Neutral Citation: [2024] UKFTT 00278 (TC)

Case Number: TC09124

FIRST-TIER TRIBUNAL
TAX CHAMBER

[Location/By remote video hearing]

Appeal reference: TC/2022/11580

INCOME TAX AND NATIONAL INSURANCE CONTRIBUTIONS – receipt by an employee of an interest in securities (the "interest") subject to a condition that the interest would be forfeited if the employee died within a specified period – whether the interest fell within the ambit of the legislation in Sections 140A et seq. of the Income Corporation Taxes Act 1988 (the "Conditional Shares Legislation"), which was the predecessor to Chapter 2 of Part 7 of the Income Tax (Earnings and Pensions) Act 2003 (the "Restricted Securities Legislation") – no - although the condition was real and would, if the employee had died within the period in which the condition applied, have given rise to meaningful commercial effects so that it could not simply be disregarded, the fact that it had been included for no business or commercial purpose and solely to bring the interest within the ambit of the Conditional Shares Legislation for tax avoidance reasons meant that the interest did not fall within it, applying a purposive construction of the Conditional Shares Legislation in accordance with the approach adopted in relation to the Restricted Securities Legislation by the Supreme Court in UBS AG v The Commissioners for Her Majesty's Revenue and Customs; DB Group Services (UK) Ltd v The Commissioners for Her Majesty's Revenue and Customs [2016] UKSC 13 *– appeal dismissed and, as a result, income tax and national insurance contributions to be charged at the point when the interest was acquired, the amount by reference to which the income tax and national insurance contributions to be charged to be agreed by the parties and, in default of agreement, to be determined by the First-tier Tribunal*

Heard on: 11, 12 and 13 MARCH 2024
Judgment date: 27 MARCH 2024

Before

TRIBUNAL JUDGE TONY BEARE
MS JANE SHILLAKER

Between

LYNX FORECOURT LIMITED

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Mr Michael Sherry, of counsel, instructed by Cooper Parry

For the Respondents: Ms Rebecca Sheldon, of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. This decision relates to an appeal against a determination and a decision, both dated 23 January 2009 and both in respect of the tax year ending 5 April 2003 – namely:

(1) a determination to income tax under Regulation 80 of the Income Tax (Pay As You Earn) Regulations 2003 (the "PAYE Regulations") in the amount of £800,000; and

(2) a decision under Section 8 of the Social Security (Transfer of Functions etc) Act 1999 to the effect that national insurance contributions ("NICs") in the amount of £153,400 is due.

2. The determination and decision in question relate to two bonuses which were paid by the Appellant to Mr Christopher Pinto, its director and controlling shareholder ("CP"), during the tax year in question. The first of those bonuses (the "2002 Bonus") was paid in respect of services provided by CP during the Appellant's accounting period ending 31 May 2002 and the second of those bonuses (the "2003 Bonus", together with the 2002 Bonus, the "Bonuses" and, each a "Bonus") was paid in respect of the services provided by CP during the Appellant's accounting period ending 31 May 2003.

3. We refer in paragraph 2 above to the fact that the Bonuses were "paid" but each Bonus was not paid in cash. Instead, it took the form of a transfer to CP (or a trust of which CP was a beneficiary) of loan notes which had been issued to the Appellant by Pinto Investments Limited ("PIL"), a company newly-incorporated with CP as its sole shareholder and sole director and his elder brother, David Pinto (an indirect minority shareholder in the Appellant) ("DP"), as its company secretary.

4. The single point which is at issue in the appeal is whether the transfer of those loan notes to CP or the trust fell within Sections 140A et seq. of the Income and Corporation Taxes Act 1988 (the "ICTA"). It is common ground that:

(1) if they did, then no income tax or NICs liabilities arose when the loan notes were acquired by CP or the trust and the Appellant is entitled to succeed in the appeal. (The relief from income tax in Sections 140A et seq. of the ICTA is matched by a corresponding relief from NICs in Regulation 25 of, and paragraph 9 of Part IX of Schedule 3 to, the Social Security (Contributions) Regulations 2001 (the "SSCR")); and

(2) if they did not, then the Appellant was obliged to account for income tax under Section 203 of the ICTA and Regulation 68 of the PAYE Regulations and for NICs under Regulation 67 of the SSCR when the loan notes were acquired by CP or the trust and the appeal fails. The parties have said that, if we reach the conclusion that that is the case, then we should simply determine the issue in principle and leave them to agree on the quantum of the liabilities thereby arising or, failing agreement, to ask us to determine that quantum.

THE RELEVANT LEGISLATION

5. Sections 140A et seq. of the ICTA were inserted into the ICTA by the Finance Act 1998. Consequently, for convenience, in the rest of this decision, we will refer to those provisions as the "1998 legislation".

6. The relevant terms of Section 140A of the ICTA at the time when the Bonuses were paid were as follows:

"140A.— Conditional acquisition of shares

(1) This section applies where—

(a) a beneficial interest in any shares in a company ("the employee's interest") is acquired by any person ("the employee") as a director or employee of that or another company; and

(b) the employee acquires that interest on terms that make his interest in the shares only conditional…

(3) If the terms on which the employee acquires the employee's interest are such that his interest in the shares in question will cease to be only conditional within five years after his acquisition of the interest, there shall (subject to the following provisions of this section) be no tax chargeable on the employee under Schedule E in respect of his acquisition of the interest except any tax which is so chargeable by virtue only of section 135 or 162…

(9) Any reference in this section or section 140B or 140C to shares in a company includes a reference to securities issued by a company…".

7. Section 140C of the ICTA elaborated on the language set out in Section 140A of the ICTA 1988. The relevant terms of Section 140C of the ICTA at the time when the Bonuses were paid were as follows:

"140C.— Cases where interest to be treated as only conditional

(1) For the purposes of sections 140A and 140B (but subject to the following provisions of this section) a beneficial interest in shares is only conditional for so long as the terms on which the person with that interest is entitled to it—

(a) provide that, if certain circumstances arise, or do not arise, there will be a transfer, reversion or forfeiture as a result of which that person will cease to be entitled to any beneficial interest in the shares; and

(b) are not such that, on the transfer, reversion or forfeiture, that person will be entitled in respect of his interest to receive an amount equal to or more than the amount that might reasonably be expected (if there were no provision for transfer, reversion or forfeiture) to be obtained from a sale of that interest in the open market at that time…

(5) In subsection (1) above the references, in relation to the terms of a person's entitlement, to circumstances arising include references—

(a) to the expiration of a period specified in or determined under those terms or the death of that person or any other person; and

(b) to the exercise by any person of any power conferred on him by or under those terms…"

8. For completeness, as it is highly relevant to this decision, we should note that:

(1) the 1998 legislation was re-enacted as Chapter 2 of Part 7 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"); and

(2) a few months after the ITEPA was enacted, a new and more complex Part 7 of the ITEPA was substituted by the Finance Act 2003 (the "FA 2003").

For convenience, in the rest of this decision:

(a) we will refer to the new and more complex Part 7 of the ITEPA which was inserted by the FA 2003 as the "2003 legislation"; and

(b) although the 2003 legislation refers to a provision for forfeiture upon a contingent event as a "restriction" instead of a "condition", which is the language used in the 1998 legislation, when we are dealing with such a provision in the context of the 2003 legislation we will refer to it as a "condition" as well in order more easily to compare the two regimes.

THE AGREED FACTS

9. The facts which are relevant to the appeal are agreed and are as follows:

Background

(1) the Appellant carries on a garage construction business;

(2) at the time of the 2002 Bonus, CP held directly 60% of the share capital in the Appellant, DP held indirectly 30% of the share capital in the Appellant and a Mr Philip Martin held 10% of the share capital in the Appellant;

(3) at the time of the 2003 Bonus, CP held directly 70% of the share capital in the Appellant and DP held indirectly 30% of the share capital in the Appellant;

(4) at the time of both Bonuses, the directors of the Appellant were CP and a Mr Ronald J Martin who had once held shares in the Appellant but had disposed of those shares to CP prior to the 2002 Bonus;

(5) on 15 May 2002, CP and DP attended a meeting with Mr Stephen Edwards and Mr Barry Potter, partners specialising in taxation at the accountancy firm Haines Watts ("HW"). The purpose of the meeting was to discuss possible approaches for structuring bonuses to be paid by the Appellant to CP in a tax-efficient manner;

(6) one of the approaches so discussed involved relying on the 1998 legislation to minimise the income tax and NICs which would be payable in respect of each Bonus. The essence of the approach was to ensure that:

(a) the relevant Bonus took the form of a transfer to CP or to a trust of which CP was the beneficiary of securities subject to a condition that would cause the securities to fall within the 1998 legislation (so that no charge to income tax or NICs would arise at the point when the transfer was made); and

(b) then to ensure that the securities in question had a low market value at the point when they were held by CP (or the trust on behalf of CP) unconditionally or at the point when they were the subject of a disposal;

(7) following that initial meeting, on 18 June 2002, Mr Edwards wrote to the Appellant to provide further information and advice in relation to a possible structure;

(8) on 19 July 2002, following CP's agreement to move forward with the proposal, Mr Edwards sent HW's letter of engagement to CP, noting that he had commenced drafting detailed instructions to counsel;

(9) on 1 October 2002, Mr Edwards, CP and DP attended a conference with counsel, Richard Bramwell QC, to discuss the proposal. The proposal so discussed with counsel involved:

(a) the Appellant's subscribing for loan notes issued by a company newly-incorporated by CP;

(b) the Appellant's transferring those loan notes to a trust of which DP was the trustee the terms of which trust were such that CP would cease to be entitled to the loan notes in the event of his death within a specified period of approximately 12 months following the award; and

(c) the terms of the loan notes being such that, if a charge to income tax and NICs arose in respect of them either because the period of conditionality ended or because the loan notes were the subject of a disposal, the market value of the loan notes would be low;

The 2002 Bonus

(10) on 21 October 2002, PIL was incorporated with CP as its sole shareholder and sole director and DP as the company secretary;

(11) on 13 November 2002, the directors of the Appellant resolved, subject to the approval of its members:

(a) to subscribe for £700,000 in nominal value of loan notes to be issued by PIL (the "First Loan Notes");

(b) to establish an interest in possession trust for the benefit of CP and his family; and

(c) to transfer the First Loan Notes to the trustee of the trust in part consideration for the services provided by CP to the Appellant in its accounting period ending 31 May 2002;

(12) on 15 November 2002, the members of the Appellant approved the resolutions set out above at an extraordinary general meeting;

(13) on the same day, the Appellant subscribed for £700,000 in nominal value of the First Loan Notes, which were issued by PIL. The terms of the First Loan Notes were that:

(a) they carried interest at the rate of 1% per annum;

(b) they were redeemable at par plus accrued interest on 30 days' written notice by the holder to PIL not later than 31 October 2003;

(c) subject to that, they were redeemable at par plus accrued interest on the 18th anniversary of their date of issue; and

(d) the subscription monies were required to be retained in a designated "subscription account" of PIL's for the period of 60 days after issue and could be removed from that account within that period only to satisfy PIL's obligations to pay principal and interest under the First Loan Notes or with the consent of all the noteholders;

(14) on 28 November 2002, the Appellant created the interest in possession trust referred to in paragraph 9(11)(b) above (the Lynx Settlement 2002 Trust (the "Trust")) and transferred the First Loan Notes to DP in his capacity as the trustee of the Trust. The terms of the Trust were that:

(a) the trust fund was held on trust for CP absolutely although subject to defeasance if CP failed to survive to 31 January 2004;

(b) prior to that date, the income from the trust fund was payable to CP and the trustee had the power to advance the capital of the trust fund to CP;

(c) subject to the above, the trust fund was held on trust:

(i) for CP's wife absolutely, contingently on her surviving CP;

(ii) failing which on accumulation and maintenance terms for such of CP's children who were born before 31 January 2004;

(iii) failing which for such of CP's brothers as should be living on 31 January 2004 and, if more than one of them, in equal shares; and

(iv) failing which for the British Diabetic Association;

(15) on 26 February 2003, CP transferred his shares in PIL to DP as the trustee of the Trust;

(16) on 13 May 2005, the Trust converted the First Loan Notes into preference shares in PIL;

The 2003 Bonus

(17) on 12 March 2003, the directors of the Appellant resolved, subject to the approval of its members:

(a) to subscribe for £1,300,000 in nominal value of loan notes to be issued by PIL (the "Second Loan Notes" and, together with the First Loan Notes, the "Loan Notes"); and

(b) to transfer the Second Loan Notes to CP in part consideration for the services provided by CP to the Appellant in its accounting period ending 31 May 2003 and subject to the terms of the agreement described in paragraph 9(20) below;

(18) on 15 March 2003, the members of the Appellant approved the resolutions set out above at an extraordinary general meeting;

(19) on 17 March 2003, the Appellant subscribed for £1,300,000 in nominal value of Second Loan Notes, which were issued by PIL. The terms of the Second Loan Notes were that:

(a) they carried no interest but instead the right to a redemption premium accruing at the rate of 1% per annum;

(b) they were redeemable at par plus the accrued redemption premium on 30 days' written notice by the holder to PIL not later than 30 January 2004;

(c) subject to that, they were redeemable at par plus the accrued redemption premium on the 18th anniversary of their issue; and

(d) the subscription monies were required to be retained in a designated "subscription account" of PIL's for the period of 60 days after issue and could be removed from that account within that period only to satisfy PIL's obligations to pay principal and the premium under the Second Loan Notes or with the consent of all the noteholders;

(20) on 21 March 2003, the Appellant transferred the Second Loan Notes to CP pursuant to the terms of an agreement of the same date the relevant terms of which were that:

(a) without prejudice to CP's ability to exercise any redemption rights in respect of the Second Loan Notes, CP would not transfer, or create any trust of, the Second Loan Notes during the period to 21 March 2004; and

(b) in the event of CP's death on or prior to 21 March 2004, the beneficial ownership in the Second Loan Notes not previously redeemed would revert to the Appellant and accordingly the Second Loan Notes would be required to be transferred by CP's personal representatives to the Appellant;

(21) on 9 October 2003, CP notified PIL that he wished to redeem his entire holding of the Second Loan Notes and indicated that, if PIL was minded to do so, he would be content for the redemption to be made before the expiry of the 30 day notice period required by the instrument creating the Second Loan Notes at a commensurately-reduced redemption premium;

(22) on 10 October 2003, PIL redeemed the Second Loan Notes by paying CP the sum of £1,307,336.99, of which £1,300,000 was in respect of the nominal value of the Second Loan Notes and £7,336.99 was in respect of the redemption premium accrued to the date of redemption;

The unwind

(23) at some point shortly after 20 July 2005, the ordinary shares and preference shares in PIL were transferred by DP as trustee of the Trust to the Appellant for an aggregate consideration of £730,000; and

(24) PIL was ultimately dissolved on 5 December 2018.

THE EVIDENCE

The documentary evidence

10. We were provided with copies of the documents which had been executed in the course of implementing the transactions described in paragraph 9 above along with copies of various letters from HW to CP in which HW outlined the proposal and then provided, in draft form, the documents required to implement it along with instructions on the steps to be taken to do so. In particular, we were provided with:

(1) the note of the meeting of 15 May 2002 referred to in paragraph 9(5) above;

(2) the letters from Mr Edwards to CP of 18 June 2002 and 19 July 2002 referred to in paragraphs 9(7) and 9(8) above;

(3) a letter from Mr Edwards to CP of 12 November 2002, enclosing the documents necessary to implement the initial stage of the 2002 Bonus and setting out instructions in relation to the timing of meetings and the execution of those documents. In that letter, Mr Edwards said that he would be in touch with CP later that week or early in the following week in order to guide CP through the second stage of the 2002 Bonus;

(4) a letter from Mr Edwards to CP of 13 February 2003, informing CP of the need to transfer his ordinary shares in PIL to DP as trustee of the Trust, enclosing documents needed to effect that transaction and setting out instructions in relation to the steps to be taken to that end;

(5) a letter from a Ms Suzanne Robyns, an associate of Mr Edwards at HW, of 26 February 2003, enclosing further documents in relation to the transfer of the ordinary shares in PIL by CP to DP as trustee of the Trust;

(6) a letter from Ms Robyns to CP of 12 March 2003, following a further consultation with Mr Bramwell QC in relation to the structure, enclosing the documents necessary to implement the initial stage of the 2003 Bonus and setting out instructions in relation to the timing of meetings and the execution of those documents;

(7) a letter from Ms Robyns to CP of 18 March 2003, enclosing the documents necessary to implement the second stage of the 2003 Bonus and setting out instructions in relation to the timing of meetings and the execution of those documents;

(8) minutes of a meeting of 21 July 2003 in which Mr Edwards and Ms Robyns had met with CP and Ms Emma Graves, a senior employee of the Appellant, to discuss the impact on the Loan Notes of the new 2003 legislation and possible opportunities to which the 2003 legislation gave rise; and

(9) a letter from Mr Edwards to CP of 20 July 2005 enclosing the documents necessary to enable DP as the trustee of the Trust to transfer the ordinary shares and preference shares in PIL to the Appellant.

The witness evidence

11. We were also provided with witness evidence. Sadly, although CP survived throughout both of the periods of conditionality described in paragraph 9 above, he died from lung cancer, aged 60, on 16 January 2018 and we were therefore unable to hear his evidence. However, we were provided with the testimony of DP and Mr Edwards. Much of that testimony did no more than confirm the agreed facts set out in paragraph 9 above but we were provided with the additional information set out in paragraphs 12 and 13 below.

12. DP testified that:

(1) he was a qualified solicitor who for many years had carried on private practice either in partnership or as a sole practitioner. In addition to his legal practice, he had pursued several business opportunities the profits from which had enabled him to help CP with funding when CP had formed the Appellant;

(2) his relationship with CP was generally close although they "had their ups and downs as brothers do". Tensions arose between them from time to time, particularly in relation to the Appellant's business. CP was relatively inexperienced in business matters and was reliant on him both for the Appellant's initial funding and for his greater business expertise;

(3) at the time of the Bonuses, CP had recently been diagnosed with multiple sclerosis. However, that was not itself imminently terminal. Nor was it the disease which ultimately led to his death. On the contrary, CP managed his multiple sclerosis very effectively for a long time. Thus, there was no reason to think that, during the period of conditionality referable to each Bonus, CP had any increased mortality risk by reason of his illness and his death within the conditionality period applicable to the relevant Bonus was unlikely;

(4) his involvement with the Appellant, whilst naturally influenced by the fact that CP was his brother, was necessarily business-like in order to ensure that the Appellant prospered and his investment in the Appellant was protected;

(5) similarly, whilst he was naturally influenced by CP's wishes as beneficiary of the Trust, he took his role as trustee of the Trust seriously. He was not an expert in trust law but he had a broad understanding of his responsibilities as a trustee and would have taken specialist legal advice if CP had died during the period of conditionality in relation to the 2002 Bonus. In addition, he would not have followed CP's wishes slavishly. He had his own ideas and, whilst he wanted CP to succeed, he was the more experienced of the two in business matters;

(6) due to his financial interest in the Appellant, if CP had died during the period of conditionality in relation to the 2003 Bonus, he would have taken steps on behalf of the

Appellant to enforce the contractual obligation on the part of CP's personal representatives to return the Second Loan Notes to the Appellant;

(7) he recalled that, when PIL was established, CP had an open mind about what it would do and that one possibility was that it would use the proceeds of issuing the Loan Notes to make investments;

(8) whilst he was not aware of the details, he recalled that the Second Loan Notes had been redeemed as a result of a change in tax law occurring after they had been acquired by CP; and

(9) similarly, whilst he was not aware of the details, he thought that the conversion of the First Loan Notes into preference shares in PIL had been triggered by a change in law.

13. Mr Edwards testified that:

(1) on each occasion when the proposal was implemented:

(a) there was no fixed intention on the part of CP to effect the redemption of the relevant Loan Notes or to request that DP as trustee of the Trust did so. Instead, the expectation was that the Loan Notes would be held for an extended period and possibly for their full term of 18 years;

(b) similarly, although the liquidation of PIL in the short to medium term was a possibility, another possibility was that the company would be retained indefinitely as an investment vehicle;

(c) the only settled intention was that the Loan Notes would be held on a conditional basis for a period of approximately 12 months – so that the 1998 legislation would apply to them when they were acquired by CP or by DP as trustee of the Trust - and that their terms would be such that they would fall significantly in value (by approximately 80%) prior to the date when the conditionality period ended – so that the charge to income tax and NICs which arose under the 1998 legislation in respect of them at that point would be calculated by reference to that materially-reduced value; and

(d) to that end, he had advised CP as to how he might achieve the above objectives but the decision as to whether or not to implement the transactions was taken by the Appellant and CP;

(2) whilst he thought that CP's death before the end of the conditionality period was unlikely, it was certainly a meaningful "real world" possibility. However, there was no commercial reason for making each Bonus subject to that condition. It had been inserted solely in order to bring the relevant Bonus within the 1998 legislation;

(3) he could not recollect why the structure chosen for the 2003 Bonus differed from the structure used for the 2002 Bonus. He thought that it might have been because there had been various announcements made in early 2003 in relation to employee benefit trusts and therefore it seemed risky to involve a trust on the later occasion;

(4) he thought that the reason why he had advised CP to transfer the ordinary shares in PIL to DP as trustee of the Trust during the conditionality period in relation to the 2002 Bonus was that, when the conditionality period ended, there would be a deemed disposal and re-acquisition by DP of the assets within the Trust and that, as long as the First Loan Notes and the ordinary shares were both held by DP, any chargeable gain

arising in respect of the Loan Notes could then be offset against an allowable loss arising in respect of the ordinary shares;

(5) in early 2003, there was a concern that the prevailing law in relation to conditional securities was about to change to reduce the scope for effective tax planning. That concern was realised when substantial changes to the employment-related shares regime were enacted in the FA 2003;

(6) at that point, it became necessary to review the tax treatment of the Loan Notes in the light of the new 2003 legislation. Accordingly, on 21 July 2003, he and Ms Robyns had met with CP and Ms Graves to discuss the impact of the 2003 legislation on the Loan Notes and possible opportunities to which the 2003 legislation gave rise and it was agreed that HW would instruct counsel to advise on those matters;

(7) his recollection was that counsel's advice was for CP to redeem the Second Loan Notes prior to the end of the conditionality period in relation to them as that would result in a nominal tax liability under the 2003 legislation. The reason for that was that, on his and counsel's reading of the 2003 legislation, CP was entitled to deduct the market value of the Second Loan Notes when they had been transferred to him from the redemption proceeds in calculating the taxable amount arising as a result of the redemption;

(8) he could not recall exactly why the same route had not been followed in relation to the First Loan Notes. It might have been that the analysis described above was uncertain and there was a desire not to take the same risk in relation to all of the Loan Notes or that the analysis was slightly different in relation to them because they were held by DP as trustee of the Trust and not by CP directly so that, even after a redemption, the conditionality would remain in place in relation to the redemption proceeds;

(9) although he could not recall the details, he thought that, in 2005, concerns arose in relation to possible changes in law which might affect the tax treatment of the First Loan Notes and therefore, on 10 May 2005, he had sent CP drafts of the documents required to enable the Trust to convert the First Loan Notes into preference shares in PIL;

(10) he had no knowledge of the terms of CP's will at any time and was therefore unable to comment on the identities of the beneficiaries of CP's estate upon CP's death; and

(11) prior to its dissolution in December 2018, the principal activity of PIL had been to lend funds to the Appellant.

FINDINGS OF FACT

14. We considered both witnesses to be candid and helpful and the veracity of their evidence was not challenged by the Respondents. Accordingly, we see no reason to doubt any of the evidence summarised in paragraphs 12 and 13 above and have used it in reaching our conclusions of fact. Those conclusions are as follows:

The proposal

(1) the purpose of CP and the Appellant in entering into the proposal to pay each Bonus was to enable the Appellant to account for less income tax and NICs in respect of the relevant Bonus than would have been the case if it had paid the relevant Bonus to CP in cash;

(2) in order to achieve that purpose, the proposal to pay each Bonus was designed by HW in such a way as was intended (and expected) to ensure that:

(a) the relevant Loan Notes fell within the ambit of the 1998 legislation when CP acquired his beneficial interest in the Loan Notes;

(b) unless CP were to die before the time at which the conditionality period in relation to the relevant Bonus ended, the Loan Notes would be retained by CP or DP as trustee of the Trust until some point after that time, so that the only charge to income tax and NICs which arose in respect of the Loan Notes under the 1998 legislation would be the one arising when the relevant conditionality period ended, calculated by reference to the market value of the Loan Notes at that time; and

(c) as a result of the terms of the Loan Notes, the market value of the Loan Notes when the conditionality period in relation to each Bonus ended would be very much less – approximately 80% less - than the market value of the Loan Notes on their issue and initial transfer;

(3) CP and the Appellant did not have any purpose in entering into the proposal to pay each Bonus beyond the purpose described in paragraph 14(1) above and, accordingly, on each occasion that the proposal to pay a Bonus was implemented, there was no fixed intention on the part of CP to effect the redemption of the relevant Loan Notes or to request that DP as trustee of the Trust did so, prior to the Loan Notes' final maturity date. Instead, the expectation was that the Loan Notes would be held for an extended period and possibly for their full term of 18 years;

(4) whilst the tax advantage described in paragraph 14(1) above was CP's and the Appellant's only purpose in entering into the proposal to pay each Bonus and was the only reason why the transactions comprising each Bonus were implemented, that is not to say that those transactions did not have enduring legal and commercial effects one of which – the creation and funding of an investment vehicle owned initially by CP and then by DP as trustee of the Trust – was appealing to CP. In creating PIL and obtaining funding for it, CP put himself in the same position as his brother in having a company which might make investments in due course. However, there was no fixed intention on the part of CP to make any such investments. It was merely one of several possibilities. It was also possible that PIL would be liquidated in the short to medium term. As such, we do not think that the creation and funding of PIL can be said to have been a purpose of CP and the Appellant in entering into the proposals to pay the Bonuses. As it transpired, PIL remained in existence until its dissolution in December 2018 but:

(a) it lost £1,300,000 of its funding when it was required to redeem the Second Loan Notes on 10 October 2003;

(b) its entire share capital was transferred by DP as trustee of the Trust to the Appellant at some point shortly after 20 July 2005; and

(c) its principal activity during its existence was to lend its funds to the Appellant;

The condition

(5) there was no business or commercial purpose for the insertion of the condition in the case of each Bonus. That condition was commercially irrelevant and its purpose was solely to secure that the interest in the relevant Loan Notes fell within 1998 legislation.

In relation to this question, Mr Sherry, who was appearing before us on behalf of the Appellant, submitted at the hearing that a distinction could be drawn in this case between motive and purpose, at least in the context of the Second Loan Notes. He said that:

(a) the "purpose" of a provision was what it would do and why it would do it and that was different from the "motive" underlying the insertion of the provision; and

(b) whilst there may not have been a business or commercial motive for the insertion of the condition in relation to the Second Loan Notes, the condition nevertheless had a business or commercial purpose in that CP's death within the relevant conditionality period would have resulted in the Loan Notes passing back to the Appellant and that would have made sense commercially in that CP was the driving force behind the Appellant and his death would undoubtedly have damaged the Appellant's business and profitability.

This submission is the same as the one which Mr Sherry made in *Cyclops Electronics Ltd and another v The Commissioners for Her Majesty's Revenue and Customs* [2018] UKUT 7 (TCC) ("*Cyclops*"), an Upper Tribunal case relating to the 2003 legislation which we discuss later in this decision, as recorded in *Cyclops* at paragraphs [62] to [65].

We are not persuaded by it for similar reasons to those recorded by the Upper Tribunal in *Cyclops* when commenting on the First-tier Tribunal's decision in that case – see *Cyclops* at paragraphs [67] to [69]. In short, we have been provided with no evidence to the effect that the purpose of the condition in the case of the 2003 Bonus was to ensure that the Second Loan Notes reverted to the Appellant in the event of CP's death within the conditionality period or evidence as to why that was desirable from the commercial perspective. We accept that CP's death within the conditionality period would have had a meaningful commercial effect but, as the Upper Tribunal noted in *Cyclops*, effect is not the same as purpose.

This conclusion is not very different from our conclusion in paragraph 14(4) above to the effect that the creation and funding of PIL as part of the proposals to pay the Bonuses did not form part of the purpose of CP and the Appellant in entering into the proposals. That too was something which had a meaningful commercial effect but it could not be said to amount to a purpose in entering into the proposals;

(6) on each occasion when a Bonus was paid, the risk that CP might die before the end of the conditionality period was a real risk although that risk was highly unlikely to materialise. There was no reason to think that CP's mortality risk over that period was increased following his recent diagnosis with multiple sclerosis;

(7) when the 2003 Bonus was paid, CP had the rights and powers in law effectively to bring the conditionality period in relation to the Second Loan Notes to a premature end by exercising the redemption right in relation to those Loan Notes – as he in fact did on 9 October 2003. Although the conditionality period was bound to extend until the actual redemption of the Loan Notes, that did not mean that the mortality risk would inevitably continue for at least 30 days following the giving of the redemption notice because:

(a) as CP was the sole director of PIL, he had the ability to agree on behalf of PIL to waive the 30-day notice period for redemption;

(b) in fact, that is what happened and the 30-day notice period required by the terms of the Second Loan Notes was waived by agreement between the parties when CP gave notice of his wish to redeem the Second Loan Notes on 9 October 2003; and

(c) therefore, when the 2003 Bonus was paid, CP had the rights and powers in law effectively to bring the conditionality period in relation to the Second Loan Notes to a premature end at short notice;

(8) when the 2002 Bonus was paid, the First Loan Notes were held by DP as trustee of the Trust and therefore CP did not have the rights and powers in law to bring the conditionality period in relation to the First Loan Notes to a premature end. Instead, CP was dependent on DP's both:

(a) exercising the redemption right in relation to those Loan Notes; and

(b) then exercising his discretion under the terms of the instrument creating the Trust to advance capital to CP.

Whilst DP, as CP's brother, might be expected in most cases to accede to CP's wishes, he had no legal obligation to do so and he would not inevitably have done either or both of the above, either because he considered that it would not be in his own interests as a shareholder in the Appellant or because he did not think that it was consistent with his fiduciary obligations as a trustee; and

CP's will

(9) we have heard no evidence as to the terms of CP's will over the period of time corresponding to the conditionality period in relation to each tranche of Loan Notes. Accordingly, we conclude that we are unable to identify the beneficiaries of CP's estate had he died within either conditionality period.

THE PARTIES' POSITIONS

15. The Appellant's position in the appeal is straightforward. Mr Sherry said that the language used in the 1998 legislation was clear. The award of an interest in shares or securities where the interest was subject to forfeiture upon the occurrence of the recipient's death within a specified period of no longer than 5 years fell within the terms of the legislation. The present facts met that description exactly and it was irrelevant that the terms on which the Bonuses had been paid were designed to fall within the terms of the legislation.

16. The Respondents do not accept that that is the case. Ms Sheldon, who was appearing before us on behalf of the Respondents, said that the present facts fell outside the ambit of the 1998 legislation because, in the case of each Bonus:

(1) the condition was illusory;

(2) even if the condition was real, the condition was not meaningful because a failure to satisfy it would have given rise to precisely the same commercial result as if the condition did not exist and the relevant Bonus had been paid to CP on an unconditional basis; or

(3) even if the condition was both real and meaningful, the present facts, when viewed realistically, did not fall within the 1998 legislation, when construed on a purposive basis.

17. We now elaborate on each of those three objections and set out our views on them, in turn.

THE FIRST OBJECTION

The Respondents' case

18. Ms Sheldon said that the condition in the case of each Bonus was illusory and could be disregarded in applying the 1998 legislation because:

(1) the likelihood of CP's dying within the conditionality period applicable to the relevant Loan Notes of approximately 12 months was remote; and

(2) in any event, CP could always have defeated the condition by ensuring that the relevant Loan Notes were redeemed within 30 days of his receiving the relevant Bonus.

In the case of the Second Loan Notes, this could have been achieved by the simple expedient of his exercising the right of redemption which was set out in the terms of the relevant Loan Notes. That would have ensured that, at that stage, he received the redemption proceeds unencumbered by the condition.

In the case of the First Loan Notes, the position was a little more complicated because they were held by DP as trustee of the Trust. However, as DP was CP's brother, CP would have been confident that, were he to have made a request to DP to that effect, DP would have exercised the right of redemption which was set out in the terms of the relevant Loan Notes and then exercised his discretion under the terms of the instrument creating the Trust to pay the redemption proceeds to CP as an advance of capital. That would have ensured that, at that stage, CP would have received the redemption proceeds unencumbered by the condition.

Discussion

19. As regards this first objection, we do not think that there is any merit in the argument that CP's dying within the conditionality period was remote.

20. Even though, in relation to each Bonus:

(1) there was no reason to think that CP's mortality risk over the conditionality period applicable to the relevant Bonus was increased following his diagnosis with multiple sclerosis; and

(2) CP's death within the conditionality period applicable to the relevant Bonus was highly unlikely,

the fact is that CP might well have died during the relevant conditionality period. It was a genuine risk that cannot simply be disregarded on the basis that it was highly unlikely to occur.

21. Similarly, we do not think that the fact that DP was CP's brother and might therefore have been expected in most cases to accede to CP's wishes means that the conditionality applicable to CP's beneficial interest in the First Loan Notes under the Trust can simply be disregarded. As we have already noted in paragraph 14(8) above, DP had no legal obligation to accede to those wishes and would not inevitably have done so in any given situation, either because he considered that it would not be in his own interests as a shareholder in the Appellant or because he did not think that it was consistent with his fiduciary obligations as the trustee of the Trust.

22. The Respondents are on slightly firmer ground in their submission to the effect that the conditionality applicable to the Second Loan Notes can be disregarded because CP was able at any time to bring the conditionality period in relation to the Second Loan Notes to a premature end by exercising the redemption right in relation to those Loan Notes. As we have noted in paragraph 14(7) above, that ability, coupled with the ability of CP to agree on

behalf of PIL to a waiver of the 30-day notice period required by the terms of the relevant Loan Notes, meant that CP would have been able to bring the conditionality period to an end on short notice from inception.

23. However, although that has given us pause for thought, we have concluded on reflection that this does not mean that the condition can simply be disregarded. The fact remains that, even though CP was in a position effectively to curtail the conditionality period at short notice, if he had died within the conditionality period, for however long it lasted, the consequence of that in law would have been that the Second Loan Notes were required to be re-transferred to the Appellant. Moreover, the evidence shows that, at inception, there was no intention on the part of CP or the Appellant that a redemption would occur within the conditionality period applicable to the Second Loan Notes. On the contrary, the intention was that the Second Loan Notes would not be redeemed until after the conditionality period had come to an end and the charges to income tax and NICs under the 1998 legislation had arisen by reference to the reduced value of the relevant Loan Notes. Although, as things transpired, new legislation was introduced and there was a change in tack which resulted in a redemption of the Second Loan Notes within the conditionality period, that is neither here nor there. The fact remains that the condition was intended to apply for a period of approximately 12 months and that, if CP had died at any time prior to the earlier of the redemption date or the end of the conditionality period, the relevant Loan Notes would have been required to be transferred back to the Appellant.

24. For the reasons given in paragraphs 19 to 23 above, we do not agree with the first reason which the Respondents have given for objecting to the Loan Notes' falling within the 1998 legislation.

THE SECOND OBJECTION

The Respondents' case

25. Ms Sheldon submitted that, even if the condition in the case of each Bonus could not be wholly disregarded in applying the legislation on the basis that it was illusory for either of the reasons described in paragraphs 18(1) or 18(2) above, the condition was not meaningful because CP's death within the conditionality period would have resulted in the relevant Loan Notes' being acquired by the same person or persons who would have acquired them on CP's death had CP acquired his beneficial interest in them on an unconditional basis. In the case of the First Loan Notes, this was his wife (who stood to acquire them under the terms of the instrument creating the Trust) and, in the case of the Second Loan Notes, this was his personal representatives and DP indirectly as the shareholders in the Appellant.

Discussion

26. We can deal with this second objection to the Appellant's case more briefly than we did the first.

27. As we have noted in paragraph 14(9) above, in the absence of any evidence as to the terms of CP's will at the time when the conditionality period applicable to each tranche of Loan Notes ended, we are unable to identify the beneficiaries of CP's estate had he died within either conditionality period. It follows that we cannot agree with the assertion that, had CP died within the conditionality period applicable to the First Loan Notes, those Loan Notes would necessarily have passed under the terms of the instrument creating the Trust to the same person or persons who would have acquired them on CP's death had CP acquired his beneficial interest in those Loan Notes on an unconditional basis.

28. Similarly, we cannot see how an obligation to re-transfer the Second Loan Notes to the Appellant upon CP's death within the conditionality period applicable to those Loan Notes

can possibly be said to be replicating the position which would have pertained in relation to those Loan Notes had CP acquired his beneficial interest in those Loan Notes on an unconditional basis.

29. In the first place, the Appellant, as a limited company, was a person in its own right and thus distinct from its shareholders from time to time. It is perfectly possible that, at the time of CP's death, the shareholders in the Appellant might have been individuals who were wholly unrelated to CP or DP or any member of their respective families.

30. In the second place, even if this were to be an appropriate case in which to pierce the corporate veil of the Appellant and assume that the shareholdings in the Appellant were as they actually were, not all of the shares in the Appellant were owned by CP during the conditionality period applicable to the Second Loan Notes. Throughout that conditionality period, CP owned only 70% of the Appellant. Thus, upon CP's death within the conditionality period applicable to the Second Loan Notes, a 30% indirect interest in the relevant Loan Notes would have been acquired by DP, whose investment company held the remaining shares in the Appellant. We have seen no evidence to support the proposition that DP would have received any of the relevant Loan Notes on CP's death had CP acquired his beneficial interest in those Loan Notes on an unconditional basis.

31. For the reasons given in paragraphs 26 to 30 above, we do not agree with the second reason which the Respondents have given for objecting to the Loan Notes' falling within the 1998 legislation.

THE THIRD OBJECTION

The Respondents' case

32. We now turn to the Respondents' third objection to the Appellant's case, which is that, even if the condition in each case was both real and meaningful, the present facts, when viewed realistically, did not fall within the 1998 legislation, when construed on a purposive basis.

33. In our view, this objection lies at the heart of the present appeal and raises a much more difficult question than either of the other two.

34. Before expanding on this third objection, we should explain that the parties were in agreement as to the correct approach to be adopted in considering whether a particular set of facts fell within the terms of a particular statutory provision. Mr Sherry explained that a long series of authorities starting with *WT Ramsay Ltd v Inland Revenue Commissioners* [1982] 300 ("*Ramsay*") showed that, in each case, it was necessary to ask whether the relevant legislation, when construed on a purposive basis, was intended to apply to the relevant facts, when viewed realistically – see, for example, Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 at paragraph [35], cited with approval by Lord Nicholls in *Barclays Mercantile Business Finance Limited v Mawson* [2005] 1 AC 684 ("*Mawson*") at paragraph [36].

35. Ms Sheldon agreed with that summary. In addition, there was no disagreement between the parties as to the realistic view of the relevant facts in this case.

36. However, where the parties diverged was in relation to whether the 1998 legislation, when viewed on a purposive basis, was intended to apply to those facts.

37. Ms Sheldon submitted that, on a purposive reading of the legislation in question, the present circumstances, when viewed realistically, were not such as were intended to fall within it. More specifically, she explained that the purpose of the 1998 legislation was similar to the purpose of the 2003 legislation which succeeded it. The latter legislation had

been the subject of two significant decisions of the superior courts – the Supreme Court in *UBS AG v The Commissioners for Her Majesty's Revenue and Customs; DB Group Services (UK) Ltd v The Commissioners for Her Majesty's Revenue and Customs* [2016] UKSC 13 ("*UBS*") and the Upper Tribunal in *Cyclops* – the effect of which was to confirm that the reference in that legislation to a condition subject to which employment-related securities were acquired was confined to conditions having a business or commercial purpose and did not include commercially irrelevant conditions whose only purpose was to obtain the benefit of the relief conferred by the legislation. She said that, applying the same approach to the 1998 legislation in this case, it was clear that the present facts fell outside the scope of that legislation.

38. In response, Mr Sherry submitted that:

(1) the purpose of the 1998 legislation was to ensure that an employer remunerating an employee with shares or securities on the basis that the shares or securities would be subject to forfeiture upon the occurrence of a specified event within a specified period of no longer than 5 years would not be subject to income tax or NICs at inception by reference to the value of those shares or securities as reduced by the condition but would instead be subject to income tax and NICs only at a later time – that time's being the earlier of when the shares or securities were realised by the employee, the employee's death or the end of the period of conditionality;

(2) in that regard, the legislation in question expressly contemplated that the condition could take the form of a provision requiring forfeiture upon the death of the employee or some other person within the specified period of time;

(3) the terms on which CP acquired his interest in each tranche of Loan Notes in this case were such that the relevant interest would be forfeited upon the occurrence of his death within the period of approximately 12 months;

(4) a period of approximately 12 months was a meaningful period of time; and

(5) accordingly, the legislation should apply to that acquisition with the result that no charge to income tax or NICs should arise in respect of that acquisition.

39. Mr Sherry said that, in this context, it was irrelevant that each Bonus had been deliberately designed to fall within the regime. The legislation clearly contemplated that a receipt of an interest in shares or securities on terms that provided for that interest to be forfeited if the recipient died within a specified period of no longer than 5 years should fall within the ambit of the legislation and, as long as that was the case, the legislation applied. The fact that there was no commercial or business purpose for the relevant condition and that the condition had been included solely in order to bring the interest in the shares or securities within the legislation so as to reduce the Appellant's liabilities to income tax and NICs was irrelevant.

40. In that regard, he provided examples of prior cases where the courts had not disregarded transactions or elements of transactions which had no business purpose apart from the avoidance of tax in determining whether a particular set of facts, when viewed realistically, fell within the ambit of a specific statutory provision, when construed on a purposive basis.

41. One such case was *MacNiven v Westmoreland Investments Limited* [2003] 1 AC 311 ("*Westmoreland*"), where a payment of interest by a debtor who had borrowed the money to make the payment from the creditor himself was held to be a "payment" of interest within the meaning of the provision conferring relief for payments of interest despite its circular nature and the tax avoidance purpose underlying it. Another such case was *Mawson* itself, where a

lessor was held to be entitled to capital allowances in respect of a pipeline which it had acquired under a sale and leaseback transaction despite the fact that the purchase price that it had paid for the pipeline was held with a company under the control of one of its affiliates as security for the lease rentals so that the funds had effectively moved in a circle and the lessor's counterparty did not obtain any finance.

42. Mr Sherry said that, when one took into account:

(1) the background to the enactment of the 1998 legislation;

(2) the purpose for which the legislation had been enacted; and

(3) the language used in the legislation,

it was plain that this was another example falling within the above category.

43. More specifically, he provided two main reasons for concluding that the decisions in *UBS* and *Cyclops* did not affect the application of the 1998 legislation to the Loan Notes in this case.

44. The first was that those decisions related to the 2003 legislation whereas the present case concerned the 1998 legislation. The two sets of legislation had different backgrounds and, consequently, different purposes.

45. The background to the enactment of the 1998 legislation was the Inland Revenue's belief for many years preceding the introduction of the legislation that, where an award of shares or securities was made on a conditional basis, no income tax or NICs charges arose until the condition expired. However, shortly before the 1998 legislation was introduced, the Inland Revenue had received legal advice to the effect that this was incorrect and that the correct position in law was that such awards gave rise to tax immediately on the value of the shares or securities in question as encumbered by the condition. If that state of affairs had been allowed to continue, then it would have had a detrimental effect on the overall tax take because, although the charges to income tax and NICs arose at inception, they were calculated by reference to a much lower value – namely, the value of the shares or securities as encumbered by the condition.

46. The 1998 legislation had therefore been introduced as an anti-avoidance measure to restore the position to the one which the Inland Revenue had previously considered to be correct – namely, that the tax point was deferred until the condition expired – at least in relation to awards where the condition would expire within 5 years. As it was anti-avoidance legislation, it followed that the legislation was intended to apply in all cases where the relevant condition would expire within 5 years regardless of whether or not the condition in question had a business or commercial purpose. Otherwise, it would be possible to sidestep the legislation and secure a favourable tax treatment by simply inserting a condition which had no business or commercial purpose.

47. The background to, and legislative purpose of, the 1998 legislation described in paragraphs 45 and 46 above contrasted starkly with the background to, and legislative purpose of, the 2003 legislation which was the subject of the decisions in *UBS* and *Cyclops*.

48. The background to the 2003 legislation was the Respondents' dissatisfaction at the manner in which the 1998 legislation had been operating in practice. In particular, in the period which had passed since the 1998 legislation had been introduced, the Respondents had become aware of various schemes to avoid or reduce income tax and NICs charges in the case of conditional share and security awards by artificially enhancing or depressing the value of the shares or securities in question.

49. That background was reflected in the purpose of the 2003 legislation, which was to close off loopholes. As a result of that purpose, the 2003 legislation was much more complex. For instance, it included Chapters 3A and 3B of Part 7 of the ITEPA which had no equivalent in the 1998 legislation. The purpose of the 2003 legislation was therefore in part to exclude from the legislation certain circumstances where shares or securities were received subject to conditions. It therefore made sense to construe the 2003 legislation more restrictively and, in keeping with that approach, to exclude from the scope of Chapter 2 of Part 7 of the ITEPA conditions which had no business or commercial purpose. The fact that there was no equivalent to Chapters 3A and 3B in the 1998 legislation supported the conclusion that the purpose of the 1998 legislation was simply to ensure that all awards of shares or securities which were subject to forfeiture upon the occurrence of a specified event with a specified period of no longer than 5 years would fall within it regardless of whether or not the relevant condition had a business or commercial purpose.

50. Ms Sheldon accepted that the legislation which was in issue in both *UBS* and *Cyclops* was the 2003 legislation, and not the 1998 legislation, but she submitted that the approach to construing the later legislation in *UBS* and *Cyclops* was equally applicable in this case. This was because:

(1) the purpose of both sets of legislation was the same – that of encouraging employee share ownership while preventing tax avoidance in relation to awards of shares or securities where the shares or securities were liable to forfeiture. That much had been made clear by Lord Reed JSC (with whom the other members of the Supreme Court agreed) in *UBS* at paragraphs [9] and [10]; and

(2) as a general matter, the ITEPA was a consolidating act which was intended to restate the previous legislation relating to employment income with certain minor changes – see the Upper Tribunal decision in *Martin v The Commissioners for Her Majesty's Revenue and Customs* [2015] STC 478 ("*Martin*") at paragraph [47]. It followed that the purpose of the 2003 legislation had to be the same purpose as that governing the 1998 legislation. In that regard, the fact that the 2003 legislation was not the version as originally set out in the ITEPA when that Act was enacted but had instead been inserted a few months later by the FA 2003 did not change the purpose underlying the legislation. The purpose of the later, amended, version remained the same as the purpose of the original iteration in the ITEPA.

Consequently, where the 1998 legislation referred to a condition imposed by the terms on which the relevant shares or securities were acquired, that was to be construed in such a way as to be limited to a condition having a business or commercial purpose and to exclude a commercially irrelevant condition, which was the way in which the courts had applied the 2003 legislation in *UBS* and *Cyclops*.

51. In response to the point set out in paragraph 50(2) above, Mr Sherry pointed out that the FA 2003 had substantially rewritten the whole of Part 7 of the ITEPA. It had not simply inserted a new Chapter 2. For instance, it had introduced a series of different rules in relation to computation and brought in new exemptions. It had also introduced the new Chapters 3A and 3B. As such, it would be quite wrong to conclude that the purpose of the 2003 legislation, as determined in *UBS* and *Cyclops*, was the same as the purpose of the 1998 legislation.

52. The second reason given by Mr Sherry as to why, on a purposive reading of the 1998 legislation, the present circumstances, when viewed realistically, were such as were intended to fall within the legislation was that the legislation expressly contemplated that the condition in question could be the death of a person – whether the person receiving the award or some

other person – see Sections 140A(8)(b)(ii), 140C(5)(a) and 140F(2) of the ICTA. The express references to death in those provisions demonstrated that death was one of the conditions which Parliament had had in contemplation when the legislation was framed and therefore that an award which was liable to forfeiture upon death within a specified period of no longer than 5 years was intended to fall within the scope of the legislation. There was no suggestion in the legislation that the references to death should be qualified in any way.

53. Moreover, death was not a commercial concept. Its meaning was clear. The authorities showed that, where the concept to which the relevant legislation referred was not a commercial concept, then an absence of business purpose in the transactions which had occurred was irrelevant in determining whether the transactions satisfied the terms of the legislation in question. The position in this regard was the same as in the case of legislation referring to a purely legal concept – see Lord Hoffmann in *Westmoreland* at paragraphs [49 and [50] and Henderson LJ (as he then was) in *Rossendale Borough Council v Hurstwood Properties (A) Limited and others; Wigan Council v Property Alliance Group Limited* [2019] 1 WLR [2019] EWCA Civ 364 ("*Rossendale*") at paragraphs [74] to [79].

54. A related point was that there was not an obvious distinction between a case where a condition relating to survival for a specified period had a business or commercial purpose and a case where such a condition did not.

55. To that point, Ms Sheldon said that, whilst she accepted that the express references to death in the 1998 legislation meant that there were bound to be circumstances in which the receipt of shares or securities that were liable to forfeiture upon death within a specified period of no longer than 5 years were intended to fall within the regime, that did not mean that every circumstance in which the receipt of shares or securities that were liable to forfeiture upon death within such a specified period were intended to fall within the regime. It was still necessary to consider in relation to each particular case whether or not the death-related condition in question had a business or commercial purpose and a death-related condition which was commercially irrelevant did not meet this requirement.

56. Mr Sherry made two final points in support of his position in relation to the 1998 legislation. These were as follows:

(1) first, in a case where remuneration was deferred until the recipient of the remuneration had survived for a specified period, it made perfect sense for the tax point to be deferred until the end of the deferral period. That was consistent with the approach adopted by the Supreme Court in the NICs case of *Forde and McHugh Limited v The Commissioners for Her Majesty's Revenue and Customs* [2014] UKSC 14 ("*Forde*"). An immediate tax charge in those circumstances, which is what would occur in this case if the 1998 legislation did not apply, would be counter-intuitive and difficult to calculate – see Lord Hodge JSC in *Forde* at paragraphs [16] to [19]; and

(2) secondly, a distinction could be drawn between the present case – where, under the 1998 legislation as it was expected to apply at the time when the Bonuses were paid, income tax and NICs would arise in respect of the Loan Notes at the point when the condition expired, albeit on the reduced value of the Loan Notes resulting from their terms – and the facts in *UBS* – where the taxpayers were seeking to benefit under the 2003 legislation from an exemption from income tax and NICs both at the time when the relevant award was made and then when the condition expired. That was clearly more egregious than the present case.

Discussion

57. We agree with both parties that the correct approach to adopt in any particular case is to consider whether the relevant legislation, when construed on a purposive basis, is intended to apply to the relevant facts, when viewed realistically. The decision in *UBS* did not change anything in that respect. In his judgment in *UBS*, at paragraphs [61] to [68], Lord Reed JSC referred to the prior case law in relation to the *Ramsay* principle of statutory construction with approval. He did not suggest that it was wrong or needed to be extended in any way. So too did Henderson LJ (as he then was) in the subsequent Court of Appeal decision in *Rossendale* at paragraph [62]. We therefore need in this case to carry out the twofold process of:

(1) determining the facts realistically; and

(2) determining whether, when construed on a purposive basis, the 1998 legislation was intended to apply to those facts.

58. Starting with the first of those two stages, we have set out the facts in some detail in paragraph 14 above although, for reasons which will soon become apparent, the crucial finding of fact is the one set out in paragraph 14(5) as to the purpose of the condition in the case of each Bonus.

59. However, the second of those two stages raises a more difficult question. In our view, the answer to it turns on the extent to which the approach which was adopted by the Supreme Court in *UBS* and applied by the Upper Tribunal in *Cyclops* to the construction of the reference in the 2003 legislation to the receipt of shares or securities subject to a condition should be applied in construing the similar reference in the 1998 legislation to the receipt of shares or securities subject to a condition. We explain in paragraph 60 below the reason why we have reached that view although we note that, in any event, it accords with the approach adopted by both parties in the appeal.

60. Our task is to construe the 1998 legislation on a purposive basis. The decisions in *UBS* and *Cyclops* relate to the 2003 legislation and not the 1998 legislation. As such, they are, strictly speaking, not binding upon us. Nevertheless, the 2003 legislation is concerned with the same subject matter – the receipt of employment-related shares or securities subject to a condition – and is the successor legislation to the 1998 legislation. In addition, the language of the 2003 legislation also refers to the receipt of shares or securities subject to a condition, which is the language we are considering in the appeal. It therefore follows that, unless there is a reason why a purposive construction of the 1998 legislation should differ from a purposive construction of the 2003 legislation, we should follow the views of the two superior courts in relation to the 2003 legislation in construing the 1998 legislation.

61. Before embarking on that task, there are two preliminary points which we should make.

62. The first is of course to reiterate that *UBS* and *Cyclops* related to the 2003 legislation and not the 1998 legislation. We do not agree with Ms Sheldon's submission that the decision in *Martin* compels the conclusion that both sets of legislation should be construed in precisely the same way. That is because the original version of Part 7 of the ITEPA when it was originally enacted was subjected to radical changes by the enactment of the FA 2003. As such, it cannot be assumed that the purpose of the 2003 legislation following the substantial amendments to the original version of Part 7 of the ITEPA by the FA 2003 - which amended legislation was the subject of the decisions in *UBS* and *Cyclops* - must necessarily be precisely the same as the purpose of the 1998 legislation.

63. Having said that, it is apparent from the terms of Lord Reed JSC's decision in *UBS* that the 1998 legislation shared certain common aims with the 2003 legislation. That is apparent

from Lord Reed JSC's summary of the background and context to the 2003 legislation in *UBS* at paragraphs [3] to [12] and [75]. It is clear from those paragraphs that the 2003 legislation was part of a continuum in relation to the tax treatment of conditional employee share ownership that started with the 1998 legislation.

64. The purpose of both regimes in the broadest sense was to encourage employee share ownership. However, it goes further than that. A common feature of both regimes was a desire to ensure that, in the case of an award of shares or securities subject to a condition which would expire within 5 years, income tax and NICs would not be charged at inception when the award was made, by reference to the value of the shares or securities as encumbered by the condition, but would instead be charged on the value of the shares or securities on the earlier of the date of disposal and the date when the condition fell away.

65. As Lord Reed JSC explained in *UBS*, it was considered necessary to legislate in order to achieve that outcome because the Inland Revenue had received legal advice shortly before the introduction of the 1998 legislation to the effect that, "in relation to remuneration provided in the form of shares subject to forfeiture,…a charge to tax arose at the time when the shares were first awarded, on a value reduced by the risk of forfeiture." Lord Reed JSC went on to explain that the Inland Revenue press release announcing the 1998 legislation of 17 March 1998 and the explanatory notes which accompanied the subsequent draft legislation made it plain that "the advice gave rise to two problems. First, it was considered fairer to tax shares which were subject to the risk of forfeiture at the point when the risk was lifted or, if earlier, when the shares were sold, rather than when the shares were acquired. That was because it was at the point when the restriction was lifted that the value of the shares could most easily be determined, and that the employee was often able to realise their value. Secondly, it was considered necessary to prevent tax avoidance schemes involving remuneration in shares subject to forfeiture from being set up in order to exploit the new understanding of the legal position" (see *UBS* at paragraphs [8], [9] and [75] and the Inland Revenue press release at paragraphs [4] to [9]). It follows that both the 1998 legislation and, in due course, the 2003 legislation were designed to counter the avoidance opportunities which would arise if income tax and NICs were to be charged when the relevant award subject to a condition was made and were not to be deferred.

66. However, the 2003 legislation was enacted against the background of the Inland Revenue's experience of how the 1998 legislation had been operating in the period since it had been enacted. The 2003 legislation therefore had an additional anti-avoidance purpose which was quite separate from the one mentioned in paragraph 65 above. That additional anti-avoidance purpose was described in *UBS* at paragraph [75] as the need to address "aspects of the previous provisions which were considered to leave them vulnerable to avoidance or to create anomalies."

67. In short, both the 1998 legislation and the 2003 legislation were intended to forestall avoidance opportunities which could arise if income tax and NICs were to be charged when the relevant award subject to a condition was made but the 2003 legislation had the additional tax avoidance-related intention of closing off other avoidance opportunities.

68. The second preliminary point concerns how the decisions in *UBS* and *Cyclops* should be addressed in the context of this case. In our view, at this stage, when we are considering the question of whether the present facts fall within the ambit of the 1998 legislation, construed on a purposive basis, very little turns on the precise facts of *UBS* and *Cyclops* or the extent to which those facts are distinguishable from the present facts. This is because it is common ground that the ratio of the two cases is that the 2003 legislation is to be construed in such a way that the reference in that legislation to a condition subject to which employment-related securities are acquired is confined to a condition having a business or commercial purpose and does not include a commercially irrelevant condition whose only

purpose is to obtain the benefit of the relief conferred by the legislation. The only thing that we need to decide at this stage is whether the 1998 legislation is required to be construed in precisely the same way so that the reference in that legislation to a condition subject to which employment-related securities are acquired should be similarly restricted in its scope.

69. In answering that question, we were initially attracted by Mr Sherry's distinction between the different backgrounds to the two sets of legislation. We can see the merits in the argument that:

(1) the 1998 legislation was enacted in order to forestall tax avoidance opportunities arising from having an immediate tax point on the value of shares or securities as encumbered by a condition;

(2) as such, it should be construed widely in order to apply to all awards of shares or securities which are subject to a condition that expires within 5 years even if the condition in question has no business or commercial purpose;

(3) any other approach to construing that legislation would enable a taxpayer to insert a commercially irrelevant condition in order to take itself outside the legislation for tax avoidance purposes;

(4) the 2003 legislation was enacted to address aspects of the 1998 legislation which left the 1998 legislation vulnerable to avoidance or to create anomalies; and

(5) as such, the 2003 legislation should be construed more restrictively in order to ensure that it fulfills its purpose and should therefore exclude commercially irrelevant conditions, which is why *UBS* and *Cyclops* were decided in the way they were.

70. However, we have ultimately decided that the conclusions set out above are not consistent with the judgment of Lord Reed JSC in *UBS*. In order to explain why we have reached that conclusion, we need to set out at some length an extract from the section of his judgment headed "*Purposive construction*" as follows:

"[74] Nevertheless, the context of Chapter 2 provides some indication of what Parliament intended. Part 7 is clearly concerned with particular taxation issues which arise when employees are remunerated in shares and other securities. As was noted in para 12 above, the purposes of Part 7 were identified in broad terms in *Grays Timber Products* as being threefold:

(1) to promote employee share ownership, particularly by encouraging share incentive schemes;

(2) since such schemes require benefits to be contingent on future performance, creating a problem if tax is charged on the acquisition of the shares in accordance with Abbott v Philbin, to wait and see in such cases until the contingency has fallen away; and

(3) to counteract consequent opportunities for tax avoidance.

[75] The background to Chapter 2, explained more fully in paras 3-11 above, supports that view. Fiscal legislation concerning employment-related securities had its origins in anomalies which arose where shares awarded to employees as a form of remuneration, for business or commercial reasons, were subject to restrictions designed to incentivise future performance. The taxation of the shares in accordance with general principles of the law of taxation, as established in *Weight v Salmon* and more particularly in *Abbott v Philbin*, had the effect that the sum charged to tax failed to reflect the economic gain realised by the employee in the event that the shares increased in value as intended. Parliament's response was to impose a charge to tax when the restrictions were lifted (subject to the exemption of favoured arrangements), rather than when the shares were acquired. Chapter 2, as originally enacted, re-enacted provisions introduced in 1988 in order to prevent the application of *Abbott v Philbin*, and forestall consequent opportunities for tax avoidance. The amended version of

Chapter 2 with which these appeals are concerned was enacted shortly afterwards to address aspects of the previous provisions which were considered to leave them vulnerable to avoidance or to create anomalies. The structure of the legislation continued to be based on the exemption of restricted securities from income tax when the shares were acquired, and the imposition of a charge to tax when the restrictive conditions were lifted, subject to a widely drawn exemption from the latter charge.

[76] It is in the context explained in para 74, and against the background described in para 75, that it is necessary to consider the scope of the exemption on acquisition conferred by section 425(2), and more specifically the question whether, in section 423(1), the words "any contract, agreement, arrangement or condition which makes provision to which any of subsections (2) to (4) applies" should be construed as referring to "provision" with a genuine business or commercial purpose.

[77] Approaching the matter initially at a general level, the fact that Chapter 2 was introduced partly for the purpose of forestalling tax avoidance schemes self-evidently makes it difficult to attribute to Parliament an intention that it should apply to schemes which were carefully crafted to fall within its scope, purely for the purpose of tax avoidance. Furthermore, it is difficult to accept that Parliament can have intended to encourage by exemption from taxation the award of shares to employees, where the award of the shares has no purpose whatsoever other than the obtaining of the exemption itself: a matter which is reflected in the fact that the shares are in a company which was brought into existence merely for the purposes of the tax avoidance scheme, undertakes no activity beyond its participation in the scheme, and is liquidated upon the termination of the scheme. The encouragement of such schemes, unlike the encouragement of employee share ownership generally, or share incentive schemes in particular, would have no rational purpose, and would indeed be positively contrary to rationality, bearing in mind the general aims of income tax statutes.

[78] More specifically, it appears from the background to the legislation that the exemption conferred by section 425(2), in respect of the acquisition of securities which are "restricted securities" by virtue of section 423(2), was designed to address the practical problem which had arisen of valuing a benefit which was, for business or commercial reasons, subject to a restrictive condition involving a contingency. The context was one of real-world transactions having a business or commercial purpose. There is nothing in the background to suggest that Parliament intended that section 423(2) should also apply to transactions having no connection to the real world of business, where a restrictive condition was deliberately contrived with no business or commercial purpose but solely in order to take advantage of the exemption. On the contrary, the general considerations discussed in para 77 above, and the approach to construction explained in paras 64 and 68 above, point towards the opposite conclusion."

71. In paragraph [75] of the extract set out above, Lord Reed JSC identified the two distinct types of tax avoidance which Chapter 2 of Part 7 of the ITEPA was intended to prevent and which we have described in paragraphs 63 to 67 above – namely:

(1) forestalling the opportunities for avoidance which would potentially arise from the application of *Abbott v Philbin* [1961] AC 352 – in other words, from the imposition of an immediate charge to tax on the value of the shares or securities as reduced by the condition; and

(2) addressing aspects of the 1998 legislation (as re-enacted in the original version of Chapter 2 of Part 7 of the ITEPA) which were considered to leave it vulnerable to avoidance or to create anomalies.

72. As we have already noted in paragraphs 63 to 67 above, the first type of tax avoidance is the one which the 1998 legislation was also intended to counteract whilst the second type of tax avoidance was a target that was unique to the 2003 legislation, based as it was on the Inland Revenue's experience of how the 1998 legislation had operated in practice since its introduction.

73. In paragraph [77], Lord Reed JSC then turned to consider how that background should inform the construction of Chapter 2 and noted that "the fact that Chapter 2 was introduced partly for the purpose of forestalling tax avoidance schemes self-evidently makes it difficult to attribute to Parliament an intention that it should apply to schemes which were carefully crafted to fall within its scope, purely for the purpose of tax avoidance. Furthermore, it is difficult to accept that Parliament can have intended to encourage by exemption from taxation the award of shares to employees, where the award of the shares has no purpose whatsoever other than the obtaining of the exemption itself…". We consider that the reference in the above words to "forestalling tax avoidance schemes" is crucial in answering the question which we have to address in this decision. That language deliberately echoes the language used by Lord Reed JSC in paragraph [75] in referring to the first type of tax avoidance which the 2003 legislation was intended to counteract and not the second. In paragraph [75], Lord Reed JSC had referred to "[forestalling] consequent opportunities for tax avoidance" when referring to the first type of tax avoidance and to "[addressing] aspects of the previous provisions which were considered to leave them vulnerable to avoidance or to create anomalies" when referring to the second. It follows that, in our view:

(1) the purposive approach to construction which Lord Reed JSC was adopting in paragraph [77] was based on the fact that the 2003 legislation was intended to forestall the first type of tax avoidance and he was not in any way basing his approach on the fact that the 2003 legislation was also intended to address the second type of tax avoidance; and

(2) Lord Reed JSC was drawing the opposite conclusion from the one drawn by Mr Sherry as to the impact of Parliament's intention to forestall the first type of tax avoidance on the ability of commercially irrelevant conditions to fall within the terms of the 2003 legislation. In fact, Lord Reed JSC described any conclusion other than the one he was espousing as "self-evidently … difficult".

74. In our view, given that Lord Reed JSC was basing his purposive approach to construction on the fact that the 2003 legislation was intended to forestall the first type of tax avoidance and not on the fact that the 2003 legislation was also intended to address the second, his words apply equally to the 1998 legislation as they did to the 2003 legislation. This is because the 1998 legislation was also intended to forestall the first type of tax avoidance, as we have noted in paragraphs 63 to 67 above. Indeed, with the substitution in the second part of paragraph [77] of a reference to an interest in loan notes for the reference to the shares, Lord Reed JSC could just as easily have been describing the present facts as he was describing the schemes that he was considering in that case.

75. It follows from this that we can see no basis on which to distinguish the purposive construction of the condition-related language in the 2003 legislation which was adopted by the Supreme Court in *UBS* from the purposive construction of the condition-related language in the 1998 legislation in which we are now engaged and therefore that, on a purposive construction of that language, a commercially irrelevant condition which has been inserted solely to bring an award within the ambit of the 1998 legislation does not fall within the scope of that legislation.

76. That conclusion is sufficient for us to reach our decision in principle in the appeal because we have already set out our conclusion that the condition in this case had no business or commercial purpose – see paragraph 14(5) above. However, we would make the following additional observations in relation to Mr Sherry's submissions:

(1) first, we do not think that the various express references to death which are contained within the 1998 legislation change the answer we have reached above. That is because we agree with Ms Sheldon that those references simply mean that an award

of shares or securities which is subject to a condition referring to death within a specified period of time falls within the legislation in circumstances where the relevant condition is fulfilling a real business or commercial purpose. It does not mean that a case where a condition on those terms is commercially irrelevant and has been inserted solely to bring the award of shares or securities within the scope of the legislation achieves that purpose.

The position in this regard is no different from the death-related condition which was in issue in *Cyclops* where the Upper Tribunal emphatically rejected the proposition that the mere fact that death was a "real world" event as compared to the conditions which were in point in *UBS* made any difference to the outcome in that case – see *Cyclops* at paragraphs [63], [64] and [71]. In particular, we do not see how the fact that the 1998 legislation made express reference to death whereas the 2003 legislation did not renders inapplicable the reasoning set out by the Upper Tribunal on this issue;

(2) secondly, for the reasons given by Lord Reed JSC in paragraphs [81] to [84] of his judgment in *UBS*, we do not see any relevance in this context in the fact that the 2003 legislation contained anti-avoidance provisions in Chapters 3A and 3B of Part 7 of the ITEPA whereas the 1998 legislation had no equivalent. The question of whether the relevant shares or securities were acquired subject to a condition is a wholly separate question from whether the value of the shares or securities have been artificially inflated or reduced. In answering the former question, which is our task in this decision, the existence or otherwise within the relevant legislation of provisions dealing with the latter question is irrelevant.

Moreover, the anti-avoidance provisions in Chapters 3A and 3B of Part 7 of the ITEPA should properly be seen as fulfilling the second anti-avoidance purpose of the 2003 legislation to which we have referred in paragraphs 63 to 67 above and not the first and it was the first anti-avoidance purpose, which it had in common with the 1998 legislation, that was the basis of Lord Reed JSC's reasoning in *UBS* at paragraph [77];

(3) thirdly, we do not think that the observations of Lord Hodge JSC in *Forde* as to when a contribution into a retirement benefits scheme the enjoyment of which depended on the relevant employee's survival to retirement age should give rise to tax advances matters in the light of the position which is accepted by both parties – and which accords with the legal advice received by the Inland Revenue prior to the enactment of the 1998 legislation - which is that a receipt of an interest in securities that did not fall within the 1998 legislation gave rise to an immediate liability to income tax and NICs; and

(4) fourthly, we can see no significance in this context in the distinction drawn by Mr Sherry between the total exemption from income tax and NICs which was sought by the taxpayers in *UBS* and the somewhat more modest purpose of the Appellant in this case which was merely to reduce the quantum of those liabilities. In both cases, the relevant taxpayers were seeking to pay less income tax and NICs than, on our view of the law, they should.

77. Finally, for completeness, we should note that:

(1) we have concluded in paragraph 14(4) above that, although the creation and funding of PIL had commercial effects, those effects were not part of the purpose of CP or the Appellant in entering into the proposals to pay the Bonuses. However, even if that conclusion were to be wrong, it would not change the outcome of the appeal because, as the Upper Tribunal noted in *Cyclops* at paragraph [70], the relevant

consideration in this context is the purpose for the inclusion of the condition and not the purpose for the proposal as a whole or for any other aspect of the proposal; and

(2) the Respondents in this case did not submit that there was an alternative route to immediate chargeability to income tax and NICs based on the potential application to the facts in this case of the Supreme Court decision in *RFC 2012 plc (in liquidation) (formerly The Rangers Football Club plc v Advocate General for Scotland* [2017] UKSC 45 ("*Rangers*"). We therefore heard no submissions on the point and express no view on it. We would say only that:

(a) the Upper Tribunal in *Cyclops* at paragraphs [74] and [81] said that it did not find it necessary to consider the potential application of the *Rangers* decision to the facts in that case because, based on its view of the amounts which were chargeable to income tax and NICs as a result of its conclusion that the awards in that case fell outside the 2003 legislation, the application of the principle set out in the *Rangers* decision would have given rise to the same tax outcome as the one to which its analysis had already given rise;

(b) notwithstanding the above, in *Cyclops* at paragraphs [75] to [81], the Upper Tribunal addressed the question of whether the principle set out in the *Rangers* decision could apply to an acquisition of employment-related securities which did not qualify for exemption from income tax and NICs under the 2003 Legislation. In that regard, it noted that:

(i) in paragraph [46] of the *Rangers* decision, Lord Hodge JSC had said that the principle did not apply to an acquisition of employment-related securities falling within Part 7 of the ITEPA; and

(ii) despite a degree of ambiguity in that statement, it should be interpreted as meaning that the principle should not apply to all acquisitions of employment-related securities and not simply to acquisitions of employment-related securities which qualified for exemption from income tax and NICs under Part 7 of the ITEPA; and

(c) the above approach suggests that the principle might also not apply to an acquisition of employment-related securities before the enactment of the ITEPA which did not qualify for exemption from income tax and NICs under the 1998 legislation.

78. For the reasons set out in paragraphs 54 to 77 above, we agree with the third reason which the Respondents have given for objecting to the Loan Notes' falling within the 1998 legislation.

DISPOSITION

79. It follows from the analysis set out above that, in our view, the appeal fails.

80. It was common ground that the effect of this conclusion is that, in the case of each Bonus, the Appellant became liable to account for income tax and NICs when the Loan Notes were transferred to CP or DP, as trustee of the Trust, as the case may be. This accords with the conclusions reached in *UBS* at paragraphs [90] to [97] and *Cyclops* at paragraphs [82] to [103]. However, those decisions gave rise to very different outcomes when it came to quantifying the amounts by reference to which the income tax and NICs were chargeable.

81. In *UBS*, where the schemes in question involved redeemable preference shares which were not wholly represented by cash but by other assets whose value could vary, the Supreme Court held that the earnings received by the employees were the preference shares in

question, with the result that the measure of earnings was the value of the relevant preference shares on receipt, after taking into account the relevant condition – see *UBS* at paragraphs [90] to [95].

82. In contrast, in *Cyclops*, where the schemes in question involved redeemable securities in what were effectively "money-box" companies, the Upper Tribunal held that the arrangements, when viewed realistically, were no more than disguised or artificially-contrived methods of paying cash to the employees and therefore the measure of earnings was equal to the principal amount of the relevant securities without taking into account the relevant condition - see *Cyclops* at paragraph [102].

83. At the hearing, it was agreed that we would leave the question of quantum to be determined by the parties by agreement but that, failing agreement, the parties could apply to us to determine the question. We therefore heard no submissions in relation to the question of quantum and we express no conclusions in relation to that question. We merely note that:

(1) this is a highly fact-dependent exercise, as was shown in the different outcomes in *UBS* and *Cyclops*; and

(2) therefore, that, in seeking to agree the quantum of the liabilities to income tax and NICs in respect of the Bonuses, the parties are likely to derive considerable assistance from the passages in the decisions in *UBS* and *Cyclops* set out in paragraphs 80 to 82 above.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

84. 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.

TONY BEARE
TRIBUNAL JUDGE

RELEASE DATE: 27th MARCH 2024