Part 7 to include anti-avoidance provisions – although, notably, the definition of chargeable event had not been widened to include a liquidation. Rather, HMRC invited the Tribunal to ignore the relevant legislation (their statement of case contended that "ITEPA Part 7 Ch 2 is simply irrelevant") and adopt an artificial analysis of the transactions such that Part 7 was devoid of effect.

58. Absent any special legislation the well-established general position was that where an employee received shares from his employer then the current value of those shares constituted an emolument of the employee, but the proceeds of any future disposal or realisation of those shares were not emoluments: *Abbot v Philbin* [1960] 2 All ER 763. Over the years various statutory interventions had deliberately modified that general position in various ways. The regime in force at the time relevant to the current appeals was that in Part 7. Part 7 constituted a comprehensive code setting out exactly how and when employment-derived securities are taxed as income. Part 7 was replete with statutory constructs such as "employment related securities", "restricted securities", and "chargeable events"; and made detailed provision for elections to disapply certain rules, with strict time limits. Part 7 was clearly the type of legislation the courts had described as "closely articulated" (per Lord Millett (at [149]) in *CSR v Arrowtown Assets* (2004) 6 ITLR 454), or "prescriptive" (per Mummery LJ (at [38]) in *Mayes*), or "legal" or "juristic" (per Lord Hoffmann (at [32-34]) in *MacNiven*). This strongly suggests that one must respect the legal form of the transactions carried out – irrespective of their purposes and whether they were pre-ordained: see *Campbell v HMRC* [2004] STC (SCD) 396 (at [77-94]), approved by the House of Lords in *BMBF v Mawson* [2005] STC 1 (at [38]).

59. As Toulson LJ observed in *Mayes* (at [107]):

> "The particular consequences in the present case were obviously not foreseen or intended by the legislature; but legislation, especially legislation which is highly engineered, can have unintended consequences."

60. Lord Hoffmann in *MacNiven* (at [62]) referred to his comments in *Norglen Ltd (in liquidation) v Reeds Rains Prudential Ltd* [1999] 2 AC 1 (at [13–14]):

> "If the question is whether a given transaction is such as to attract a statutory benefit, such as a grant or assistance like legal aid, or a statutory burden, such as income tax, I do not think that it promotes clarity of thought to use terms like stratagem or device. The question is simply whether upon its true construction, the statute applies to the transaction. Tax avoidance schemes are perhaps the best example. They either work (*Inland Revenue Commissioners v. Duke of*

> *Westminster* [1936] A.C. 1) or they do not (*Furniss v. Dawson* [1984] A.C. 474.) If they do not work, the reason, as my noble and learned friend, Lord Steyn, pointed out in *Inland Revenue Commissioners v. McGuckian* [1997] 1 W.LR. 991, 1000, is simply that upon the true construction of the statute, the transaction which was designed to avoid the charge to tax actually comes within it. It is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes."

61. It was the clear intention of Ch 2 of Part 7 to exclude any charge to income tax on the acquisition of the restricted securities, and instead impose income tax on the subsequent happening of a "chargeable event". The intention was to achieve a higher income tax charge – the value of the shares on acquisition was depressed by the restrictions attached to the shares and so suffering income tax only on acquisition might be attractive to some employees. For that reason, Ch 2 was widely drafted and designed to take precedence over s 62 and the benefits code. There was however an *elective* procedure (s 425(3)) whereby an employee could opt out of the Ch 2 treatment and agree to suffer the income tax charge on acquisition. The exemption in s 425 was not conditional upon any minimum period of ownership of the securities, nor upon the securities being in a company that trades or engages in any business, nor upon the intentions of the employer or the employee in providing or receiving the securities. Had any such qualifications been intended then they would have been expressly provided (see, for example, the requirement for a trading company for CGT gift relief under s 165(2) TCGA 1992, or the minimum holding period requirement for IHT business property relief under s 106 IHTA 1984). The obligation to report promptly acquisitions of restricted securities precluded the application of Part 7 being dependent on the happening of events subsequent to the acquisition. Even if, as HMRC contend, the liquidation of the SPV had been pre-ordained from inception, that would be irrelevant to determining whether the employees had acquired restricted securities as defined in s 423. There was also, prior to December 2004, no anti-avoidance provision and no such provision could be read into Part 7 – that was why specific anti-avoidance provisions had been introduced by a new s 431B for December 2004 onwards.

62. In *Gray's Timber Products* (which concerned Ch 3D of Part 7, rather than Ch 2 as in the current appeals) Lord Walker described the context of the Part 7 legislation:

> "[4] Part 7 of ITEPA 2003 is headed 'Employment Income: Income and Exemptions Relating to Securities.' Its provisions reflect three different, and to some extent conflicting, legislative purposes. First there is Parliament's recognition that it is good for the economy, and for social cohesion, for employees to own shares in the company for which they work. Various forms of incentive schemes are therefore encouraged by favourable tax treatment (those in force in 2003 are covered in Chs 6–9 inclusive of Pt 7).
>
> [5] Second, if arrangements of this sort are to act as effective long-term incentives, the benefits which they confer have to be made contingent, in one way or another, on satisfactory performance. This creates a

> problem because it runs counter to the general principle that employee benefits are taxable as emoluments only if they can be converted into money, but that if convertible they should be taxed when first acquired. …
>
> [6] The principle of taxing an employee as soon as he received a right or opportunity which might or might not prove valuable to him, depending on future events, was an uncertain exercise which might turn out to be unfair either to the individual employee or to the public purse. At first the uncertainty was eased by extra-statutory concessions. But Parliament soon recognised that in many cases the only satisfactory solution was to wait and see, and to charge tax on some 'chargeable event' (an expression which recurs throughout Pt 7) either instead of, or in addition to, a charge on the employee's original acquisition of rights.
>
> [7] That inevitably led to opportunities for tax avoidance. The ingenuity of lawyers and accountants made full use of the 'wait and see' principle embodied in these changes in order to find ways of avoiding or reducing the tax charge on a chargeable event, which might be the occasion on which an employee's shares became freely disposable (Ch 2) or the occasion of the exercise of conversion rights (Ch 3). The third legislative purpose is to eliminate opportunities for unacceptable tax avoidance. Much of the complication of the provisions in Pt 7 (and especially Chs 3A, 3B, 3C and 3D) is directed to counteracting artificial tax avoidance. There is a further layer of complication in provisions which regulate the inevitable overlaps between different chapters. It is regrettable that ITEPA 2003, which came into force on 6 April 2003 and was intended to rewrite income tax law (as affecting employment and pensions) in plain English, was almost at once overtaken by massive amendments which are in anything but plain English."

63. If Ch 2 could be read as containing some principle that restricted securities could be ignored because they were being used as a vehicle for tax avoidance, then s 431B (introduced in 2004) would be redundant and need never have been introduced by way of amendment to Part 7.

64. In the very recent case of *UBS* the Upper Tribunal had outlined the arrangements as follows (at [1]):

> "Each case involved the use of a carefully planned tax avoidance scheme which was designed to enable the appellant bank to provide substantial bonuses to employees in the tax year 2003–04 in a way that would escape liability to both income tax and national insurance contributions ('NICs'). The mechanism chosen for this purpose was an award of redeemable shares in a special purpose offshore company set up to participate in the scheme. It was intended that the shares thus awarded to employees would be 'restricted securities' subject to the special taxation regime contained in Ch 2 of Pt 7 … If the plan worked, the shares would escape taxation under the detailed and prescriptive provisions of Ch 2, and the only tax to which they would potentially be subject in the hands of the employees would be capital gains tax

('CGT'). In practice, however, such liability was likely to be non-existent for non-UK domiciled employees, of whom there were a large number, provided they took care not to remit the proceeds of redemption of the shares to the UK; while for employees who were UK-domiciled, the scheme was structured so as to enable redemption to take place after the shares had been held by them for two years, by when (with the benefit of business taper relief) the rate of CGT chargeable would be only 10%, unless the employee had meanwhile left the bank's employment."

65. The Upper Tribunal (at [34]) adopted the description by the First-tier Tribunal ("FTT") of the transactions undertaken by UBS:

> "Generalising across this appeal and the other appeal heard by the tribunal, and in broad outline, the steps involved in the scheme, as HMRC saw it, were as follows …
>
> (1) The bank decided that it would give certain employees amounts by way of bonuses in addition to other earnings for the year. It was asserted by the bank that this was done in such a way that the amounts did not constitute earnings of the employees.
>
> (2) Company Z was created in an offshore jurisdiction. Company Z was not controlled by the bank.
>
> (3) A special class of shares was created in Company Z; the shares in that class ("the restricted shares") were subject to non-permanent restrictions.
>
> (4) The bank - or another company or special purpose vehicle ("SPV") - purchased the restricted shares.
>
> (5) The purchaser received the restricted shares, passing legal title to a nominee, and allocated beneficial interests in the restricted shares to the employees identified at (1) in amounts equal in value to the amounts that the bank had decided would be payable as bonuses to those employees.
>
> (6) Exemption from a charge to tax on the acquisition of the beneficial interests in the restricted shares by those employees at step (5) was asserted under s 425 of ITEPA.
>
> (7) A short while later, the restrictions were removed from the restricted shares. Exemption from a charge to tax on those employees on this event was asserted under s 429 of ITEPA.
>
> (8) A further short while later, those employees became entitled to redeem their beneficial interests in the restricted shares. Arrangements were made so that the restricted shares could be redeemed by Company Z when timely applications were made. The redemptions took place at a value that was, or was contended to be, slightly less than the price paid by the bank or SPV for the restricted shares. Many employees redeemed their restricted shares at this time.
>
> (9) Employees were entitled not to redeem their restricted shares on this occasion but, if they wished, could hold them in the scheme for the

two years necessary to mitigate a charge to capital gains tax. Some did so and then redeemed their restricted shares.

(10) A short while after the two-year period ended, the rest of the shares that were previously restricted were redeemed at the initiative of Company Z, and Company Z ceased any activity.

(11) In due course Company Z was wound up."

66. The Upper Tribunal summarised the outcome of the FTT proceedings as follows:

"[6] The FTT dismissed the bank's appeal in each case, but not for identical reasons because there were some important factual differences between the two schemes, which had been devised and implemented independently of each other and with different teams of professional advisers. In broad terms, however, the issues in each case can be grouped under three headings:

(1) First, did the employees become entitled to be paid their bonuses in money before the sums allocated to them were applied in acquiring scheme shares? If the answer to this question is yes, the bonuses were subject to income tax and NICs in the usual way, and the scheme failed because, if for no other reason, it came into operation too late: the tax and NIC liabilities which it was designed to avoid would already have been triggered, and nothing in the schemes could remove those liabilities retrospectively.

(2) Secondly, assuming the answer to the first question to be no, and also assuming the provisions of Ch 2 to be applicable, did any charge to tax arise in accordance with those provisions? In practice, this question involves consideration of two main technical issues: (a) were the scheme shares 'restricted securities' within the meaning of the definition of that term in s 423 of ITEPA? And if so, (b) were the employees entitled to exemption under s 429 for the charge to tax that would otherwise admittedly have arisen under s 426 on the happening of a chargeable event when the shares ceased to be subject to the relevant restriction? In order for the scheme to succeed, each of those questions needs to be answered in the affirmative: in other words, the shares awarded to the employees had to be 'restricted securities', and the exemption under s 429 had to be available.

(3) Thirdly, and as an alternative to (2), can it be concluded, by application of the *Ramsay* principle as it is now to be understood, that on a realistic appraisal of the facts the scheme fell outside the scope of Ch 2 altogether (rather than that the Ramsay principle affected the application of particular elements of the statutory regime)? (See *WT Ramsay Ltd v IRC, Eilbeck (Inspector of Taxes v Rawling)* [1981] STC 174, [1982] AC 300.)

[7] In the UBS appeal, the FTT answered the first question in HMRC's favour in relation to the guaranteed element of the bonuses of a small group of about ten employees, but subject thereto held that no entitlement to payment of cash bonuses had crystallised before the

scheme was set in motion. Under our second heading, the FTT held that the scheme shares were not restricted securities, with the result that the scheme failed, but (if that conclusion was wrong) that the exemption under s 429 was available; or (in other words) that, subject to the global *Ramsay* argument, the scheme would have succeeded if the shares were indeed restricted securities. However, the FTT also held that HMRC succeeded on the *Ramsay* argument, so in its view the scheme failed on both broadly purposive and more narrowly technical grounds.

[8] In the DB appeal, none of the employees had guaranteed amounts of bonus, and the FTT held, in line with its reasoning on the UBS appeal, that no entitlement to payment of bonuses had crystallised for any of the employees before the transfer of funds into the scheme. Under our second heading, the FTT held (on materially different facts from those in UBS) that the shares were restricted securities, and (again on materially different facts) that the s 429 exemption was available, so on a technical analysis the scheme succeeded. However, the FTT again held under the third head that the *Ramsay* argument succeeded, so the overall result was, once more, that the scheme failed."

67. In relation to what the Upper Tribunal termed "the money entitlement issues", it stated:

"[54] The basic question under this heading is whether any of the employees became entitled to payment of their bonuses in money *before* the sums which had been allocated to them within UBS were applied in the acquisition of, and the grant to them of beneficial interests in, the NVS. Resolution of this question does not depend on the provisions of Ch 2, but on the application to the facts of the basic charge to income tax on earnings from employment."

68. The Upper Tribunal held that to be "entitled to payment" required a present right to *present* (not future) payment:

"[61] … That question is whether the words 'entitled to payment' in Rule 2 of s 18(1) denote only a present right to present payment, or whether they are wide enough to include a right to payment in the future (which may or may not be subject to defeasance or contingencies). UBS argues for the former interpretation, while HMRC argue for the latter. Surprising though it may seem, there appears to be no direct authority on the point.

[62] In our view there are several powerful reasons which indicate that the former interpretation is correct."

69. The Upper Tribunal (reversing the FTT on this point) decided that the shares were restricted securities – in particular, that it was immaterial that any "loss" occasioned by the forfeiture provisions was covered by the hedging arrangements (at [101-109]), or that any loss could be only minimal although not negligible (at [198-199]). Further, the Upper Tribunal rejected HMRC's argument that provisions in the articles of the company which were inserted merely to circumvent certain provisions in Ch 2 should be ignored for that reason (at [150-151]).

70. That left the only matter on which HMRC might be successful as the *Ramsay* argument. The Upper Tribunal reversed the FTT on this point, stating as follows:

> "[160] The FTT then stated its conclusions (see at [139]–[140]):
>
> > *'[139] In other words, the scheme delivered all employees within it a significant gain in the actual cash bonus receivable as compared with the receipt of earnings, whatever the outturn of the scheme arrangements, although there was a possibility of an insignificant loss as between the outturns under the probable and improbable alternative outturns of the scheme. Further, if employees so chose, the timetable of the arrangements was much the same as applied to the receipt of earnings. The tribunal does not consider that, in reality, the scheme can be properly described as one providing restricted securities within the scope of Ch 2 of Pt VII [sic] of ITEPA.*
> >
> > *[140] The tribunal therefore takes the view that [UBS] fails in this appeal by reference to the application of Ch 2 of Pt 7 of ITEPA to the facts of the scheme as a whole.'*
>
> [161] With all due respect to the FTT, we are bound to say that we find its reasoning on this part of the case very difficult to follow. The FTT found (at [95]) that the NVS were real shares, some of which were held by employees for more than two years, and real dividends were paid on them. The FTT therefore accepted that the NVS were 'securities', which in that context must mean securities within the meaning of Ch 2, and said that the 'more significant question' was whether they were restricted securities. The FTT then went on to hold (wrongly, in our view) that they were not restricted securities. But if the NVS were securities within the meaning of Ch 2—and the contrary seems to us unarguable—how can it then be said that the scheme as a whole nevertheless falls outside the scope of Ch 2?
>
> [162] Unless all the FTT meant was that the securities were not restricted securities, in other words merely stating other reasons for their earlier conclusion, the only plausible basis for such a contention, in our judgment, would be if, on a realistic appraisal of the facts, the scheme was not one which provided securities (in the form of the NVS) to employees, but one which provided them with money. By virtue of ITEPA, s 420(5)(b), 'money' is excluded from the definition of 'securities' which applies for the purposes of Chs 1 to 5. We readily accept that, in an appropriate case, it might well be possible to construe 'money' in this context purposively, and to treat the exception as applying to arrangements which, viewed realistically, are no more than disguised or artificially contrived methods of paying money to employees. There is plenty of authority for applying a *Ramsay* approach (in the sense explained by Arden LJ in *Astall* to 'money in, money out' schemes of that kind: see, for example, *NMB* (payment of bonuses by the purchase and immediate sale of platinum sponge) and *DTE Financial Services Ltd v Wilson (Inspector of Taxes)* [2001] EWCA Civ 455, [2001] STC 777, 74 TC 14 (payment of bonuses through artificial trust arrangements which ended with the falling in of

a contingent reversionary interest a few days after the scheme was set in motion). However, caution is needed because everything always depends on a careful scrutiny of the particular statutory provisions in issue, and it is impossible to generalise from instances where such an analysis is appropriate to a broad proposition that any tax avoidance scheme designed to turn an otherwise taxable bonus into something else, and to leave the employee at the end of the day with money in his pocket, will necessarily fail in its object. It also needs to be remembered that the mere existence of a tax avoidance motive is, in itself, irrelevant, although it may of course throw light on matters such as the commerciality of the arrangements made, or the likelihood of pre-planned events occurring.

[163] The need for caution in attributing too broad a meaning to the 'money' exception in s 420(5)(b) is reinforced by the fact that the definition of 'securities' in s 420(1) includes debentures and other instruments creating or acknowledging indebtedness, while s 424(1)(c) makes it clear that redeemable shares are also included. Thus securities which are convertible into money, and a wide range of securities which create, evidence or secure indebtedness, plainly fall within the scope of Pt 7. Moreover, since one of the legislative purposes of Pt 7 is, as Lord Walker said in *Gray's Timber* ([2010] STC 782 at [7], [2010] 1 WLR 497 at [7]), to eliminate opportunities for unacceptable tax avoidance, including in particular Chs 3A, 3B, 3C and 3D, one naturally expects the definition of 'securities' for the purposes of (among others) those chapters to be a wide one, and the exceptions to it to be relatively narrow.

[164] Wherever the precise boundary of the 'money' exception should be drawn, it is in our opinion clear that the facts of the present case fall well outside it, and that the NVS are therefore within the definition of 'securities'. The real and enduring nature of the NVS, combined with the fact that nearly half of them were not redeemed for two years, makes it impossible to ignore them, or to regard them as a mere vehicle for the transfer of money. It is true that over half of the NVS were redeemed at the first opportunity, in March 2004, and it was plainly intended that this opportunity would be taken by those employees who would not in practice be liable to CGT on a disposal of the shares. But even in their case the shares were held for a period of almost two months, and because of the investment in UBS shares the amount received on redemption bore no necessary relation to the initial amount of the bonus. Furthermore, HMRC have never sought to argue that those employees who redeemed their shares at the first opportunity should be taxed differently from those who held their shares until 2006.

[165] A related aspect of the matter is that the sums determined by HMRC to be due from UBS, by a determination notice issued under reg 80 of the Income Tax (Pay As You Earn) Regulations 2003, SI 2003/2682 ('PAYE Regulations') on 13 October 2008, were tax on the gross amount paid by UBS into ESIP, not tax on the different amount eventually received by the employees when the NVS were redeemed. In our view there is no intellectually coherent way, in this case, of

equating the payment in by the employer with the ultimate payment out received by the employee, and the facts are resistant to any form of high-level Ramsay analysis or reconstruction. The problems for HMRC are compounded by the fact that Ch 2 contains a very detailed and prescriptive code for dealing with restricted securities, in the context of a part which had as one of its main objectives the countering of tax avoidance. Experience has shown that advantage can sometimes be taken of detailed statutory codes of this general nature in a way that is resistant to a *Ramsay* analysis, with the result that even the most artificial of tax avoidance schemes may succeed in their object. For a recent example, which also involved a chargeable event regime although in the context of life insurance policies, see the decisions of Proudman J and the Court of Appeal in *Mayes v Revenue & Customs Comrs* [2009] EWHC 2443 (Ch), [2010] STC 1, affirmed at [2011] EWCA Civ 407, [2011] STC 1269, 81 TC 247.

[166] In his oral submissions, Mr Lasok [counsel for HMRC] deployed a kaleidoscopic variety of arguments designed to persuade us, in one way or another, that the FTT's conclusion on this part of the case, if not all of the reasoning by which the FTT reached it, could and should be upheld. We admire his ingenuity, but are unpersuaded. In our judgment the FTT's conclusion was in law an impossible one, and there is no proper basis for holding that the scheme fell outside the scope of Ch 2. It follows that we would allow UBS's appeal on this ground, as well as on the restricted securities issue."

71. It was accepted that in determining (for example, in historical NIC avoidance cases) whether an asset was a "payment in kind" it was relevant to consider whether there was an intention that the asset be enjoyed as such, or instead that it be exchanged for (or becoming) cash. However, that reasoning could not be transposed to the construction of "employment-related restricted securities", which can only be ascertained by reference to the specific definitions in Part 7. There was nothing in Part 7 that connoted that the securities should be intended to be enjoyed for their own sake.

72. This had been considered by the Upper Tribunal recently in *Aberdeen*. Warren J (at [4]) summarised "the essence of the scheme" used by the taxpayer in that case as follows:

"(a) AAM established an offshore employee benefits trust ('EBT') for its employees, which was a discretionary trust with professional trustees from the Isle of Man. The beneficiaries were senior employees or directors of AAM who were to be rewarded with additional remuneration for past performance (an 'employee').

(b) Substantial funds were transferred by AAM into the EBT.

(c) An Isle of Man company (a 'company'—referred to by the tribunal as a 'money box company') with £2 share capital was created or acquired for each employee who, because of his good performance, was to be favoured. The directors of the company were professional

administrators from Jersey or the Isle of Man from the same organisation as the professional trustees.

(d) The EBT subscribed for the two shares in the company. One share was paid for at par (£1) and the other at a very substantial premium which might range from about £100,000 to nearly £2.9m (the tribunal's summary refers to a figure of 'over £1m' but the larger figures appears from the details given later in the decision).

(e) At or about the same time, a family benefits trust ('FBT') was established by the trustees of the EBT for each of the employees; the beneficiaries were the employee and his immediate family with a charitable longstop. The trustee of the FBT was a professional trustee again from the same organisation. The trust fund of the FBT was a nominal £10 provided by the EBT.

(f) The company's authorised share capital was increased by £10,000 and it then granted to the FBT an option to subscribe for 10,000 ordinary shares in the company. The existence of the option was said by AAM to dilute the value of the two original shares.

(g) One or both shares in the company were transferred to a nominee company for behoof of the employee.

(h) The option would subsist usually for a year and would then lapse without exercise. In practice, none of the early options, which were exercisable for one year, was exercised. Later options, which were granted for ten years, have not yet lapsed but none has been exercised.

(i) The employee held the beneficial interest in the company. He benefited by inter alia receiving soft loans or the use of property from the company. In this way, as the tribunal put it—

'the employee receives substantial additional financial benefits which are said to be immune from liability for PAYE and national insurance contributions. Had the employee simply been paid a cash bonus of an identical amount to the sums paid into the money box company for good performance, the bonus would have fallen within the PAYE and national insurance regimes.'

(j) The company would ultimately be stripped of its funds by one means or another. Some tax consequences might ensue depending on how this was carried through."

73. Warren J concluded:

"[10] … it is clear that the exit strategy (ie how the employee would obtain the benefits which he wanted by virtue of his ownership of the shares) was really a matter for the decision of the employee. Subject, no doubt, to the lawfulness of any request, the directors would comply with the employee's wishes. It is true that there was no arrangement that there would be a particular outcome, indeed, there was no communication between the directors of the company and the employee concerned until after transfer of the shares. But the tribunal expressly stated at [29] on p 40 of the decision that the facts, viewed realistically, show unequivocally that control was vested in the

employee who had access to the pot of money contained within the corporate money box. And at [43] on p 43 of the decision, the tribunal expressly stated that the directors would, in reality, be inevitably compelled to comply with the employee's wishes. Whether that is a finding of fact or a reflection of the powers which the employee would have as owner of the company does not, in my view, matter. The point is that, as a result of the arrangements, the employee became the owner of a company from which he could in practice extract the cash within it whenever he wished, albeit that a tax charge of one sort or another, depending on the method of extraction, might result. To use different language, it was preordained that the employee would receive 100% of the shares in a cash-rich company. It was not pre-ordained that he would use his control of the company in any particular way but how he would do so was his choice, a choice which would in practice be observed and implemented by the directors."

74. The point before the Upper Tribunal was whether HMRC had been correct to assess the employer to PAYE (on the value of the shares) instead of assessing the employees themselves. Warren J stated:

"[81] ... The purpose of the scheme was to provide a bonus to employees. It was the mechanism by which the benefit of a sum of money was to be channelled to an employee, although it failed in its aim of diluting the value of the shares, and thus of providing an actual substantial value to the employee at a diluted value for income tax purposes. The scheme was a composite transaction; the scheme itself, ending as the tribunal found with the transfer of shares, did not provide the employee with cash or money in his own bank account, but it did provide the employee with the rights of a shareholder holding 100% of the shares in a cash-rich debt-free company. As the tribunal held (see [10], above) the facts, viewed realistically, show unequivocally that control was vested in the employee who had access to the pot of money contained within the corporate money box and the directors would, in reality, be inevitably compelled to comply with the individual employee's wishes. And as I put it in that paragraph, the employee became the owner of a company from which he could in practice extract the cash within it whenever he wished, subject of course to whatever tax charge of one sort or another, depending on the method of extraction, might result.

[82] But even so, the employee had no present right to receipt of cash from the company when its shares were transferred to him. The case is different from *Garforth (Inspector of Taxes) v Newsmith Stainless Ltd* [1979] STC 129, [1979] 1 WLR 409 where the directors had an immediate right to payment (even though it might have been necessary to sue for the debt, just as it might be necessary to sue on a cheque representing payment of salary if the employer defaulted). Mr Ghosh [counsel for HMRC] says that what the employee received was as good as money. I do not agree with that. There is a difference, in my view, between an immediate right to obtain money (eg by drawing on a bank account to which salary has been credited by direct debit or cheque) and obtaining money only after the implementation of a procedure required by company law. This is not a case where it is possible to lift

> the corporate veil so as to treat the company's money as that of the employee. Nor, on the findings of fact, is this a case where the composite transaction ends up with money (in the conventional sense) in the hands of the employee (eg in his bank account). Indeed, it needs always to be remembered that the emolument in question is the shares and not the money in the company.
>
> [83] In my judgment, the transfer of shares to an employee was not a 'payment' to that employee for the purposes of s 203. The powers which he had over 'his' company did not result in his rights being 'as good as cash' as Mr Ghosh would have it or, as I would say, being able to turn what was prima facie a benefit in a form not consisting of money (ie shares) into a benefit consisting of money. The money is not unreservedly at the disposal of the employee, a condition which is, I consider, a necessary, even if not a sufficient, condition for there to be a payment within s 203 [TA 1988 – being the predecessor of the PAYE rules in Part 11 ITEPA]."

75. In the current appeals, just as in *Aberdeen*, the employees became entitled to shares in the SPV, which gave them the right to extract the cash within it whenever they wished, subject to any tax charges on such extraction. But, just as in *Aberdeen*, that did not entail that the money in the SPVs was unreservedly at the disposal of the employees. Access to the money was subject to company law procedures, which are relevant to the classification of the shares for tax purposes. It was up to the employees to do as they wished on receipt of the shares. Mr Litman decided that his SPV would trade in corporate bonds for two years, but following professional advice regarding a possible change of law he decided to wind up his SPV only a few months later. The employees of TPSS, by contrast, decided to wind up their SPVs the day after they acquired them – even in their case, however, whether they wound up their SPVs was entirely a matter for them as controlling shareholder.

76. There was no prior contractual entitlement against the employer for a money bonus. The only entitlement ever enjoyed by the employees was to a transfer of the shares in the relevant SPV. There was no entitlement to be paid a sum of money. The employee received a discretionary bonus in the form of A shares in the relevant SPV. There was a clear commercial purpose - to reward employees – although it was accepted that the employers were seeking to achieve tax advantages by giving restricted shares to the employees; that was why the arrangements had been properly reported under the (then new) DOTAS rules. What the employee received from the liquidator of SPV was dependent on his rights as shareholder, and the results of any dealings by the SPV with its own assets.

77. Mr Litman's SPV traded in securities and generated profits on which corporation tax of over £2,000 was assessed and paid. HMRC had made no attempt to explain how profits arising to and taxed on the SPV is consistent with their analysis that Tower provided Mr Litman with cash and not shares in SPV. One of the bonds held was in Bradford & Bingley and had it not been disposed of earlier, would have significantly decreased in value – that pointed to the reality of the situation. In fact, on liquidation of his SPV Mr Litman received more that the amount his employer had subscribed for the shares.

78. In *Aberdeen* Warren J (at [32]) specifically distinguished the case of *DTE*. In *DTE* the scheme was described by Jonathan Parker LJ (at [41]) as follows :

> "As I see it, viewing the matter through *Ramsay* eyes, the composite transaction in the instant case involved only three relevant stages: first, the purchase by DTE of the contingent reversionary interest; second, the assignment of that interest to Mr MacDonald; and third, the payment of the cash sum by the trustee to Mr MacDonald when the interest fell into possession."

Warren J stated:

> "[32] *DTE v Wilson*, it is to be noted, was a case where the employee ended up with cash, and was always intended to end up with cash; the composite transaction included the step of providing him with cash. That is to be contrasted with the present case where the pre-ordained series of transactions ended with the transfer of shares and only put the employee in the position of being able to obtain cash if he wanted it."

79. The current appeals could similarly be distinguished from *DTE*.

(1) The receipt of money in the hands of the employee was not pre-ordained at inception – the pre-ordained steps terminated in the acquisition by the employee of the A shares and (as in *Aberdeen*) what the employee did with those shares was a matter for them to decide.

(2) Even if the liquidation of SPV was the final step in the pre-ordained series of transactions, the correct analysis would still be that shares were awarded to the employees. In *Aberdeen* the Upper Tribunal decided that (the predecessor legislation to) ss 18, 684 & 686 applied only where there had been a payment of money, and then had to determine whether the transfer of share in that case constituted a payment of money. In the current appeals the starting point is not the mechanism under which an admitted charge to income tax is to be collected (from the employer by PAYE or instead from the employees) but whether a tax charge arises at all. The A shares fall within Ch 2 Part 7 and that is the end of the relevant analysis.

80. *Aberdeen* is clear authority that an award of shares, even in a money-box company where in practice the employees would strip the company of its funds in one way or another, is *not* a payment of money under ss 18, 684 & 686 ITEPA. In the current appeals the position of the Appellants is even stronger that that of the taxpayer in *Aberdeen*. In *Aberdeen* the shares were not restricted securities – the scheme depended on the value of the shares being severely depreciated by the existence of certain options, and that was held not to work. In the current appeals, by contrast, all the Appellants need to establish is that the shares were restricted securities, and the ultimate receipt of cash by the employee was irrelevant to that issue.

81. HMRC had not challenged the deductions taken by the employer companies for the cost of provision of the shares and, therefore, appeared to accept that the award was made for the purposes of the companies' trades.

82. If the definition of chargeable event (in s 427) had included the liquidation of SPV then HMRC would not argue that the transfer of the shares was a cash payment; they would instead argue, correctly, that the liquidation triggered taxable income by reference to the value of the shares at that time (per s 428). The only reason for HMRC pursuing its line that the award of the shares was a cash payment was simply to seek to fill what HMRC realises is a gap in the legislation – and so HMRC asks the Tribunal to apply the legislation as if a completely different transaction had occurred.

83. Little guidance could be obtained from *PA Holdings* as that case was concerned only with whether a dividend should be taxed as employment income (the old schedule E provisions) or a corporate distribution (the old schedule F provisions). The issue of separate (and mutually exclusive) employment tax regimes was not in point in *PA Holdings*. *PA Holdings* was not even cited by the Upper tribunal in *UBS*. In *PA Holdings* it was concluded that the shares were merely a method of delivering a cash bonus, rather than an enjoyment of share rights. In *PA Holdings* even after the award of shares an employee lost the right to a dividend if he ceased employment. By contrast, in the case of the Appellants the SPVs were entirely under the control of the relevant employees as soon as the shares were awarded, and anything received from the SPV was received by virtue of shareholder rights. In *PA Holdings* the amount of dividend was dictated by the employer – the amounts received by the employees did not arise from the shares but from the powers retained by the employer - whereas in the current case the amounts extracted from the SPV were decided by the employee as shareholder.

84. *Sloane Robinson* (described further at [92] below) was clearly distinguishable in that the points allocation giving rise to the bonuses was apparently decided at the start of each accounting year (see [6] to [10]), and also the liquidation decision was taken by the holder of a different class of shares to those awarded to the employees (see [18]).

Case for the Respondents

85. Mr Brennan for HMRC submitted as follows.

86. There was a tax avoidance scheme, as admitted by the Appellants. The employers wanted to pay money bonuses, and dressed up that decision so as to take advantage – if they could – of the employment-related securities legislation. The money was put into a money box company and then taken out again. Part 7 was irrelevant because there was an award of money, and the award of shares was merely a means of delivering the money. The Appellants and their advisers had confused an award of earnings with the mechanism for its delivery. The insertion of the steps that created the form of (ultimately) distributions in liquidations did not deprive the payments of their character of emoluments.

87. Ever since *Ramsay* the courts had repeatedly refused to take a step-by-step dissecting approach to the scheme undertaken. The courts had also repeatedly rejected the approach that the mere description of something as "an award of shares" should be taken at face value. In the recent case of *PA Holdings* the Court of Appeal

had considered a scheme where the employer sought to pay discretionary bonuses by adopting arrangements whereby employees who would have been paid bonuses were awarded shares and received dividends. The main issue was whether the bonus was taxable as employment income or dividend. Moses LJ explained the results of the hearings in the First-tier and Upper Tribunals as follows:

> "[23] On the basis of those facts the First-tier Tribunal concluded (see [2009] SFTD 209 at [71]) that the cash received by the employees was a profit arising from the employment because it was made in reference to the services the employee rendered by virtue of his office and was something in the nature of a reward for past, present or future services (the test applied by Upjohn J in *Hochstrasser (Inspector of Taxes) v Mayes; Jennings v Kinder (Inspector of Taxes)* (1958) 38 TC 673 at 685, [1959] Ch 22 at 33). The First-tier Tribunal also concluded that if it viewed the transactions realistically and applied the relevant statutory provisions construed purposively to those transactions, it reached the same result. First, it relied upon the fact that if any employee left employment it ceased to be eligible under the 1999 ET, even if that employee left after the close of the financial year and after PA had handed over funds to Mourant. This was designed to keep employees at PA. Second, it relied on the fact that PA had gone out of its way to 'sell' the arrangements to employees. The arrangements, the First-tier Tribunal found, were inherently part of the process of motivating and awarding employees, of which the presentations were themselves part (see at [70]). In those circumstances the First-tier Tribunal found that the payments received by the employees were emoluments. But they then continued by concluding they were also dividends or distributions within the scope of Sch F. Accordingly, they applied s 20(2) of ICTA since they thought both Sch E and Sch F were relevant. Section 20(2) required the cash received by the employees to be taxed under Sch F as dividends and not under Sch E as emoluments (see at [86] and [89]). However, absent any equivalent provision in SSCBA, since they were emoluments, they were earnings for the purposes of the SSCBA 1992 and were liable to NICs.
>
> [24] The Upper Tribunal adopted the same approach and reached the same conclusion. They concluded that the dividends fell within the meaning of dividend or distribution under s 209 of ICTA and that the inevitable consequence was that they were chargeable under Sch F and not under Sch E by virtue of the operation of s 20(2) of ICTA. They too agreed that the dividends were remuneration derived from employment for the purposes of the SSCBA."

88. Moses LJ confirmed (at [4]) that the facts must be subjected to a realistic appraisal, and stated:

> "[35] The conventional approach of the courts is to look at all the circumstances of the case in order to answer the one statutory question, namely whether the income receipts of the employee are emoluments or profits from employment …

> [37] This requires the court not to be restricted to the legal form of the source of the payment but to focus on the character of the receipt in the hands of the recipient".

89. Moses LJ stated that once the conclusion had been reached that emoluments had been paid to the employees then it was unnecessary to consider further whether the income could constitute dividend income rather than employment income:

> "[59] ... In concluding that the payments were emoluments in the hands of PA's employees, they [the First-tier Tribunal and the Upper Tribunal] hit the nail on the head. But they failed to drive it in. They concluded that the payments were emoluments by having regard to all the circumstances of the case and by looking to the substance and purpose of the payments and not to the mere form in which they were received. In reaching their conclusion, they followed a long-accepted, traditional approach to the facts. That approach enabled them, within accepted limits, to look beyond the form of distributions, mere machinery, by which the intention to pay bonuses was fulfilled.
>
> [60] Once that conclusion had been reached, there was no room whatever for any further consideration of a different schedule. If the payments were emoluments in the hands of PA's employees, they could not be dividends or distributions in the hands of those employees. Any other conclusion offends the basic principle expressed in *Salisbury House Estate Ltd v Fry* that if income falls within one schedule it cannot be taxed under another. The First-tier Tribunal and Upper Tribunal concluded that the payments were from employment, on an analysis of the facts which, as I believe, cannot be impugned. It follows that that income cannot also be charged under any other schedule, let alone Sch F."

90. The same conclusion would be reached by following a *Ramsay* approach:

> "**Viewed through *Ramsay* eyes**
>
> [66] This conclusion is sufficient to uphold the Revenue's appeal. It owes little to the Revenue's deployment of familiar anti-avoidance jurisprudence. This is not a case where it is necessary to erect any new signposts or to paint the old. But I should not overlook the application of the principles summarised by Lord Nicholls in *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2004] UKHL 51 at [32], [2005] STC 1 at [32], [2005] 1 AC 684:
>
>> '[32] The essence of the new approach was 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 …'
>
> He subsequently adopted (at [36]) the neat apothegm, often cited thereafter, of Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets Ltd* ([2003] HKCFA 46 at [35], (2004) 6 ITLR 454 at [35]):

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

> [67] The purpose of the relevant statutory provisions is to classify the income according to an appropriate and mutually exclusive schedule. In the instant appeal, viewed realistically, the payments were emoluments.
>
> [68] The insertion of the steps which created the form of dividends or distributions did not deprive the payments of their character as emoluments. The insertion had no fiscal effect because s 20, construed in its statutory context, does not charge emoluments under Sch F. The exotic attempt advanced orally by Mr Mullan [counsel for taxpayer] to classify both the award of the shares and the distributions as income and thereby raise the spectre of double-recovery fails for the same reason. The award of the shares and the declaration of the dividend were, in reality not separate steps but the process for delivery of the bonuses.
>
> [69] This is the approach which led to the conclusion that the transfer of platinum sponge to directors as a bonus was 'earnings' and not 'payments in kind' for the purposes of the Social Security (Contributions) Regulations 1979, SI 1979/591. The court looked at the substance of the transaction (see *NMB Holdings Ltd v Secretary of State for Social Security* (2000) 73 TC 85 at 125). The arrangements whereby the directors could immediately sell the platinum sponge for cash, to the bank which held the sponge, stamped the transaction as something different from 'payments in kind' exempt from the Social Security legislation (see the endorsement of the court's approach and conclusion by Lord Hoffmann in *MacNiven* [2001] STC 237 at [68], [2003] 1 AC 311 at [68]).
>
> [70] Similarly in *DTE Financial Services Ltd v Wilson (Inspector of Taxes)* [2001] EWCA Civ 455, [2001] STC 777, 74 TC 14, a composite transaction consisted of three stages, the purchase by an employer of a contingent reversionary interest in a trust fund in a sum equivalent to the intended bonus, the assignment of that interest to the employee and the payment of the cash sum by the trustee when the interest fell into possession. Viewed, as Jonathan Parker LJ put it, 'through *Ramsay* eyes', the company decided that its employee should have a £40,000 bonus and the employee got that bonus (see [2001] STC 777 at [41], 74 TC 14 at [41]). In the instant appeal PA decided that its employees should receive a bonus, Mourant identified which of the employees, from the list provided by PA, should receive a bonus and those employees received a bonus. That, to adopt the dismissive terms of Special Commissioner de Voil in *DTE*, was the beginning and end of the matter. It is, in my view, the beginning and end of these appeals."

91. The current appeals should be dismissed for the same reasons as in *PA Holdings*. The provision of the A shares in the SPVs was nothing more than the mechanism for delivery of bonuses as rewards from employment. A realistic

appraisal of the facts required rejection of any suggestion that the "award" of shares was anything other than a wrapper for the value of the bonuses. The cash received by the employees was a profit arising from the employment because it was made in reference to the services they rendered by virtue of their employment (or office) and was in the nature of a reward for past, present or future services. The rewards which the employees received were for their services as employees (or directors) during the relevant year. The process started with the decision of the employer to pay bonuses, and ended with the receipt of the bonuses ultimately in the form of distributions on winding-up of the SPVs. Where the money was deposited during the time the machinery of the scheme was operating that did not require the conclusion that the character of what came out was different from the character of what went in. If the amount that came out of the wrapper was numerically less than went in, that was just an acceptable cost of the scheme.

92. In the recent First-tier Tribunal case of *Sloane Robinson* the Tribunal had evaluated a scheme as follows:

> "[14] At that time, a scheme had already been worked out by Robson Rhodes for dealing with at least part of the remuneration for the employees for the financial year ending 28 February 2004 and, if possible, subsequent years. It involved delivering shares to the employees, subject to forfeiture in certain circumstances, for example if the employee left the company within 12 months, was in breach of any requirement imposed on him by the Financial Services Authority ('FSA'), or indeed at the absolute discretion of the directors.
>
> [15] The value of the shares would be represented by investments held by S1, and their ultimate value would depend on how the investments fared. The employees would have 'some element of certainty' however, in that a fixed dividend would be paid and only after that could the discretionary forfeiture provisions operate. The appellant would capitalise S1 and request the trustee to invest in low risk securities such as Treasury stock and other low risk investments. The plan was that S1 would be seen to operate independently of the appellant, and neither it nor the employees would retain control of the funds subscribed."

93. The Tribunal found in favour of HMRC and stated:

> "[89] The case for the application of Pt 7 of the 2003 Act was forcefully pressed by Mr Ghosh [counsel for the taxpayer], on the basis principally that the facts would admit of no other course. The case, he said, was inevitably one in which the tribunal must recognise that the employees had a distinct legal character as such and, until awarded the shareholdings they received in S1 and S2 by the appellant, they had nothing. They therefore had received shares, or a beneficial interest in shares, and must be taxed under the provisions of Pt 7 designed explicitly for such a case.
>
> [90] Although we have found that the employees were entitled to monetary amounts, and that those amounts had been credited to them in the books of the appellant before an interest in the shares of S1 and S2 arose, we must address this alternative argument on the basis that

> those findings are unable to be sustained. We look principally for guidance to the very recent decision of the Court of Appeal in *PA Holdings*. There, in a scheme a good deal more complex than that in this case, the taxpayer employer had wished to pay its employees discretionary annual bonuses. The company's employees had no contractual right to the bonuses, though a clear expectation that they would be paid in accordance with criteria which had been published to them.
>
> …
>
> [93] It is difficult to see how this case could be distinguished from *PA Holdings*. The sums eventually paid in the liquidation to the employees were, to all intents and purposes, the same sums as had been paid into the two companies by the appellant at the outset—para [35]. The employees received what they expected to receive, and from the appellant's viewpoint the bonuses had been distributed in accordance with the agreed amounts drawn down from accumulated profit in order to capitalise the companies. It is unnecessary for us to express any view on the purposes for which the provisions of Pt 7 of the 2003 Act were enacted, because it suffices to say that in these circumstances they cannot apply to a situation which is already covered by ss 18 and 686 of the Act.
>
> [94] A word should be added about the fact of the investment activity undertaken in the companies. We have recorded what actually took place - paras [29]–[31] - and it remains to evaluate it. Our assessment of the investment activity that took place was that it was essentially cosmetic, and that no significant risk was ever contemplated in regard to it."

94. The scheme followed by the current appellants was very similar. For TPSS there was a direct agreement between the two directors and the ability for each director to choose what to do with his SPV. For Tower the reasonable inference was that the amount of Mr Litman's bonus had been agreed before shares were allocated to him. For TPSS there had been no investment activity – not even a cosmetic one. For Tower the investment activity was just cash deposits with the bank or bonds with minimal risk – really a holding strategy until Mr Litman saw fit to enjoy the cash.

95. The position was the same as in the unsuccessful attempt to avoid NIC by paying bonuses in "platinum sponge" in *NMB* where Langley J stated (at 124):

> "***Inserted Steps with no Commercial Purpose*****:** It is important to note that Lord Brightman [in *Furniss v. Dawson*] made it quite plain that the fact that the overall transaction had a legitimate commercial or business purpose (in *Furniss v. Dawson* the sale of the shares, in this case the payment of a bonus) is not what this requirement is referring to. It refers to the steps inserted by which that purpose is achieved. In this case everything that was done following the decision to pay bonuses of a given cash amount was done to ensure that the amount (or very close to it) was received by the directors. But the purchase, transfer and re-purchase of the platinum sponge located in Hong Kong had no commercial or business purpose at all. Neither NMB nor the

> directors had any use for platinum sponge; it was of course chosen simply because it was a commodity to which the Regulations did not expressly apply. It also follows in my judgment that those steps had no purpose other than to avoid the payment of secondary contributions on the bonuses and cannot sensibly be described as tax mitigation. Both counsel accept that the distinction is an exclusive one and that it overlaps with the final question in Lord Brightman's formulation, but in this case there was no genuine tax loss to be realised, no genuine wish to split a freehold estate, no express reliance on a specific statutory provision of the kind in issue in *Willoughby*. What there was was a decision to pay and the actual receipt of cash bonuses with an artificial scheme created in the middle whereby the money went into and out of platinum sponge in the course of about 24 hours. Looked at as a whole, that, in my judgment, is tax avoidance not mitigation."

96. That was expressly approved by Lord Hoffmann in *McNiven* (at [68):

> "… I have no doubt that Langley J was right when he recently decided in [*NMB*] that a payment of bonuses to directors in the form of platinum sponge held in a bank, accompanied by arrangements under which they could immediately sell it for cash to the bank, was not a 'payment in kind' which fell to be disregarded for the purpose of national insurance contributions. In commercial terms the directors were paid in money. It is obvious that such a transaction was not what the Social Security (Contributions) Regulations 1979, SI 1979/591 contemplated as a payment in kind. But there can be equally little doubt that the bonuses were 'paid' and, in the absence of some contrary context, I can see no reason not to treat them as paid when the directors were credited with platinum sponge and the employer's obligation to pay them was discharged."

97. To the extent that it was necessary or desirable to consider the detail of the tax avoidance scheme followed by the Appellants, the following factors were relevant and notable:

(1) There was no element of incentivisation of the employees to work harder in the business of the SPVs - they were not working in such a business. Thus one of the purposes of the Part 7 legislation as identified by Lord Walker in *Gray's Timber Products* was not met by the scheme arrangements.

(2) Indeed, there was no such business. That was obvious in the case of the TPSS SPVs, which were wound up immediately after the shares were awarded. Tower argued that it was in a different position but there was in fact no trading by the Tower SPV. From 31 March 2004 to 27 May 2004 the entire £1 million pound funds were simply placed on Barclays 7 day deposits. On 27 May 2004 £200,000 was put into General Electric Floating Rate Notes and on 8 June 2004 £305,000 was put into Bradford & Bingley Euronotes. Those bonds were sold on 16 July 2004 at a modest and low-risk profit of £1,819. Liquidation was effected on 5 August 2004. For the last seven days the funds were again placed on deposit before being distributed by the liquidator.

(3) The restrictions on the A shares were effectively self-imposed by the directors who enjoyed the shares. They had no real effect. Forfeiture would be at 95% of market value if certain events occurred before 2009, but the scheme was never intended to run that long. The possibility of forfeiture was a fanciful contingency built in so as to allow the participants to say they were not the outright owners of a money box company – as such it should be ignored: per Lord Nicholls in *IRC v Scottish Provident Institution* [2005] STC 15:

> "[22] Thus the contingency upon which SPI rely for saying that there was no composite transaction was a part of that composite transaction; chosen not for any commercial reason but solely to enable SPI to claim that there was no composite transaction. It is true that it created a real commercial risk, but the odds were favourable enough to make it a risk which the parties were willing to accept in the interests of the scheme.
>
> [23] We think that it would destroy the value of the *Ramsay* principle of construing provisions such as s 150A(1) of the 1994 Act as referring to the effect of composite transactions if their composite effect had to be disregarded simply because the parties had deliberately included a commercially irrelevant contingency, creating an acceptable risk that the scheme might not work as planned. We would be back in the world of artificial tax schemes, now equipped with anti-*Ramsay* devices. The composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned."

(4) The reason for there being two Rule 18 lead appellants was that the Appellants had placed importance on the time that elapsed before the SPV was wound up (and the cash extracted). HMRC's opinion was that this was irrelevant but the data were that the time elapsed between award of shares and liquidation was 122 days for Tower, which was the longest period for any of the participants in the scheme; the next longest was 85 days and for eleven participants in the scheme it was seven days or less. For TPSS, it was a reasonable inference from the evidence that it had been decided to liquidate the SPVs even before the shares were awarded.

(5) Even in the case of Tower – which the Appellants seemed to regard as a "best case" – all that happened was that the SPV held the money for slightly longer than the other participants. It did not have any trade or business of investment, nor was it ever intended to do any such thing.

(6) The Appellants accept that some of the scheme documents were not created on the dates they bear. At the very least, that indicated that the participants were just going through the motions and signing documents in pursuance of a scheme.

(7) When the TPSS SPVs were liquidated the distribution in respect of the B shares, which truly belonged to the employer, was actually paid to the A shareholder employee instead. The amount was small but this further demonstrated that the participants were merely engaged in a paper exercise. The company law rights of the employer as B shareholder were just ignored.

There was never any intention for the shares to be retained, let alone for the SPV to engage in any trade.

98. *Aberdeen* concerned a different fact pattern where the funds in the money box companies were enjoyed in a number of different ways – soft loans (never repaid) and dividends, see [8(g)] of *Aberdeen* – whereas in the current appeals it was always intended that the funds would be extracted by a tax-free liquidation dividend – that was precisely the way the tax advantage in the scheme was planned to be obtained.

99. The scheme involved in *UBS* was considerably more complicated and sophisticated than that followed by the Appellants – the scheme in the current case was simply money-in-money-out, and *UBS* explicitly acknowledged that such schemes were amenable to a *Ramsay* approach – see *UBS* at [162].

100. In relation to establishing the date of payment, this was governed by s 18 and s 686. Accordingly, although it may have been earlier, Rules 2 and 3 (as defined in those provisions) had the effect that the very latest date at which the payments fell into charge (for the purposes of income tax, PAYE and NIC) was the date on which the employer awarded the shares and in so doing undertook the commitment to operate the (relevant) share scheme in favour of the employee.

101. The suggestion that the PAYE system could not apply to HMRC's analysis of the bonuses was addressed in *DTE*. Jonathan Parker LJ summarised the scheme used in that case:

> "[16] According to a minute of a board meeting held on or before Wednesday 19 April 1995 (the precise date is not material) the three directors 'contemplated'—without, of course, deciding—that DTE would pay them each a bonus of £40,000. On 19 April 1995 DTE provided the operator of the scheme with all the details necessary to set the scheme machinery in motion in relation to each of the three directors. On Monday 24 April 1995 the requisite contingent reversionary interest was created. The following day, Tuesday 25 April 1995, DTE took an assignment of the interest for a consideration of £40,600 (the additional £600 representing the fee payable by DTE for entering into the scheme). Next day, Wednesday 26 April 1995, DTE assigned the interest on to Mr MacDonald. On Friday 28 April 1995 the interest fell into possession and a sum of £40,000 was duly remitted to Mr MacDonald's bank account.
>
> [17] DTE's accounts for the year ended 30 April 1995 record, with admirable candour: 'Bonus payments were made in the form of assignments of interests in Offshore Trusts.'"

102. Jonathan Parker LJ concluded in relation to PAYE:

> "[42] So far as the *Ramsay* issue is concerned, therefore, the only question (to my mind) is whether it is legitimate to apply the *Ramsay* principle—or, if one prefers, adopt a *Ramsay* approach—to the concept of 'payment' in the context of the statutory provisions relating to PAYE. In my judgment it plainly is. I accept Mr Glick's [counsel for HMRC's] submission that in the context of the PAYE system the

concept of payment is a practical, commercial concept. In some statutory contexts the concept of payment may (as Lord Hoffmann pointed out in *MacNiven*) include the discharge of the employer's obligation to the employee, but for the purposes of the PAYE system payment in my judgment ordinarily means actual payment: ie a transfer of cash or its equivalent.

[43] Nor can I accept Mr Thornhill's [counsel for the taxpayer's] submission that to apply the *Ramsay* principle to the PAYE system will inevitably introduce confusion and uncertainty into the statutory code. The true position, as I see it, is that for those employers who operate the PAYE system in a straightforward manner, and who do not resort to the complexities of tax avoidance schemes, there will be neither confusion nor uncertainty; whereas for those employers who choose to operate such schemes the effect of applying the *Ramsay* principle is to restore the certainty which the legislature intended.

[44] In my judgment, therefore, the cash payment received by Mr MacDonald was a payment of assessable income within the meaning of s 203(1) of the 1988 Act. …"

Findings of Fact

103. We make the following findings of fact from the evidence we received. Not all those findings may be relevant to the approach we take to the determination of the appeals but they may be important if a higher court or tribunal considers matters. This Tribunal is the final determiner of matters of fact and we consider it appropriate that our factual findings are comprehensive, especially as these appeals (as Rule 18 lead cases) are likely to go further on onward appeal.

104. None of the employees (ie Messrs Litman, Coombs or Thorne) had any contractual right to a bonus – that is to say, all the bonuses were discretionary.

(1) We received no evidence that there were any contractual bonus rights; we were told that Mr Coombs and Mr Thorne have no written contracts of employment.

(2) The letters of engagement between BR and the two employer companies both referred to "discretionary bonuses", as did the BR advice letters (10 February 2004 re Tower and 21 September 2004 re TPSS).

105. Both Appellants had surplus cash and took advice from BR on the manner in which funds could be extracted, and the tax consequences thereof. BR proposed the scheme, being a discretionary bonus in the form of an award of shares in a money box SPV which would later be liquidated and distribute the cash to the employee. The Appellants decided to adopt the scheme and then followed it through as advised.

(1) Both Tower and TPSS had surplus cash reserves. Mr Coombs and Mr Thorne could have decided to extract cash from TPSS by way of a dividend to themselves and/or their wives (as "B" shareholders in TPSS) or instead pay bonuses to themselves as employees, or perhaps some other legitimate manner of

cash extraction (eg pension contributions). In the case of Tower, dividends would have routed cash away (in part) from Mr Litman but there was still the possibility of bonuses or pension contributions. That is a financial and fiscal decision faced by every successful SME on a regular basis. Having taken professional advice from BR, they in fact decided to extract the cash by using the scheme proposed to them by BR. The scheme then swung into action.

(2) The advice letter from BR to Tower dated 10 February 2004 states:

> "Dear Bernard
>
> **Proposed Bonus Payments**
>
> I am writing, as promised, following our recent meeting at which we discussed the various ways in which your company could provide discretionary bonus payments to the directors and certain senior employees."

The letter goes on to explain the tax consequences (deductibility to the employer, and PAYE and NIC liabilities) of cash bonuses and "non-cash bonuses"; it then focuses on the scheme, summarising tax counsel's opinion and giving certain health warnings, and sets out BR's fee basis. We find that by the time this letter was provided to Mr Litman the decision had already been reached that the scheme would be implemented, because of its expected tax efficiency. First, the letter is accompanied by an engagement letter for execution which, although it refers to "suitable methods for providing discretionary bonuses to [Tower's] directors and employees", is specifically tailored to the scheme – for example, the fee quoted is explained (in the advice letter) to be geared to the expected tax savings from the scheme. Secondly, when TPSS decide to use the scheme (over seven months later) exactly the same advice letter and engagement letter are sent by BR; we mean no criticism of BR for that but it does point to the use of a generic letter, rather than one tailored to the individual client's position, and thus we do not accept the implication which might be drawn from the wording of the letter that any cash extraction methods other than the scheme were really being contemplated after BR put the scheme to their client.

106. The scheme was a marketed tax avoidance scheme.

We deal briefly with the point concerning the incorrect dating of some of the scheme documentation. We accept the witnesses' evidence that they were told not to date the documents and they interpreted that instruction as meaning that where documents were already dated then they should not amend those dates. We consider nothing turns on that matter, except that we concur with HMRC that it demonstrates the participants processing pre-prepared standard form scheme documents rather than exercising any independent judgment on the contents thereof.

107. The scheme had no commercial purpose, other than the intended obtaining of a tax advantage.

(1) We consider that obvious in the case of TPSS; the money went into and out of the SPVs almost immediately and there was no commercial reason for bouncing the cash through the SPVs.

(2) On Tower, we do not accept that there was any commercial merit in placing the cash in a SPV where it could be held and invested for a period of time; the fact that income arose through interest from the deposits does not alter this conclusion. The true reason why that was done was for the tax advantages that were expected from that course of action, as detailed in our further findings below.

108. The only purpose of the inclusion of the forfeiture provisions in the articles of the SPVs was to ensure the "A" shares qualified as restricted securities for the purposes of s 423.

We do not accept the assertions by the witnesses that the provision in the SPV articles that an employee could be required to dispose of his shares at 95% of their value, had any commercial purpose. We acknowledge that an *effect* of the forfeiture provisions was to reduce slightly the value of the A shares in certain circumstances connected with the employee leaving, but we do not accept that employee retention was a *purpose* of those provisions – they were included solely to ensure that the A shares constituted restricted securities under the Part 7 legislation. The discount of only 5% would be an ineffective deterrent; the employees in both appeals were effectively the long-term owner-manager or owner-managers of the respective employer companies and so very unlikely even to consider leaving; and the advice letters from BR are transparent that the provision is driven by the requirements of s 423 (even down to the detail of the five year limit in s 425).

109. It was intended from the outset that the SPVs would be liquidated at the earliest time compatible with the technical requirements of the scheme.

(1) In the case of the TPSS SPVs, the liquidator had already been selected by BR and was, in effect, on standby to wind-up the SPVs. Mr Coombs stated in his oral evidence that when he instructed the transfer of the money to his SPV on 28 September 2004 it was already his intention to wind-up the company the next day.

(2) Mr Litman in his oral evidence stated that it was possible that he would continue to use his SPV as an investment or trading vehicle for the future. We do not accept that was ever his intention. One important reason why we have no difficulty reaching this conclusion is that this was, of course, the "magic ingredient" in the tax planning scheme: a liquidation of the SPV (and consequent distribution of cash to the employee shareholder) did not constitute a chargeable event under s 427. We consider it fanciful (and thus untenable) that Mr Litman really intended to take his money box company forward to do anything other than effect a winding-up as soon as the scheme allowed the cash to be extracted. It is true that the SPV invested its cash in the sense of placing it on deposit with Tower's bank, and it also did buy a couple of bonds that were sold shortly after acquisition. But those minimal investment activities were motivated solely by the

anticipated availability of CGT business asset taper relief (see our findings at [110] below) and that required a two year activity period. Both Mr Litman and Mr Woods were candid that the liquidation was eventually accelerated (despite the CGT disadvantage) because there was a risk of legislative change that might derail the scheme, and so the cash was then stripped out as soon as possible.

110. The only reason for the holding and investment of the cash by the SPV was to attempt to qualify for CGT business asset taper relief on the liquidation of the SPV.

(1) In the case of TPSS the cash was never in the SPVs long enough to be invested. Both Mr Coombs and Mr Thorne in their witness statements confirmed that it was not their intention to run the SPVs as investment or trading companies.

(2) The funds were held by the Tower SPV for some weeks, during which time they were mainly on rolling deposits with the bank and for a few days were partly invested in two bonds. We are satisfied that the reason for this investment activity was not any commercial motivation (although inevitably some interest was earned), nor even related to the income tax and NIC objectives of the scheme. Instead this was steered purely by the CGT analysis of the scheme by the advisers. In their letter to Mr Litman dated 10 February 2004 BR advised, "Tax counsel favours [SPV] having a trade of dealing in investments because he is of the view that if the law is changed so that the deemed base cost of the shares in [SPV] for CGT purposes is reduced (presumably to nil), 50% of the gain arising on the liquidation proceeds would then be tax free under the rules concerning business asset taper relief …". That was also why Mr Litman ran his SPV as he did – to quote from his witness statement, "… it was advisable that the shares that would be transferred to me would be in a TradeCo that trades over a two year period following the acquisition in order to ensure that any gain on the shares on liquidation would be subject to full business asset taper relief."

111. Although as a matter of company law the bonuses had to be approved by the shareholders and directors of the employer, in fact there was no realistic possibility of any outcome other than that the bonuses would be paid exactly as detailed in the scheme documentation prepared in advance for each employer.

(1) In the case of TPSS everything was under the control of Mr Coombs and Mr Thorne. We do not accept Mr Coombs' statement that there was a possibility of he and Mr Thorne deciding at the last moment not to vote through the scheme transactions as envisaged by the documentation drafted for them by BR. From initial advice to liquidation all events took place during September 2004; the time from the formal advice letter to liquidation was just eight days. Everything proceeded exactly as planned from the outset.

(2) The factual position on Tower is more complicated. Mr Litman's oral evidence was that matters had to be decided by the shareholders in general meeting and a board meeting of directors. We accept that is, of course, the formal legal position but having carefully considered all the evidence we find as fact there was no realistic possibility of any outcome other than the approval of a bonus to Mr Litman alone, comprising all the "A" shares in the SPV. All the necessary detailed documentation had been supplied by BR in advance and that

was, we find, not done just in case the bonus was voted, or even because that was the likely outcome, but because the voting of the bonus was the only realistic outcome. We do not accept that it was a realistic possibility that, having put one million pounds into the SPV a few days previously, Tower might be left holding that money box company for the future if the EGM and board meeting did not vote a bonus for Mr Litman. We find that the intention from the outset was that all the "A" shares in the SPV would be awarded to Mr Litman in pursuance of the scheme. We do not accept Mr Litman's evidence that at the meetings with the other members of his family they might have decided to award a bonus to any other employee – the only other employee who could conceivably be in the frame was Mr Gallacher who had never previously been paid a bonus, and whose main method of remuneration was through a parallel trading partnership arrangement. Further, the money was already earmarked for the bonus for Mr Litman – on 30 March 2004 BR wrote to Mr Litman:

> "Dear Bernard
>
> BONUS ARRANGEMENTS
>
> I gather that the bank account of [SPV] has now been opened and that the money, namely £1,000,001 in respect of Tower Radio Limited's subscription for shares in that company has been transferred.
>
> As you know, the plan is for the 1,000,000 "A" ordinary £1 voting shares in [SPV] to be transferred to you as discretionary bonuses for the years to 30 April 2003 and 2004. To achieve this, the shareholders of Tower Radio Limited need to give approval to the transfer of the company's assets to a director under s 320 Companies Act 1985 and the directors of Tower Radio Limited need to hold Board Meetings to vote the bonuses. In this regard, I attach the following:"

That letter then explains the enclosed documentation prepared for execution, including board minutes, EGM minutes, stock transfer form and new share certificate. It is true that the letter includes in several places the phrase "if you are happy with the terms of these proposed minutes, …" but taken as a whole the letter clearly puts forward the scheme documentation for execution on the basis that the bonus belongs to Mr Litman – the letter even goes into the detail of explaining that the 2003 bonus will be tax deductible in the 2004 accounts of the employer rather than the 2003 accounts, but that carry-back relief should be available. The clear evidence of Mr Woods was that a large number of shelf companies was used for participants in the scheme, in part because where a client was to use the scheme for more than one employee then separate companies would be used for each employee. That is exactly what happened with TPSS – each of Mr Coombs and Mr Thorne received the A shares in their own SPV (E147 and E148). For Tower there was only one SPV because it was intended all along that Mr Litman (alone) would receive the A shares. If it had been possible that other employees (for example, Mr Gallacher) might receive bonuses then further SPVs would have been taken off the shelf in advance for use for those employees, and BR would have expanded or duplicated the scheme documentation prepared in advance so as to accommodate those extra SPVs – as BR did in the case of TPSS. We find there was no real question that

the A shares in the SPV might go to anyone other than Mr Litman; nor that his fellow family shareholders/directors might vote against his bonus. Everything proceeded exactly as planned from the outset.

Consideration and conclusions

Approach Adopted

112. The matters for us to determine are those stipulated in the Rule 18 direction (see [1] above):

> "Whether the sums or benefits received by officers or employees pursuant to arrangements registered as Disclosed Tax Scheme 54003391 and adopted by the Lead Case Appellants and others during the tax years 2003-04 and/or 2004-05 are:
>
> (a) chargeable to income tax as employment income, and, if so, as PAYE income; and/or
>
> (b) constitute earnings liable for National Insurance Contributions."

113. HMRC's position for issuing the disputed assessments is, to quote from their statement of case:

> (a) "[The employer] company decided to pay a money bonus to the relevant employee. There was no intention to reward him with shares, otherwise than in order to obtain a tax and NIC advantage by appearing to do so while in fact providing him with a reward of money.
>
> (b) Reading the statutory provisions purposively, and applying them to the transactions viewed realistically, ... the bonus was one paid in money and … ITEPA Part 7 Ch 2 is simply irrelevant.
>
> (c) In any event, once the decision was taken to award the relevant individual a bonus, PAYE became payable at that time, by virtue of the timing provisions in ITEPA s 18 and s 686 Rules 2 and/or 3(a), (b) and/or (c). What was done thereafter, by way of awarding shares in the SPV and then winding it up, was irrelevant to the incidence of PAYE and NIC"

114. We are grateful to both leading counsel for their presentations of the issues. In particular, for dealing expertly with the decision of the Upper Tribunal in *UBS* which was released only the day before our hearing of the current appeals. *UBS* considers, in depth, certain tax planning arrangements designed to avoid income tax and NIC on share awards to employees. HMRC place considerable weight on the Court of Appeal decision (which we understand is not to be the subject of any onward appeal) in *PA Holdings*. Unfortunately, *UBS* does not discuss *PA Holdings*, although Mr Brennan (on instructions) informed us that the authority was cited to the Upper Tribunal.

115. Having considered all the relevant authorities and the submissions of both sides, we consider the best approach for us to take is to address in turn what the Upper Tribunal in *UBS* (at [6]) identified as the three relevant issues:

(1) First, what the Upper Tribunal called (as shall we) **The Money Entitlement Issue** – "did the employees become entitled to be paid their bonuses in money before the sums allocated to them were applied in acquiring scheme shares? If the answer to this question is yes, the bonuses were subject to income tax and NICs in the usual way, and the scheme failed because, if for no other reason, it came into operation too late: the tax and NIC liabilities which it was designed to avoid would already have been triggered, and nothing in the schemes could remove those liabilities retrospectively."

(2) Secondly, what we shall call **The ITEPA Issue** – "assuming the answer to the first question to be no, and also assuming the provisions of Ch 2 to be applicable, did any charge to tax arise in accordance with those provisions?". In *UBS* this was subdivided into a number of sub-issues; in the current appeals we do likewise but (because of the detail of the tax planning scheme adopted) specify them differently as:

(a) Should the forfeiture provision in the SPV articles be disregarded?

(b) If the answer to (a) is No, were the relevant shares "restricted securities" within s 423?

(3) Thirdly, and as an alternative to (2), what the Upper Tribunal called (as shall we) **The Broad *Ramsay* Issue** – "can it be concluded, by application of the *Ramsay* principle as it is now to be understood, that on a realistic appraisal of the facts the scheme fell outside the scope of Ch 2 altogether (rather than that the *Ramsay* principle affected the application of particular elements of the statutory regime)?"

116. Before addressing those issues, we summarise the outcomes on each in *UBS*. In that case there were two taxpayers: UBS itself and a member of the Deutsche Bank group. For UBS itself the First-tier Tribunal answered the three issues: (1) No (except for ten employees); (2) Yes; (3) Yes. The Upper Tribunal upheld (1) except that it also included the ten employees; upheld (2); but reversed the decision on (3). For DB the First-tier Tribunal answered the three issues: (1) No; (2) No; (3) Yes. The Upper Tribunal upheld (1) but reversed the decision on (2) and (3). We understand leave has been granted in both cases to appeal to the Court of Appeal.

The Money Entitlement Issue

117. In *UBS* the Upper Tribunal stated :

> "[54] The basic question under this heading is whether any of the employees became entitled to payment of their bonuses in money *before* the sums which had been allocated to them within UBS were applied in the acquisition of, and the grant to them of beneficial interests in, the [award shares]. Resolution of this question does not depend on the provisions of Ch 2, but on the application to the facts of the basic charge to income tax on earnings from employment.
>
> …

> [61] At the heart of this part of the case is a question of construction … That question is whether the words 'entitled to payment' in Rule 2 of s 18(1) denote only a present right to present payment, or whether they are wide enough to include a right to payment in the future (which may or may not be subject to defeasance or contingencies). UBS argues for the former interpretation, while HMRC argue for the latter. Surprising though it may seem, there appears to be no direct authority on the point.
>
> [62] In our view there are several powerful reasons which indicate that the former interpretation is correct."

118. The Upper Tribunal then (at [63] to [70]) set out its rationale for that conclusion, which we do not repeat here as for our purposes we are bound to follow their conclusion (at [70]) – that to be "entitled to payment" (for the purposes of Rule 2 s 18) requires a present right to present payment, not merely a right to payment in the future.

119. On the facts in *UBS* the Upper Tribunal found that none of the employees of either appellant enjoyed a present right to present payment of a money bonus before the share awards were made. As already noted, that finding involved a reversal of the First-tier Tribunal's conclusion on ten UBS employees who had guaranteed amounts of bonuses. The Upper Tribunal's reasoning was:

> "[71] … Even on the most favourable view of the facts from HMRC's perspective, we do not think it can be said that any of the relevant employees, including those with guaranteed minimum bonuses, became entitled to immediate payment of the sums which UBS decided to award to them on 23 January 2004. Quite apart from the fact that no information about the awards was communicated to the employees at that stage, their only contractual right under their contracts of employment, even after the amount of their bonuses had been privately determined by UBS, was to have it paid to them on or around the February pay day. At best, therefore, it was a right to a future payment, which would not mature into a taxable receipt for income tax and PAYE purposes unless and until it became immediately payable. That never happened, because by prior agreement with the employees who had applied to participate in the scheme, the relevant parts of their bonuses were applied by UBS in the purchase of NVS [ie the award shares] and the conferral of beneficial interests in those shares on the employees. The shares were admittedly earnings from the employees' employment with UBS, but they were non-monetary earnings, and by virtue of s 19(4) they were treated as received at the time when the benefit was provided, that is to say on 29 January 2004.
>
> [72] In relation to the 416-odd employees who had no guaranteed minimum bonus, the finding by the FTT (see [2010] SFTD 1257 at [73]) that they 'were not entitled to, or to be paid, their bonuses until the February pay day' is in our judgment unassailable. In relation to the handful of employees with a guaranteed minimum bonus, the FTT considered that their entitlement to the minimum amount made all the difference, because they had an enforceable right to be paid that sum. However, it is clear from the sample contract of employment which

was considered by the FTT, and extracts from which they quoted, that the cash element of the award, including the guaranteed minimum amount, would be paid after deduction of tax 'in or about February following the calendar year specified in the awards'. In our view this must be understood as a reference to the February pay day, and there is no ground for supposing that the right to immediate payment of the bonus, or any part of it, would accrue earlier for the employees in this category than it would for those without a guaranteed minimum. Furthermore, there is a logical difficulty in the view which the FTT appears to have adopted that the right to be paid the guaranteed minimum did not accrue until 23 January 2004. Since the guarantee was provided when the contract of employment was entered into, the contractual right to future payment of the guaranteed minimum must have accrued at that date, even if the right was liable to be defeated on the happening of certain conditions (for example if the employee was dismissed for misconduct). At the date when the contract was entered into, the right was on any view a right to payment in the future, and on the construction which we would place on Rule 2 there would be no taxable receipt of it before the future pay day when it was actually paid. We are satisfied, therefore, that the FTT fell into error in holding that the relevant employees received the guaranteed minimum amounts of their bonuses on 23 January 2004.

[73] We should add that Mr Lasok [counsel for HMRC] advanced a number of further arguments to the general effect that, whatever the original contractual arrangements may have been between UBS and the employees who participated in the ESIP scheme, their contracts must have been varied (whether expressly or by necessary implication) in such a way as to confer a right to immediate payment of the part of their bonuses which was applied by UBS in the purchase of NVS. Only on such a footing, submitted Mr Lasok, could UBS have applied the relevant sums on the employees' behalf. We do not consider it necessary to review these arguments in any detail, however, because we consider that they all suffer from the same fallacy. We are unable to see any necessity, either legal or factual, for the bonuses to have become immediately payable to the employees before UBS could apply them in the purchase of the NVS. It was enough that UBS had decided what amounts it would award to each employee before the scheme was set in motion. There was no need for the employees to have first acquired the right to have the relevant parts of their bonuses paid to them in money, and in our view there is nothing in the scheme documentation which brought about such a result.

[74] For all these reasons, we conclude that there was no receipt of money earnings by any of the employees, including those with guaranteed minimum bonuses, before the scheme was set in motion."

120. For completeness, a similar conclusion with the same outcome was reached in relation to the DB employees, at [190] to [193].

121. In the current case, we have made a finding of fact (see [104] above) that none of the employees had any contractual right to a bonus – that is to say, all the bonuses were discretionary.

122. So far we have, as it were, trodden the same path as the Upper Tribunal in *UBS* and, on the facts of the current case, we conclude that none of the employees (ie Messrs Litman, Coombs or Thorne) enjoyed a present right to present payment of a money bonus before the share awards were made. That was the end of the path for the Upper Tribunal in *UBS* but in the current case HMRC set considerable store by the Court of Appeal decision in *PA Holdings*. As already mentioned, *UBS* does not discuss *PA Holdings.*

123. The avoidance scheme in *PA Holdings* (see [7] to [20]) may be summarised as:

(1) Existing employee benefit trust incorporates SPV.

(2) Employer contributes cash to trust, and trustees transfer funds (as capital contribution) to SPV.

(3) Employer hands list of proposed bonuses to trustees.

(4) Trustees award shares in SPV to employees (largely but not entirely as set out on the list). The shares are subject to forfeiture rights (extending to any dividends thereon) if the employee leaves the employment before a stated date.

(5) SPV declares dividend (effectively all the cash put in at (2) above).

124. The anticipated fiscal advantages were (see [1]): "the cash the employees received as dividend income is subject to the Sch F rates and not to the basic or higher rates. Additionally, … there is no liability to make national insurance contributions ('NICs') in respect of these payments."

125. Moses LJ stated:

> "[2] Both the First-tier Tribunal and the Upper Tribunal were agreed that the income the employees received was from their employment (see [2009] UKFTT 95 (TC), [2009] SFTD 209 and [2010] UKUT 251 (TCC), [2010] STC 2343 respectively). But both also agreed that, because that income was received in the form of dividends, the provisions of Sch F and s 20(2) of the Income and Corporation Taxes Act 1988 ('ICTA') dictated the conclusion that the income had to be taxed as dividends or distributions under Sch F and could not be charged as emoluments under Sch E. Since there was no equivalent to s 20(2) in the Social Security Contributions and Benefits Act 1992 ('SSCBA'), the finding that the income was from employment meant that the payments were 'earnings' for the purposes of the SSCBA and thus liable to NICs.
>
> [3] HMRC ('the Revenue') appeal against the decision of the Upper Tribunal, contending that the dividends were in reality bonuses and liable to be taxed under Sch E; Sch F and s 20(2) do not apply. PA contends, as an additional ground for upholding the decision, that the dividend income was not from employment. PA also appeals against the decision that the payments received in the form of dividends were 'earnings' for the purposes of SSCBA on the same basis: that the income was not from employment."

126. The point which the Court of Appeal (like the lower tribunals) was called upon to decide was whether the dividends paid by the SPV to the employees were remuneration from their employments. The Court of Appeal (like the lower tribunals) decided they were remuneration. The lower tribunals had then gone on to consider whether s 20(2) ICTA ("… no distribution which is chargeable under Schedule F shall be chargeable under any other provision of the Income Tax Acts …" (unfortunately incorrectly quoted at [27] of the Court of Appeal decision)) resulted in the dividends being Schedule F (rather than Schedule E) income. However, the Court of Appeal firmly stated (at [59] to [60]) that was unnecessary – having concluded that the dividends were emoluments from employment in the hands of the employees,

> "… there was no room whatever for any further consideration of a different schedule. If the payments were emoluments in the hands of PA's employees, they could not be dividends or distributions in the hands of those employees. Any other conclusion offends the basic principle expressed in *Salisbury House Estate Ltd v Fry* that if income falls within one schedule it cannot be taxed under another. The First-tier Tribunal and Upper Tribunal concluded that the payments were from employment, on an analysis of the facts which, as I believe, cannot be impugned. It follows that that income cannot also be charged under any other schedule, let alone Sch F."

127. We reiterate that the point for decision in *PA Holdings* was *whether the dividends paid by the SPV to the employees* were remuneration from their employments. That is not the issue before us in the current case. HMRC do not contend that the distributions paid by the liquidators of the SPVs to the "A" shareholders are remuneration; instead the contention is that the award of the "A" shares by the employer to the employee was a money bonus. In *PA Holdings* the taxpayer accepted that the award of the shares was an emolument (albeit a tax exempt one) and the only dispute concerned the subsequent dividends:

> "[32] PA Holdings contends that the source of payments transferred by Juris [the trustees' nominee] to the persons beneficially entitled to them was their beneficial interest in the shares. *The shares, and not the dividends, were emoluments and exempt from charge by virtue of s 140A, ICTA. Section 140A(3) exempts from tax chargeable under Sch E an employee's acquisition of a conditional interest in shares (provided that the employee's interest ceases to be conditional within five years from acquisition).* The source of the dividends received by the employees was the shares and they received them in their capacity as shareholders and not as employees." [emphasis added]

128. For completeness, that last point is also contained in the First-tier Tribunal decision ([2009] SFTD 209) at [59] and the Upper Tribunal decision ([2010] STC 2343) at [23]. The First-tier Tribunal decision also records (*ibid*) that HMRC agreed that the share awards were exempt under s 140A ICTA because the shares were "conditional shares". That exemption (as rewritten) is now in s 425 ITEPA, which gives the tax exemption on acquisition of restricted securities – which is, of course, a key component of the BR scheme adopted by the Appellants.

129. Thus we consider that the point addressed by *PA Holdings* is distinct from that put to us in this case. In *PA Holdings* the parties were agreed that – to use ITEPA terminology – the share awards were restricted securities within Ch 2 Part 7; the dispute was about the tax treatment of the dividends subsequently declared on those shares. Accordingly we do not consider that *PA Holdings* assists us in the current case. That returns us to where we were at [122] above before turning to look at *PA Holdings*, which was that none of the employees (ie Messrs Litman, Coombs or Thorne) enjoyed a present right to present payment of a money bonus before the share awards were made.

130. For those reasons we find in favour of the Appellants on The Money Entitlement Issue.

The ITEPA Issue

Should the forfeiture provision in the SPV articles be disregarded?

131.We have made a finding of fact that the only purpose of the inclusion of the forfeiture provisions in the articles of the SPVs was to ensure the "A" shares qualified as restricted securities for the purposes of s 423 (see [108] above). Does that mean one should disregard the forfeiture provision? If so then the shares would, we consider, no longer qualify as restricted securities under s 423.

132. A similar argument was advanced by HMRC in *UBS*, where the Upper Tribunal called it "the 'sham' argument". Mr Brennan for HMRC in the current hearing did not use the word "sham" but he submitted that the restrictions on the A shares were effectively self-imposed by the directors who enjoyed the shares, and had no real effect. In *UBS* the Upper Tribunal described the point put to them as follows (at [134]):

> "HMRC have a separate and largely self-contained argument based on the contention that art 2(15) of the Articles of ESIP is an artificial device which was never intended to have legal effect, and that it should therefore be disregarded. If that contention is correct, it is common ground that … the exemption in s 429 of ITEPA would accordingly be unavailable."

133. The conclusion of the Upper Tribunal was:

> "[150] In this statutory context, we ask ourselves whether it is possible, as a matter of construction of s 416(2)(b) and (c), to disregard art 2(15) on the ground that it was deliberately designed to circumvent those provisions in a way that would have been commercially unacceptable to UBS had ESIP in fact gone into liquidation while the shares were owned by UBS, and which was in practice acceptable to UBS only because the possibility of a liquidation occurring during that period was so remote that it could safely be ignored.
>
> [151] The argument is tempting, but with some regret we do not think we can yield to it. There is a clear distinction between the rights

> attaching to the NVS [ie the award shares], which is a question of law to be determined by construction of the articles, on the one hand, and the likelihood of the happening of an event which would bring those rights into play, on the other hand. The sheer improbability of a liquidation occurring during UBS's period of ownership of the shares cannot, in itself, be a reason for construing art 2(15) as if it meant the opposite of what it says, or for ignoring it altogether—particularly where such a liquidation is required to be supposed by s 416 itself. Furthermore, since art 2(15) is expressed to apply at any time when the NVS are beneficially owned by UBS or another group company, there can be no basis for disregarding it for the purposes of s 416 merely because the period of ownership was (and was always intended to be) very short. During that period, the inescapable fact is that the NVS were beneficially owned by UBS and nobody else; and the rights which attached to the NVS were those in art 2(15), not those in art 2(7)–(14). Application of s 416(2) to this state of affairs produces the result that UBS did not control ESIP, and in agreement with the FTT we would so hold."

134. We reach a similar conclusion to the Upper Tribunal; the forfeiture clause was deliberately designed to circumvent an income tax charge by manoeuvring into the exemption afforded by s 425, on the basis that the shares met the requirements of s 423 (we consider that last point in the next section). Also, the likelihood of the clause being triggered was improbable. However, we do not feel able to conclude that the provision should be read to mean anything other than what it says, nor simply to ignore its existence.

135. The matter of the forfeiture clause remains, however, relevant in the context of a *Ramsay* approach, which we consider as the third issue (below).

Were the relevant shares "restricted securities" within s 423?

136. This was a point of extensive contention in *UBS* (see [84] *et seq*) because there UBS had implemented an ingenious hedging arrangement which meant that although the share rights contained a "forced sale" provision at less than market value – so making (UBS argued) the shares "restricted securities" within s 423 – the hedge would ensure the employee actually suffered no "loss" in the event of a forced sale. That point does not arise in the current case.

137. Having decided (above) that the forfeiture provision in the SPV articles cannot be disregarded, we consider that we can dispose of this point quickly. In our opinion the forfeiture clause in the SPV's articles of association (described at [26] above) does constitute an arrangement or condition which makes provision for a forfeiture as described in s 423(2) such that the market value of the shares is less than it would be but for that provision. HMRC made no argument to the contrary. Thus the "A" shares in the SPV do constitute "restricted securities" as defined in s 423.

138. For the above reasons we find in favour of the Appellants on The ITEPA Issue.

The Broad <u>Ramsay</u> Issue

139. We adopt the statement by Mummery LJ in *Mayes*:

> "[71] … I very much doubt whether, since [*Barclays Mercantile Business Finance Ltd v*] *Mawson*, it really is necessary to return each time to the base camp in *Ramsay* and trek through all the authorities from then on. For practical purposes, it should, in general, be possible to start from the position stated in the unanimous report of the Appellate Committee in *Mawson* at [26]–[42] under the heading 'The *Ramsay* principle.' *Mawson* was obviously meant to be a significant judicial stocktaking of the 'new approach' to the construction of revenue statutes first applied in *Ramsay* and followed subsequent cases on the *Ramsay* principle. The stated aim in the report delivered by Lord Nicholls was to 'achieve some clarity about basic principles' whilst recognising realistically that it is no doubt (see [2005] STC 1 at [27], [2005] 1 AC 684 at [27])—
>
> > '… too much to expect that any exposition will remove all difficulties in the application of the principles because it is in the nature of questions of construction that there will be borderline cases about which people have different views …'
>
> [72] I would prefer to incorporate, rather than replicate, in this judgment all that follows that passage in *Mawson*. The House of Lords has already unanimously decided and clarified in *Mawson* the important point of principle raised by HMRC in this appeal, ie the scope of application of the *Ramsay* principle. A summary of the key paragraphs in *Mawson*, which themselves are a summary of the legal position in the light of the previous case law, could not begin to do full justice to the authoritative text of the Committee's report and might give rise to the kind of further doubts that the Appellate Committee wished to dispel by their guidance. The principle is now clearer, but, as this case shows, the difficulties in its application and the scope for different conclusions remain and are probably irremovable by any legitimate judicial process."

140. In the passage referred to by Mummery LJ, Lord Nicholls (at [36]) quoted the words of Ribeiro PJ in *CSR v Arrowtown Assets Ltd* (2004) 6 ITLR 454 at [35] (in *PA Holdings* Moses LJ described it (at [66]) as a "neat apothegm"):

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

"The relevant statutory provisions, construed purposively"

141. Part 7 relates to "special rules about cases where securities … are acquired in connection with an employment" (s 417(1)). The Part 7 legislation was construed purposively by Lord Walker in *Gray's Timber Products* (at [4] onwards). His exact words are quoted at [62] above but we précis the "three different, and to some extent conflicting, legislative purposes" which he identified:

(1) It is good for the economy, and for social cohesion, for employees to own shares in the company for which they work. Various forms of incentive schemes are therefore encouraged by favourable tax treatment.

(2) If arrangements of this sort are to act as effective long-term incentives, the benefits which they confer have to be made contingent, in one way or another, on satisfactory performance. The principle of taxing an employee as soon as he receives a right or opportunity which might or might not prove valuable to him, depending on future events, is an uncertain exercise which might turn out to be unfair either to the employee or to the public purse. In many cases the only satisfactory solution is to wait and see, and to charge tax on some "chargeable event" either instead of, or in addition to, a charge on the employee's original acquisition of rights.

(3) The third legislative purpose is to eliminate opportunities for unacceptable tax avoidance. Much of the complication of the provisions in Pt 7 is directed to counteracting artificial tax avoidance.

"The transaction, viewed realistically."

142. From our findings of fact above we consider the realistic view of the transactions is as follows.

143. All the elements of the transaction were components of a tax avoidance scheme that had no commercial purpose (other than the intended obtaining of a tax advantage). The forfeiture provision in the SPV articles had no commercial purpose and was inserted solely for tax avoidance reasons. From inception it was intended that all the "A" shares in the SPV would be awarded to the pre-designated employee. From inception it was intended that the money box SPV would be liquidated, and the cash distributed to the pre-designated employee, at the earliest time compatible with the technical requirements of the scheme. Any investment activity by the SPV during its short life was solely for tax avoidance purposes.

144. Our view is that the scheme was a composite transaction consisting of a series of steps that began with the decision to use the BR scheme and ended with the receipt of the liquidation distributions by the employee.

"Viewed through Ramsay eyes"

145. The recent case of *Aberdeen* also examined a scheme involving the award to employees of shares in money box companies. We would summarise the scheme used by Aberdeen as follows:

(1) Employer establishes an employee benefit trust and settles funds on trustees.

(2) Trustees incorporate a number of SPVs, one for each employee eligible for a bonus, and contribute cash to each SPV.

(3) Trustees also settle a number of subtrusts, again one for each employee eligible for a bonus.

(4) Each SPV grants a share option to one of the subtrusts.

(5) Trustees appoint SPV shares to (nominee for) employee.

(6) Share option lapses without exercise.

(7) SPV makes soft loan of cash to employee.

5 146. The plan was that the value of the shares awarded at step (5) was negligible because it was diluted by the existence of the share option. That was rejected by the First-tier Tribunal and not appealed to the Upper Tribunal; the issue on appeal was solely whether the tax charge on the emolument was a liability of the employer (under PAYE) or instead the employee (see [5]). However, we have found the analysis of 10 the scheme - or rather the commentary on the First-tier Tribunal's analysis of the scheme - by the Upper Tribunal (Warren J) very useful in our consideration of the current case.

147. Warren J (at [4]) described the position of the transaction after our step (6) as:

> "(i) The employee held the beneficial interest in the company. He 15 benefited by inter alia receiving soft loans or the use of property from the company. …
>
> (j) The company would ultimately be stripped of its funds by one means or another."

148. Warren J (at [8(i)]) described the First-tier Tribunal's conclusion on a *Ramsay* 20 approach to the transaction:

> "In their discussion of the *Ramsay* issue (see *WT Ramsay Ltd v IRC* [1981] STC 174, [1982] AC 300), the tribunal expressed the conclusion, at [27] on p 39 of the decision, that—
>
> > 'it is reasonably clear on the facts found that there was a composite 25 transaction consisting of a series of steps which began with the establishment and transfer of money into the EBT and *ended with the transfer of the shares to the employees.* Thereafter, a variety of financial arrangements and transactions could and indeed did take place'. (Mr Prosser's [counsel for taxpayer's] emphasis added.)
>
> 30 In other words, unlike in other tax avoidance cases, such as *DTE Financial Services Ltd v Wilson (Inspector of Taxes)* [2001] EWCA Civ 455, [2001] STC 777, 74 TC 14, the transfer of the shares did not form part of a composite transaction which ended with a payment of money, unless the share transfer of itself was, or was to be treated as, a 35 payment of money."

149. Warren J stated (emphasis added):

> "[10] ... Reading the decision as a whole, it is clear that the exit strategy (ie how the employee would obtain the benefits which he wanted by virtue of his ownership of the shares) was really a matter for 40 the decision of the employee. Subject, no doubt, to the lawfulness of any request, the directors would comply with the employee's wishes. It is true that there was no arrangement that there would be a particular

> outcome, indeed, there was no communication between the directors of the company and the employee concerned until after transfer of the shares. But the tribunal expressly stated at [29] on p 40 of the decision that the facts, viewed realistically, show unequivocally that control was vested in the employee who had access to the pot of money contained within the corporate money box. And at [43] on p 43 of the decision, the tribunal expressly stated that the directors would, in reality, be inevitably compelled to comply with the employee's wishes. Whether that is a finding of fact or a reflection of the powers which the employee would have as owner of the company does not, in my view, matter. The point is that, as a result of the arrangements, the employee became the owner of a company from which he could in practice extract the cash within it whenever he wished, albeit that a tax charge of one sort or another, depending on the method of extraction, might result. To use different language*, it was preordained that the employee would receive 100% of the shares in a cash-rich company. It was not pre-ordained that he would use his control of the company in any particular way* but how he would do so was his choice, a choice which would in practice be observed and implemented by the directors."

150. Warren J (at [12]) identified the issues before him:

> "(a) Whether the employee in reality receives a payment of money (the *Ramsay* Issue)?
>
> (b) Whether the employee should be regarded as receiving money, being the money owned by the company, when he acquired shares in the company on the basis that the money owned by the company was unreservedly at the disposal of the employee (the cash box issue).
>
> (c) Whether the shares were readily convertible assets as defined in the relevant legislation (the PAYE issue)."

151. Warren J took the first two issues together, as they "overlap to a very great extent as does my discussion of them" (at [17]). He confirmed (at [15]):

> "… the guidance in *BMBF v Mawson* required the tribunal to identify the relevant transaction to which the tax legislation was to be applied and that this involved the tribunal in considering the relevant documents and the relevant evidence as to the intentions held by the parties."

152. Returning to the First-tier Tribunal's conclusion in *Aberdeen* (see [148] above), in the current case we have reached a different conclusion on the transaction "viewed through *Ramsay* eyes". Unlike the Tribunal in *Aberdeen* which explicitly found that the "composite transaction … ended with the transfer of the shares to the employees", we have found that the composite transaction ended with the receipt of cash (the inevitable liquidation distribution) by the employee.

153. Following from the First-tier Tribunal's conclusion Warren J stated (emphasis added):

> "[81] … The purpose of the scheme was to provide a bonus to employees. It was the mechanism by which the benefit of a sum of

money was to be channelled to an employee, although it failed in its aim of diluting the value of the shares, and thus of providing an actual substantial value to the employee at a diluted value for income tax purposes. The scheme was a composite transaction; *the scheme itself, ending as the tribunal found with the transfer of shares, did not provide the employee with cash or money in his own bank account*, but it did provide the employee with the rights of a shareholder holding 100% of the shares in a cash-rich debt-free company. As the tribunal held (see [10], above) the facts, viewed realistically, show unequivocally that control was vested in the employee who had access to the pot of money contained within the corporate money box and the directors would, in reality, be inevitably compelled to comply with the individual employee's wishes. And as I put it in that paragraph, the employee became the owner of a company from which he could in practice extract the cash within it whenever he wished, subject of course to whatever tax charge of one sort or another, depending on the method of extraction, might result.

[82] But even so, the employee had no present right to receipt of cash from the company when its shares were transferred to him. The case is different from *Garforth (Inspector of Taxes) v Newsmith Stainless Ltd* [1979] STC 129, [1979] 1 WLR 409 where the directors had an immediate right to payment (even though it might have been necessary to sue for the debt, just as it might be necessary to sue on a cheque representing payment of salary if the employer defaulted). Mr Ghosh [counsel for HMRC] says that what the employee received was as good as money. I do not agree with that. There is a difference, in my view, between an immediate right to obtain money (eg by drawing on a bank account to which salary has been credited by direct debit or cheque) and obtaining money only after the implementation of a procedure required by company law. This is not a case where it is possible to lift the corporate veil so as to treat the company's money as that of the employee. Nor, on the findings of fact, is this a case where the composite transaction ends up with money (in the conventional sense) in the hands of the employee (eg in his bank account). Indeed, it needs always to be remembered that the emolument in question is the shares and not the money in the company.

[83] In my judgment, the transfer of shares to an employee was not a 'payment' to that employee for the purposes of s 203. The powers which he had over 'his' company did not result in his rights being 'as good as cash' as Mr Ghosh would have it or, as I would say, being able to turn what was prima facie a benefit in a form not consisting of money (ie shares) into a benefit consisting of money. The money is not unreservedly at the disposal of the employee, a condition which is, I consider, a necessary, even if not a sufficient, condition for there to be a payment within s 203."

154. Our finding in the current case, as already stated, is that the scheme did not end until it provided the employee with cash. The scheme is, therefore, distinguishable from that considered in *Aberdeen*. In *Aberdeen* the end point of the scheme was (the First-tier Tribunal found) the holding of the money box SPV shares by the employee, who could do what he wished with the SPV and its cash (subject to company law

formalities). In the current case the end point of the scheme was the liquidator's cash distribution to the employee, which (as we have found) was preordained from the inception of the scheme and was inevitable (not least because it was the "magic ingredient" of the scheme).

155. Thus we distinguish the current case from *Aberdeen*. We also consider the current case should be distinguished (in relation to this *Ramsay* issue) from *UBS*.

156. In *UBS*, as stated at [116] above, the First-tier Tribunal decided the *Ramsay* issue against both UBS and DB, but the Upper Tribunal reversed that decision for both taxpayers. The conclusion of the First-tier Tribunal was (at [139] to [140]):

> "[139] In other words, the scheme delivered all employees within it a significant gain in the actual cash bonus receivable as compared with the receipt of earnings, whatever the outturn of the scheme arrangements, although there was a possibility of an insignificant loss as between the outturns under the probable and improbable alternative outturns of the scheme. Further, if employees so chose, the timetable of the arrangements was much the same as applied to the receipt of earnings. The tribunal does not consider that, in reality, the scheme can be properly described as one providing restricted securities within the scope of Ch 2 of Pt VII [ie 7] of ITEPA.
>
> [140] The tribunal therefore takes the view that [UBS] fails in this appeal by reference to the application of Ch 2 of Pt 7 of ITEPA to the facts of the scheme as a whole."

157. The Upper Tribunal criticised that conclusion, saying:

> "[161] With all due respect to the FTT, we are bound to say that we find its reasoning on this part of the case very difficult to follow. The FTT found (at [95]) that the NVS were real shares, some of which were held by employees for more than two years, and real dividends were paid on them. The FTT therefore accepted that the NVS were 'securities', which in that context must mean securities within the meaning of Ch 2, and said that the 'more significant question' was whether they were restricted securities. The FTT then went on to hold (wrongly, in our view) that they were not restricted securities. But if the NVS were securities within the meaning of Ch 2—and the contrary seems to us unarguable—how can it then be said that the scheme as a whole nevertheless falls outside the scope of Ch 2?
>
> [162] Unless all the FTT meant was that the securities were not restricted securities, in other words merely stating other reasons for their earlier conclusion, the only plausible basis for such a contention, in our judgment, would be if, on a realistic appraisal of the facts, the scheme was not one which provided securities (in the form of the NVS) to employees, but one which provided them with money."

158. Before quoting further from the Upper Tribunal's decision, we comment on some significant differences between the fact patterns in *UBS* and the current case.

(1) In *UBS* the two schemes each involved several hundred employees of multinational financial services companies. The employer had a sophisticated remuneration structure, operated by a compensation committee. The employer's human resources department considered the tax planning scheme and explained it, via extensive brochures, to the large number of employees eligible to participate in the scheme. Employees who might be favoured with a bonus were free to choose (or perhaps more accurately, express a preference) to take a cash bonus instead of participating in the scheme (although that would be less tax advantageous to them, as well as to the bank employer). The process of awarding bonuses to employees was formalised and independent of the employees. Employees were, in effect, told, any bonus is discretionary and not yet decided but *if* you were to be rewarded then in what *form* would you like the bonus to be – shares or cash? (see, for example, [174] of *UBS*).

(2) In the current appeals, by contrast, there is a very close identity between the employers and their respective employees. It was, in effect, the employees who made the decision to implement the scheme proposed by BR. The only aim was to extract the surplus cash from the employer company. The fact that the scheme used shares of an SPV was, we consider, irrelevant to the employees – if the scheme had instead involved, say, platinum sponge or defeased trust interests then provided BR had advised that it would put the surplus cash into the hands of the employees in a tax efficient manner, the employees would have adopted it. The only rationale for the SPV was to put money in and then strip it out again as soon as possible thereafter.

159. Returning to the Upper Tribunal's consideration in *UBS*, they continued:

> "[162] … By virtue of ITEPA, s 420(5)(b), 'money' is excluded from the definition of 'securities' which applies for the purposes of Chs 1 to 5. We readily accept that, in an appropriate case, it might well be possible to construe 'money' in this context purposively, and to treat the exception as applying to arrangements which, viewed realistically, are no more than disguised or artificially contrived methods of paying money to employees. There is plenty of authority for applying a *Ramsay* approach (in the sense explained by Arden LJ in *Astall[])]* to 'money in, money out' schemes of that kind: see, for example, *NMB Holdings Ltd v Secretary of State for Social Security* (2000) 73 TC 85 (payment of bonuses by the purchase and immediate sale of platinum sponge) and *DTE Financial Services Ltd v Wilson (Inspector of Taxes)* [2001] EWCA Civ 455, [2001] STC 777, 74 TC 14 (payment of bonuses through artificial trust arrangements which ended with the falling in of a contingent reversionary interest a few days after the scheme was set in motion). However, caution is needed because everything always depends on a careful scrutiny of the particular statutory provisions in issue, and it is impossible to generalise from instances where such an analysis is appropriate to a broad proposition that any tax avoidance scheme designed to turn an otherwise taxable bonus into something else, and to leave the employee at the end of the day with money in his pocket, will necessarily fail in its object. It also needs to be remembered that the mere existence of a tax avoidance motive is, in itself, irrelevant, although it may of course throw light on

> matters such as the commerciality of the arrangements made, or the likelihood of pre-planned events occurring.
>
> [163] The need for caution in attributing too broad a meaning to the 'money' exception in s 420(5)(b) is reinforced by the fact that the definition of 'securities' in s 420(1) includes debentures and other instruments creating or acknowledging indebtedness, while s 424(1)(c) makes it clear that redeemable shares are also included. Thus securities which are convertible into money, and a wide range of securities which create, evidence or secure indebtedness, plainly fall within the scope of Pt 7. Moreover, since one of the legislative purposes of Pt 7 is, as Lord Walker said in *Gray's Timber* ([2010] STC 782 at [7], [2010] 1 WLR 497 at [7]), to eliminate opportunities for unacceptable tax avoidance, including in particular Chs 3A, 3B, 3C and 3D, one naturally expects the definition of 'securities' for the purposes of (among others) those chapters to be a wide one, and the exceptions to it to be relatively narrow.
>
> [164] Wherever the precise boundary of the 'money' exception should be drawn, it is in our opinion clear that the facts of the present case fall well outside it, and that the NVS are therefore within the definition of 'securities'. The real and enduring nature of the NVS, combined with the fact that nearly half of them were not redeemed for two years, makes it impossible to ignore them, or to regard them as a mere vehicle for the transfer of money. It is true that over half of the NVS were redeemed at the first opportunity, in March 2004, and it was plainly intended that this opportunity would be taken by those employees who would not in practice be liable to CGT on a disposal of the shares. But even in their case the shares were held for a period of almost two months, and because of the investment in UBS shares the amount received on redemption bore no necessary relation to the initial amount of the bonus. Furthermore, HMRC have never sought to argue that those employees who redeemed their shares at the first opportunity should be taxed differently from those who held their shares until 2006."

160.To answer Ribeiro PJ's "ultimate question", we find it inconceivable that Part 7 as construed purposively by Lord Walker was intended to apply to the realistic view of the transaction. Taking each of Lord Walker's three identified purposes in turn:

(1) None of the employees worked for the relevant SPV and no good for the economy (or social cohesion) came through their ownership of the "A" shares;

(2) There was no long-term incentive, effective or otherwise – the TPSS SPVs were being wound up almost before they received the cash and the Tower SPV was folded as soon as it was feared that the tax advantages of the scheme might be prejudiced by legislative amendment; and

(3) The scheme is a clear example of "unacceptable" and "artificial" tax avoidance.

161. Lord Nicholls (in *BMBF v Mawson* at [38]) emphasised "the need to focus carefully upon the particular statutory provision and to identify its requirements

before one can decide whether … elements inserted for the purpose of tax avoidance should be disregarded or treated as irrelevant for the purposes of the statute."

162. Having, courtesy of Lord Walker, identified the requirements of Part 7 we find no difficulty in deciding that the following elements of the transaction were inserted for the purpose of tax avoidance should be disregarded or treated as irrelevant for the purposes of Part 7:

(1) The incorporation of the SPVs;

(2) The inclusion of the forfeiture clause in the articles of the SPV;

(3) The award of the "A" shares to the employee;

(4) The investment activities of the Tower SPV; and

(5) The liquidation of the SPV and subsequent distributions by the liquidator.

163. We find that, on the facts as we have found them in the current case, we do not need to consider the detail of s 420(5)(b) or the other minutiae of Part 7. The scheme followed by the Appellants is a blatant example of what the Upper Tribunal called a "money in, money out" arrangement. If insolvency law and banking practice had permitted then we have no doubt the TPSS SPVs would have paid their cash to Messrs Coombs and Thorne the day after it was received from the employer. If Mr Litman had been satisfied with the expected income tax and NIC benefits rather than also seeking the CGT BPR benefit then, again, the cash would have come out to him almost as soon as it went into the SPV. The employer's surplus cash was just bounced through the SPV to the employee, and everything else was merely paper-shuffling. The fact that (to use Moses LJ's phrase in *PA Holdings*) the "process for delivery" of the cash, or (to use Warren J's phrase in *Aberdeen*) the "mechanism by which the benefit of a sum of money was to be channelled to an employee", happened to involve securities should not, we consider, sidetrack us into the detailed provisions of Part 7. That would put the cart before the horse – the "disregarded elements" include everything to do with those securities (incorporation, issue, transfer, and liquidation) and the result is that, viewed through *Ramsay* eyes, the securities are disregarded. In *UBS* the Upper Tribunal on the facts in that case considered it needed to respect the existence of the restricted securities and thus apply Part 7 to them. That cannot be a general approach to be applied regardless of the facts of the individual case before the Tribunal – otherwise any planning device, even the most (to borrow Lord Walker's terminology) "unacceptable" and "artificial", that happened to include employee-related securities would be immune from the *Ramsay* approach, which is clearly not the case.

164. Having disregarded all those elements listed at [162] above taken together, we find the only coherent analysis of the transaction is that the surplus cash of the employer was paid to the relevant employees.

165. Accordingly, we find for the Respondents on The Broad *Ramsay* Issue.

166.We should briefly mention the First-tier Tribunal decision in *Sloane Robinson* as that was cited to us, and make two points. First, the Tribunal there clearly considered

the matter before them was disposed of by the decision *in PA Holdings*; we have (at [127-129] above) explained why we consider *PA Holdings* does not assist us in this case. Second, that Tribunal did not have the benefit of the views of the Upper Tribunal as set out in *UBS*.

Consequences of the application of the Ramsay approach

167. What are the consequences for the Appellants of the recharacterisation of the transaction?

168. Mr Goodfellow pointed out that adopting a *Ramsay* approach would produce several fiscal anomalies: Mr Litman had actually received (slightly) more cash (from the liquidator) than the amount HMRC said was assessable earnings; the SPV had paid corporation tax on its profits arising from use of the cash that HMRC said had really gone straight to Mr Litman; how could Part 7 operate (eg the reporting and elective procedures) if the award of shares was really assessable earnings?; indeed, how could the PAYE system operate in those circumstances? We acknowledge those difficulties but in our view they are merely the inevitable consequences of a recharacterisation of a transaction – whether that recharacterisation results from a *Ramsay* approach or a misunderstanding by the participants of the true nature of the transaction. Where under a *Ramsay* approach a transaction is to be reanalysed in the light of (to use *BMBF v Mawson* terminology) disregarded elements then the higher courts – so far as we are aware – have been reluctant to stipulate how all the practical effects of that reanalysis (for example, the formalities in the tax code concerning time limits for issuing assessments or making claims) should be accommodated. But that does not mean the recharacterisation cannot or does not take place. Jonathan Parker LJ tackled that directly in *DTE* (quoted at [102] above) regarding the effect of the *Ramsay* approach on PAYE events, and concluded:

> "The true position, as I see it, is that for those employers who operate the PAYE system in a straightforward manner, and who do not resort to the complexities of tax avoidance schemes, there will be neither confusion nor uncertainty; whereas for those employers who choose to operate such schemes the effect of applying the *Ramsay* principle is to restore the certainty which the legislature intended."

169. We note that Warren J in *Aberdeen* undertook a detailed analysis of the application of the PAYE system to the scheme used by the taxpayer in that case (at [84] onwards) but we have already (at [155-156] above), for the reasons stated there, distinguished *Aberdeen* from the current case.

Decision

170. The answer to the specified Rule 18 common or related issues (see [1] above) is that the sums or benefits received by officers or employees pursuant to arrangements registered as Disclosed Tax Scheme 54003391 and adopted by the Lead Case Appellants and others during the tax years 2003-04 and/or 2004-05 are chargeable to income tax as employment income and as PAYE income; and also constitute earnings liable for National Insurance Contributions.

171. The appeals of both Appellants are DISMISSED.

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

PETER KEMPSTER
TRIBUNAL JUDGE

RELEASE DATE: 11 July 2013

APPENDIX

Relevant Legislation

5 173. Unless otherwise stated, all statutory references are to the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"). Legislation is cited as in force at the relevant times.

174. Section 62 gives the general definition of "earnings" (and this definition is adopted for PAYE purposes by reg 2 Income Tax (PAYE) Regulations 2003 (SI 10 2003/2682)):

> "62 **Earnings**
>
> (1) This section explains what is meant by "earnings" in the employment income Parts.
>
> (2) In those Parts "earnings", in relation to an employment, means—
>
> 15 (*a*) any salary, wages or fee,
>
> (*b*) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or
>
> (*c*) anything else that constitutes an emolument of the employment.
>
> (3) For the purposes of subsection (2) "money's worth" means 20 something that is—
>
> (*a*) of direct monetary value to the employee, or
>
> (*b*) capable of being converted into money or something of direct monetary value to the employee.
>
> (4) Subsection (1) does not affect the operation of statutory provisions 25 that provide for amounts to be treated as earnings (and see section 721(7))."

175. Part 7 makes special provisions in relation to securities, and includes the following provisions.

30 176. Section 420 gives the general definition of "securities" and includes "shares in any body corporate (wherever incorporated)". Section 421B defines "employment-related securities" as "securities … acquired by a person where the right or opportunity to acquire the securities … is available by reason of an employment of that person …".

35 177. Section 423 defines "restricted securities":

> "423 **"Restricted securities" and "restricted interest in securities"**
>
> (1) For the purposes of this Chapter employment-related securities are restricted securities or a restricted interest in securities if—

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(a) there is any contract, agreement, arrangement or condition which makes provision to which any of subsections (2) to (4) applies, and

(b) the market value of the employment-related securities is less than it would be but for that provision.

(2) This subsection applies to provision under which—

(a) there will be a transfer, reversion or forfeiture of the employment-related securities, or (if the employment-related securities are an interest in securities) of the interest or the securities, if certain circumstances arise or do not arise,

(b) as a result of the transfer, reversion or forfeiture the person by whom the employment-related securities are held will cease to be beneficially entitled to the employment-related securities, and

(c) that person will not be entitled on the transfer, reversion or forfeiture to receive in respect of the employment-related securities an amount of at least their market value (determined as if there were no provision for transfer, reversion or forfeiture) at the time of the transfer, reversion or forfeiture.

(3) This subsection applies to provision under which there is a restriction on—

(a) the freedom of the person by whom the employment-related securities are held to dispose of the employment-related securities or proceeds of their sale,

(b) the right of that person to retain the employment-related securities or proceeds of their sale, or

(c) any other right conferred by the employment-related securities,

(not being provision to which subsection (2) applies).

(4) This subsection applies to provision under which the disposal or retention of the employment-related securities, or the exercise of a right conferred by the employment-related securities, may result in a disadvantage to—

(a) the person by whom the employment-related securities are held,

(b) the employee (if not the person by whom they are held), or

(c) any person connected with the person by whom they are held or with the employee,

(not being provision to which subsection (2) or (3) applies)."

178. Sections 425-427 govern chargeability:

"425 **No charge in respect of acquisition in certain cases**

(1) Subsection (2) applies if the employment-related securities—

(a) are restricted securities, or a restricted interest in securities, by virtue of subsection (2) of section 423 (provision for transfer, reversion or forfeiture) at the time of the acquisition, and

(b) will cease to be restricted securities, or a restricted interest in securities, by virtue of that subsection within 5 years after the acquisition (whether or not they may remain restricted securities or a restricted interest in securities by virtue of the application of subsection (3) or (4) of that section).

(2) No liability to income tax arises in respect of the acquisition, except as provided by—

(a) Chapter 3 of this Part (acquisition by conversion),

(b) Chapter 3C of this Part (acquisition for less than market value), or

(c) Chapter 5 of this Part (acquisition pursuant to securities option).

(3) But the employer and the employee may elect that subsection (2) is not to apply to the employment-related securities.

(4) An election under subsection (3)—

(a) is to be made by agreement by the employer and the employee, and

(b) is irrevocable.

(5) Such an agreement—

(a) must be made in a form approved by the Board of Inland Revenue, and

(b) may not be made more than 14 days after the acquisition.

426 **Charge on occurrence of chargeable event**

(1) If a chargeable event occurs in relation to the employment-related securities, the taxable amount counts as employment income of the employee for the relevant tax year.

(2) For this purpose—

(a) "chargeable event" has the meaning given by section 427,

(b) "the taxable amount" is the amount determined under section 428, and

(c) "the relevant tax year" is the tax year in which the chargeable event occurs.

(3) Relief may be available under section 428A (relief for secondary Class 1 contributions met by employee) against an amount counting as employment income under this section.

(5) This section is subject to section 429 (case outside charge under this section).

427 **Chargeable events**

(1) This section applies for the purposes of section 426 (charge on occurrence of chargeable event).

(2) Any of the events mentioned in subsection (3) is a "chargeable event" in relation to the employment-related securities.

(3) The events are—

(a) the employment-related securities ceasing to be restricted securities, or a restricted interest in securities, in circumstances in which an associated person is beneficially entitled to the employment-related securities after the event,

(b) the variation of any restriction relating to the employment-related securities in such circumstances (without the employment-related securities ceasing to be restricted securities or a restricted interest in securities), and

(c) the disposal for consideration of the employment-related securities, or any interest in them, by an associated person otherwise than to another associated person (at a time when they are still restricted securities or a restricted interest in securities).

(4) For the purposes of this Chapter there is a variation of a restriction relating to the employment-related securities if any restriction in relation to them is removed or varied."

179. Section 431 governs disapplication elections:

"431 **Election for full or partial disapplication of this Chapter**

(1) The employer and the employee may elect in relation to employment-related securities which are restricted securities or a restricted interest in securities that—

(a) for the relevant tax purposes their market value at the time of the acquisition is to be calculated as if they were not, and

(b) sections 425 to 430 are not to apply to the employment-related securities.

(2) Or the employer and the employee may elect in relation to employment-related securities which are restricted securities or a restricted interest in securities that—

(a) for the relevant tax purposes their market value at the time of the acquisition is to be calculated, and

(b) sections 425 to 430 are to apply to the employment-related securities,

as if any specified restriction did not apply to the employment-related securities.

(3) For the purposes of subsections (1) and (2) "the relevant tax purposes" are—

(a) determining any amount that is to constitute earnings from the employment under Chapter 1 of Part 3 (earnings),

(b) determining the amount of any gain realised on the occurrence of an event that is a chargeable event by virtue of section 439(3)(a) (conversion),

(c) operating Chapter 3C of this Part (acquisition of securities for less than market value), and

(d) determining any amount that counts as employment income of the employee under Chapter 5 of this Part (securities acquired pursuant to securities option).

(4) An election under this section—

(a) is to be made by agreement by the employer and the employee, and

(b) is irrevocable.

(5) Such an agreement—

(a) must be made in a form approved by the Board of Inland Revenue, and

(b) may not be made more than 14 days after the acquisition."

180. Although not in force at the times relevant to the current appeals, we note that Finance (No 2) Act 2005 inserted a new s 431B with effect in relation to securities acquired after 2 December 2004:

"431B **Securities acquired for purpose of avoidance**

Where employment-related securities are restricted securities or a restricted interest in securities, the employer and the employee are to be treated as making an election under section 431(1) in relation to the employment-related securities if the main purpose (or one of the main purposes) of the arrangements under which the right or opportunity to acquire the employment-related securities is made available is the avoidance of tax or national insurance contributions."

181. The general PAYE provisions are given by s 683(1) & (2):

"683 **PAYE income**

(1) For the purposes of this Act and any other enactment (whenever passed) "PAYE income" for a tax year consists of—

(*a*) any PAYE employment income for the year,

(*b*) any PAYE pension income for the year, and

(*c*) any PAYE social security income for the year.

(2) "PAYE employment income" for a tax year means income which consists of—

(*a*) any taxable earnings from an employment in the year (determined in accordance with section 10(2)), and

(*b*) any taxable specific income from an employment for the year (determined in accordance with section 10(3)).”

182. The definitions of “receipt” and “payment” are given by s 18 and, for the purposes of PAYE, s 686:

“18 **Receipt of money earnings**

(1) General earnings consisting of money are to be treated for the purposes of this Chapter as received at the earliest of the following times—

Rule 1

The time when payment is made of or on account of the earnings.

Rule 2

The time when a person becomes entitled to payment of or on account of the earnings.

Rule 3

If the employee is a director of a company and the earnings are from employment with the company (whether or not as director), whichever is the earliest of—

(a) the time when sums on account of the earnings are credited in the company's accounts or records (whether or not there is any restriction on the right to draw the sums);

(b) if the amount of the earnings for a period is determined by the end of the period, the time when the period ends;

(c) if the amount of the earnings for a period is not determined until after the period has ended, the time when the amount is determined.

(2) Rule 3 applies if the employee is a director of the company at any time in the tax year in which the time mentioned falls.

(3) In this section “director” means—

(a) in relation to a company whose affairs are managed by a board of directors or similar body, a member of that body,

(b) in relation to a company whose affairs are managed by a single director or similar person, that director or person, and

(c) in relation to a company whose affairs are managed by the members themselves, a member of the company,

and includes any person in accordance with whose directions or instructions the directors of the company (as defined above) are accustomed to act.

(4) For the purposes of subsection (3) a person is not to be regarded as a person in accordance with whose directions or instructions the directors of the company are accustomed to act merely because the directors act on advice given by that person in a professional capacity.

(5) Where this section applies—

(a) to a payment on account of general earnings, or

(b) to sums on account of general earnings,

it so applies for the purpose of determining the time when an amount of general earnings corresponding to the amount of that payment or those sums is to be treated as received for the purposes of this Chapter."

"686 **Meaning of "payment"**

(1) For the purposes of PAYE regulations, a payment of, or on account of, PAYE income of a person is treated as made at the earliest of the following times—

Rule 1

The time when the payment is made.

Rule 2

The time when the person becomes entitled to the payment.

Rule 3

If the person is a director of a company and the income is income from employment with the company (whether or not as director), whichever is the earliest of—

(a) the time when sums on account of the income are credited in the company's accounts or records (whether or not there is any restriction on the right to draw the sums);

(b) if the amount of the income for a period is determined before the period ends, the time when the period ends;

(c) if the amount of the income for a period is not determined until after the period has ended, the time when the amount is determined.

(2) Rule 3 applies if the person is a director of the company at any time in the tax year in which the time mentioned falls.

(3) In this section "director" means—

(a) in relation to a company whose affairs are managed by a board of directors or similar body, a member of that board or body,

(b) in relation to a company whose affairs are managed by a single director or other person, that director or person, and

(c) in relation to a company whose affairs are managed by the members themselves, a member of the company,

and includes any person in accordance with whose directions or instructions the company's directors (as defined above) are accustomed to act.

(4) For the purposes of subsection (3) a person is not regarded as a person in accordance with whose directions or instructions the

company's directors are accustomed to act merely because the directors act on advice given by that person in a professional capacity."

183. In relation to NIC, the Social Security Contributions and Benefits Act 1992 s 3 defines "earnings" and s 6 gives the liability for Class 1 contributions:

"3 **"Earnings" and "earner"**

(1) In this Part of this Act and Parts II to V below—

(*a*) "earnings" includes any remuneration or profit derived from an employment; and

(*b*) "earner" shall be construed accordingly.

(2) For the purposes of this Part of this Act and of Parts II to V below other than those of Schedule 8—

(*a*) the amount of a person's earnings for any period; or

(*b*) the amount of his earnings to be treated as comprised in any payment made to him or for his benefit,

shall be calculated or estimated in such manner and on such basis as may be prescribed by regulations made by the Treasury with the concurrence of the Secretary of State.

…"

"6 **Liability for Class 1 contributions**

(1) Where in any tax week earnings are paid to or for the benefit of an earner over the age of 16 in respect of any one employment of his which is employed earner's employment—

(a) a primary Class 1 contribution shall be payable in accordance with this section and section 8 below if the amount paid exceeds the current primary threshold (or the prescribed equivalent); and

(b) a secondary Class 1 contribution shall be payable in accordance with this section and section 9 below if the amount paid exceeds the current secondary threshold (or the prescribed equivalent).

…

(4) The primary and secondary Class 1 contributions referred to in subsection (1) above are payable as follows—

(a) the primary contribution shall be the liability of the earner; and

(b) the secondary contribution shall be the liability of the secondary contributor;

but nothing in this subsection shall prejudice the provisions of paragraphs 3 to 3B of Schedule 1 to this Act.

...

(7) Regulations under this section shall be made by the Treasury."

184. Part IX schedule 3 Social Security (Contributions) Regulations 2001 (SI 2001/1004) – as substituted by Social Security (Contributions) (Amendment No 5) Regulations 2003 (SI 2003/2085) - provides:

5 "**Certain payments by way of securities, restricted securities and restricted interests in securities, and gains arising from them, disregarded**

1. Payments by way of securities, restricted securities and restricted interests in securities, and gains arising from them, are disregarded in
10 the calculation of an employed earner's earnings to the extent mentioned in this Part.

…

9. (1) A payment by way of the acquisition of restricted securities, or a restricted interest in securities, where those securities are, or that
15 interest is, employment-related, if no charge to income tax arises under section 425 of ITEPA 2003 other than by virtue of subsection (2) of that section.

This is subject to the following qualification.

(2) This paragraph does not apply if an election has been made as
20 mentioned in subsection (3) of section 425 of ITEPA 2003.

(3) References in this paragraph to section 425 of ITEPA 2003 are to that section as substituted by paragraph 3(1) of Schedule 22 to the Finance Act 2003."

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