TC02703

Appeal number: TC/2012/00946, 08686 & 05795

CGT – artificial scheme to create allowable loss – non commercial exercise of options – ss17 and 144 TCGA; s144ZA – whether disapplied by s 144ZB – whether a "securities option" within Ch 5 Pt 7 ITEPA.
S 149AA TCGA - whether deed poll an arrangement for conversion of shares- whether employment related securities.
Ch 5 Pt 7 ITEPA: whether option acquired by reason of employment of another person; whether retrospective addition to s 420(8) has effect.
Income Tax – s 574 TA 88 – CGT loss available against income – whether qualifying trading company - whether sale of shares bargain at arm's length.

FIRST-TIER TRIBUNAL
TAX CHAMBER

(1) STEVEN PRICE **Appellants**
(2) JOHN MYERS
(3) JAMES LUCAS

- and -

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

TRIBUNAL: JUDGE CHARLES HELLIER
SHAHWAR SADEQUE

Sitting in public at Bedford Square WC1B 3DN on 10, 11, 12 and 13 December 2012

David Ewart QC and Zizhen Yang instructed by NT Advisors Ltd for the Appellants

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

DECISION

1. This appeal concerns a scheme to create losses offsetable against taxable income. The scheme took place in the closing days of 2005/06. It involved: the acquisition of options to acquire shares, the exercise of those options and payment, and the sale of the shares. It is said that the sale of those shares resulted in a capital loss which could be translated into an income loss under section 574 TA 1988 so as to be available against other income.

2. The scheme was organised by NT Advisors. They collected together batches of individuals who wished to use the scheme, and ran a 'round' of the scheme for each batch. It was likely that 10 to 20 rounds took place. The appeals before us were by participants in the first two rounds of the scheme. Mr. Myers was one of the participants in Round 1, and, if the scheme works, made a loss of £6 million available to set against his other taxable income. Mr. Price and Mr. Lucas were two of the participants in Round 2, and, if the scheme works, made allowable losses of £300,000 and £1.5 million respectively.

3. The Round 1 scheme included the following steps. First, Mr. Myers had assigned to him an option to acquire shares in Stony Heating Ltd ("SHL"). He exercised the option and paid some £6 million. SHL issued the shares to him. A few days later he sold the shares for £552. It is said that the effect of the options provisions in sections 144 to 144ZD TCGA is that for CGT purposes his allowable expenditure available for deduction in computing his gain or loss on the disposal of the SHL shares (his "CGT base cost") was £6 million and that therefore he made a capital loss of just under £6 million on their sale. Then it is said that, because SHL was a qualifying trading company, section 574 translates that capital loss into an income loss available for offset against other taxable income.

4. The same steps were followed in relation to Round 2. But with an additional tweak. On the same day as the shares were acquired in SHL they were made the subject of a deed poll executed by SHL which it is said made them "convertible securities" for the purposes of Chapter 3 of Part 7 ITEPA 2003, and thus subject to the regime in section 149AA TCGA. The application of section 149AA is said to have the effect that (even if sections 144 to 144ZD do not have the effect claimed for them in the preceding paragraph) the CGT base cost of the shares was the amount paid for them namely some £330,000 by Mr. Price and £1.5 million by Mr. Lucas. They too sold their shares shortly after acquisition for an almost negligible amount and claim capital losses of just less than the subscription amounts. These capital losses they say are translated into income losses by virtue of section 574 TA 88.

5. When considering the legislation in the following parts of this decision, we use as tokens the figures applicable to Mr Myers –the £6m and the £552 – but the discussion is applicable to the other two appellants.

6. The magic of the scheme was to ensure that, in the round, the participants did not make the kind of economic loss which one would normally associate with

acquiring shares for £6m and disposing of them for £552. After the preplanned steps of the scheme had taken place each participant owed his subscription price for the SHL shares (the £6m) to a discretionary trust of which he was the principal beneficiary, and whose assets consisted mainly of that debt. Thus the principle economic effect of the scheme for Mr Myers was to leave him as the beneficiary of a trust to which he owed £6m: and the effect of the scheme was a flow of £6m of value from his net assets into that trust. This was achieved with the help of a series of loans and share redemptions and subscriptions in which monies moved from Hambros Bank through the participating entities and back to Hambros.

7. The appellants claimed the offset of the loss in their tax returns for the year ending 5 April 2006. After opening enquiries HMRC issued closure notices amending their returns on the basis that no loss accrued on the sale of the SHL shares, that any capital loss was disallowable, and that if a capital loss arose section 574 did not transmute it into an income loss. The appellants appeal against those conclusions and amendments.

8. We shall return to the detail of the statutory provisions after setting out our findings of fact and the detail of the operation schemes, but the reader may find that the following summary of the issues raised by HMRC may illuminate our description of the facts:

(1) The appellants' arguments in relation to the option provisions rely on section 144ZA TCGA applying. If it applies the CGT base cost of the SHL shares acquired on the exercise of an option will be the exercise price of the option (£6 million). But section 144ZA applies only if among other things the following conditions are satisfied:

(a) the option was a "securities option" within Chapter 5 Part 7 ITEPA. It would be such if it was:

(x) provided to a person by reason of his or another's employment (HMRC say it was not), and

(y) not subject to a retrospective anti-avoidance provision in Finance Act 2006 which came into force in relation to options acquired on or after 2 December 2004 (HMRC say it was). (The announcement that these retrospective clauses would be included in FA 2006 appears to have been the trigger for the additional convertible feature in Round 2); and

(b) the exercise price exceeded the value of the shares acquired.

(2) Section 574 translates a CGT loss into an income loss only if:

(a) SHL was a "qualifying company". That is dependent upon whether the activities of SHL and its subsidiaries taken as a whole were trading: HMRC say they were not because of the vast amounts of money moving around within SHL as part of the scheme; and

(b) the disposal of the shares was pursuant to a bargain at arm's length for full consideration: HMRC say it was not.

(3) In relation to Round 2, the taxpayers' argument for a loss depends also on section 149AA which provides that the CGT base cost of employee related convertible securities is the actual amount paid for them. Two issues arise:

(a) whether the SHL shares were convertible securities within section 149AA - the taxpayers arguing that they were because the deed poll declared them to be convertible into promissory notes;

(b) whether the provisions of section 149AA, if they apply, take precedence over the options provisions in sections 144 to 144ZD if those provisions have the effect for which HMRC contend.

Our Findings of Fact.

9. There was a statement of agreed facts. We heard oral evidence from Dr. Colin Masters, a solicitor, who was the sole director of SHL and effected the corporate actions of SHL which formed part of the schemes; from Nigel Forster, a director of Stony Heating and Bathroom Supplies Limited ("Bathrooms"), a company which became a subsidiary of SHL, and whose activity was the business of a plumbing shop in the Milton Keynes area; and from Matthew Jenner of NT Advisors who masterminded the operation of the schemes. We find the following facts from that evidence (acknowledging that to the extent the paragraphs below relate to the effects of agreements under English law they may be findings of law) .

10. Bathrooms is a company whose business at all relevant times was the operation of plumbing shop. It had an annual turnover of some £600,000, paid wages and salaries, and made annual and profits and losses in the £10,000s. That business was managed by Mr Forster. Until 16 March 2006 Mr. Forster was the holder of the only share issued by Bathrooms. On that date he transferred that share to SHL for £1000.

11. In about 2002 Mark Jenner (the brother of Matthew Jenner) was an apprentice plumber and used Mr. Forster's shop to buy supplies. He came to know Mr. Forster and in 2002 Stony Heating & Plumbing Limited ("Plumbing") was incorporated as a joint venture between Mr. Forster and Mark Jenner. Its business was to fit kitchens and bathrooms. The shares in Plumbing were held as to 49% by Mr. Forster and as to 51% by Mark Jenner. The venture did not prosper and by the end of 2005 it was virtually dormant (in the year to 30 November 2006 it had no turnover and incurred bank fees of £441 and had other income of £429). But Mark Jenner remained a director of Plumbing thereafter. Mr Forster ceased to be a director on 30 April 2007.

12. Matthew Jenner ran a tax advisory business, NT Advisors Ltd, with Mr. Anthony Mehigan. In about 2005 Matthew Jenner became aware of the scheme which is the subject of these appeals. He discussed it with a contact at SG Hambros and advice was taken from Rex Bretten QC as to its efficacy. As we have explained, the scheme relies on the acquisition of shares in a "qualifying company", viz. a trading company or group. Matthew Jenner lighted upon Bathrooms as a company whose business could fill this requirement. The scheme also required options to be acquired by reason of a person's employment (or directorship). Matthew Jenner lighted upon his brother, Mark Jenner, and his directorship of Plumbing for this requirement.

13. In the period up to March 2006 various participants decided to take part in the schemes. Arrangements were made to open bank accounts with SG Hambros Bank (Channel Islands) limited ("Hambros" or "Hambros bank") for all the entities and persons participating in the scheme. In due course monies would pass in accordance with the scheme between those bank accounts.

14. On 14 March 2006 SHL was incorporated in the British Virgin Islands ("BVI"). Dr. Masters was appointed its sole director. On 15 March 2006 it issued 100 A Shares to Mr. Forster for £1000 and, as already recorded, on 16 March 2006 it acquired Mr. Forster's share in Bathrooms for £1000. Thereafter it was in a position to be the parent company of a trading group so that capital losses on disposals of its shares might fall within section 574 TA 1988.

15. (It seemed to us that the use of SHL rather than Bathrooms itself in the structure of the scheme served three purposes: (1) so that Mr. Forster need not be involved in the legal mechanics, which could be entrusted to Dr. Masters; (2) to use the more flexible corporate laws of the BVI to deal with the issue and redemption of shares necessary for the scheme; and (3) to protect the sums of money passing during each Round from any potential claims arising from the Bathrooms business).

16. On 16 March 2006 SHL amended its memorandum and articles so that thereafter it had three classes of shares:

(1) £1 class A ordinary shares which were held by Mr. Forster (we did not see the memorandum and articles applying before 16 March, but presume that the shares issued to Mr Forster on 15 March became class A ordinary shares),

(2) £1 class B shares which could be issued for no less than £10,002 per share, had an entitlement to a set dividend of LIBOR plus 1%, and were redeemable at £1 per share at the option of the holder by notice given 12 months or more after their issue (if and when the company had sufficient surplus so to do); and

(3) 1p Preference shares which were redeemable at the option of the holder at £10,000 each. Once notice to redeem had been given the company was required to redeem the shares forthwith if it had sufficient funds in its share premium account, and, if not, to do so as soon as it had such funds.

17. It was the B shares which were the subject of the options and which, having been subscribed for some £6 million (in the case of Mr. Myers) were then sold for a comparatively negligible amount, creating the losses claimed by the scheme.

18. The Preference shares were to be part of the mechanism by which the subscription monies, which would originate from Hambros, were indirectly to be returned to it.

19. For Round 1 the following events took place:

(1) On 15 March 2006:

Mr. Myers established the John Myers life interest trust and appointed SG Hambros Trust Company (Channel Islands) as the trustee. The trust was established under Jersey law and provided that Mr. Myers would be the principal beneficiary for his life. The trustees had power to appoint to other specified beneficiaries (mainly relatives) both during and after Mr. Myers' life. The trustees had power to borrow.

(2) On 16 March 2006:

(a) By a call option agreement between SHL and Plumbing, SHL granted three options to Plumbing, each to subscribe for 10,000 B shares in SHL at variously £10,002, £10,200, and £10,020 per share. The SHL shares eventually acquired by Mr Myers were the subject of that one of those agreements which provided for an exercise price of £10,002 per share.

(b) NT Advisors wrote to Mark Jenner in relation to the options "that we understand you are to be offered by" Plumbing, and offering to pay him £300 for each assignment of options to one of their clients

(c) Plumbing offered the options to Mark Jenner. The offer was in the following terms: "The Board have ... decided ... to offer you the opportunity to acquire one of the Options .... This letter is, therefore, a formal offer to you in respect of that decision and is made by the Board because of your office with [Plumbing]..the assignment price will be £1.00 per option…you are permitted to assign any option to any person nominated by you. Any such person would have to enter into an agreement with us and also pay £1.00 per assignment.". The letter was signed by Mr. Forster.

(d) Mark Jenner then replied on the same day to Plumbing saying "I would like to direct you such that the [options] be assigned (in part) to the individuals set out in the attached list ... I hereby confirm that I am directing the Board to make the assignments as detailed on the attached list ...".

(e) [Oddly, in view of (b) to (d), it appears that on the preceding day, 15 March, Plumbing had written (p647) to Mr Myers explaining that it had decided to offer Mark Jenner the options but he had decided that "he wishes you to receive the option rights…that we had originally assigned to him.".]

(f) Mr Myers and Plumbing entered into an assignment agreement under which, in consideration for £1, Plumbing assigned to Mr Myers options over 600 shares derived from the option agreement Plumbing had made with SHL.

(g) Mr. Myers transferred £30,000 to the trustees of his life interest trust.

(h) A company called Europoint, whose shares were held on charitable trusts by SG Hambros Trust Company (Channel Islands) Limited, and

which was the beneficial owner of all the shares in a company called Gioventura, subscribed £26.30 for 2,630 1p Preference shares in SHL.

(3) On 17 March 2006:

(a) Europoint gave notice to SHL to redeem its Preference shares requiring payment to be made to Hambros bank;

(b) SHL faxed Hambros requiring them to pay £26,300,000 to Europoint's account with Hambros conditionally on the receipt into SHL's account of the monies from Round 1 individuals subscribing for SHL shares;

(c) Hambros bank and Gioventura entered into a loan facility under which Hambros would lend £26,300,000 to Gioventura. The facility agreement required Europoint to guarantee the loan, and in particular to give a charge over 'the Redeemable Preference Shares of [SHL] held by Europoint';

(d) Europoint gave a guarantee to Hambros Bank of a loan facility for £26,300,000 between Hambros Bank and Gioventura. Europoint's guarantee was secured over its Preference shares in SHL and the proceeds of redemption of those shares which were required to be paid to an account with Hambros but could be used to subscribe for additional shares in Europoint so long as paid into an account at Hambros charged to Hambros. (The loan to Gioventura by Hambros would indirectly provide the funds for the share subscription by the Round 1 participants. Those funds would enable the redemption of the Preference shares.)

(e) SG Hambros lent £26,300,000 to Gioventura under the facility;

(f) Gioventura lent £26,300,000 to the life interest trusts of the Round 1 participants including £6 million to Mr. Myers' trustees. The loan agreement specified that the loan could be used to lend money to Mr Myers to acquire B shares in SHL. It provided that after Mr Myers had used the monies to subscribe for B shares in SHL, the interest on the loan would reduce to 0.001% pa payable on redemption, and that the loan would be repayable in 79 years time.

Thus Gioventura made what to our minds was a remarkably uncommercial loan – advancing £6m in the sure expectation that its only return would be something insignificantly over £6m in 79 years time. In other words advancing £6m for consideration worth, as was later agreed between the parties, £1,500.

This loan was the key to ensuring that the material economic effect of the transactions was that Mr Myers effectively settled an obligation to pay £6m on the trusts of his trust, for as soon as he used the money deriving from the loan to pay SHL the trustee's obligation to repay Gioventura was almost wholly emasculated.

(g) Mr. Myers' trustees lent £6 million to Mr. Myers;

(h) Mr. Myers gave notice to SHL to exercise the option assigned to him over shares in SHL, and paid £6,001,200 (=£10,002 x 600) to SHL for 600 B shares.

(i) SHL, on receipt of the combined subscription monies from the Round 1 participants, paid £26,300,000 to Europoint in redemption of the 2,630 preference shares Europoint had subscribed on the previous day;

(j) Europoint paid £26,300,000 to Gioventura in subscription for 2 shares in Gioventura;

(k) Gioventura repaid the £26,300,000 borrowed from SG Hambros; and

(l) the terms of the loan by Gioventura to Mr. Myers' life interest trust became altered as a result of his subscription for the shares in SHL so that it was a repayable after 79 years with interest at the rate of 0.001% per annum.

(4) On 19 March 2006:

SHL issued 600 B shares to Mr. Myers.

(5) On 20 March 2006:

(a) Matthew Jenner, as attorney for Mr. Myers issued to persons he thought might be interested invitations to tender for Mr Myers' 600 B shares.

(b) As a result, on the same day the shares (for which Mr. Myers had paid £6,001,200 were sold to Scott Clark for £552 (92p per share).

(6) On 4 December 2006:

the trustees of Mr. Myers' trust agreed with Gioventura that they would pay £1500 in settlement of the £6 million loan;

(7) On 5 December 2006:

the trustees of Mr. Myers' trust waived £5,998,375 of the £6 million loan made to Mr. Myers.

20. Thus during 17 March £26,300,000 moved from Hambros and through a number of accounts before coming back to Hambros. The changes wrought by the transactions on that day were that at the end of it:

(1) Mr Myers was entitled to 600 shares in SHL;

(2) Mr Myers owed £6,000,000 to his life interest trust;

(3) That trust owed £6,000,000 to Gioventura, on deferred low interest terms (soon to be converted into £1500);

(4) Europoint had 2 more shares in its subsidiary Gioventura;

(5) Europoint no longer had the Preference shares in SHL; and

(6) SHL had a few thousand pounds more.

21. All the money movements took place through accounts with SG Hambros.

22. The letters from Plumbing to Mr Jenner and Mr Myers are keen (in our view overly keen) to stress that the SHL options were being made available to Mr Jenner by reason of his employment.

Round 2 (Mr Price and Mr Lucas).

23. The steps in the Round 2 were similar to those in Round 1 save (1) that they involved different amounts of money, (2) that they took place on different dates – with the days between 29 March 2006 and 5 April 2006 corresponding to the days between 15 March and 20 March; (3) that, on the day before all the money moved, SHL executed a deed poll allowing the holders of the B shares to convert them into £1 promissory notes on certain terms; and (4) although both Mr. Price's and Mr. Lucas' trusts both settled the loans from Gioventura with a small payment, only Mr. Lucas' trust waived the loan it had made to him.

24. We have not been able to incorporate a diagram of the movement of the funds, but a reader may find drawing his or her own helpful.

General findings.

25. Overall some £520 million passed through SHL during the course of all the rounds of the scheme which took place.

26. The appellants did not dispute, and we find, that the sole purpose of the arrangements was to produce tax relief which could be set against the participants' income.

27. The appellants did not dispute, and we find, that all the transactions were preplanned and took place in accordance with those plans except for: (1) a mistake in a particular bank account entry which was later corrected; (2) the precise terms of the sale of the shares pursuant to the tender (although it was accepted that a sale was planned and was likely to happen); and (3) the loan waivers by the trustees – in particular Mr. Price's trust might not waive the loan to Mr. Price in due course.

28. The execution of those plans was assisted by the participants signing undated documents delivered to NT advisors in escrow to be dated and completed on release; and by their giving powers of attorney to Matthew Jenner to act in relation to the acquisition and disposal of the SHL shares.

29. The delegation to Mr Jenner and the escrow arrangements mean in our view that there can be attributed to the arrangement constituted by any particular document an understanding of the effects and course of the arrangement as a whole. Thus for example in making payment under the option Mr Myers should be treated as knowing and intending that the making of that payment would result in the redemption of the Preference shares, the transfer of the monies to Gioventura, and the virtual extinction of his trust's liability under the loan from Gioventura.

Dr Masters

30. Dr Masters understood how the scheme worked and the steps involved. His role was limited, formal and undemanding, and involved "only a modest amount of time". He acted solely to facilitate the preordained steps. He was not remunerated for the part he played (although he was permitted to provide or promote the scheme to his own clients, and in respect of those clients who decided to participate in the scheme, he received fees from NT Advisors).

31. The documents Dr Masters executed as director of SHL were drafted by those organising the scheme. We do not doubt that Dr Masters read and understood the documents he signed as part of the scheme and that in each case he considered whether there was any reason why the company should not execute them. He did what he was asked to do when it was not improper to do it. We believe that he executed each document as part of the scheme and that each must therefore be seen in the light of the scheme as a whole. Thus for example the issuing of the B shares must be seen as for the purpose of reducing the value of the liabilities of the trustees to Gioventura, as well as for obtaining funds for the redemption of the Preference Shares; and the issue of the options as for the purpose of enabling them to be transmitted to the participants so that they could formally exercise them.

Mr. Forster

32. We thought Mr. Forster a straightforward witness. He was not a lawyer with a view of the world constrained by legal entities and saw himself as operating a business which happened to be contained within a legal structure in which he had little interest. That business was the operating of his shop, and was dependent upon his personal qualities and not the name or existence of the corporate entity through which it was conducted. He saw his remuneration as coming from the business, and not from the company. The business required his full-time attention: it was open six days a week, served some 40 customers a day, and employed, in addition to him, a part time driver and a sales assistant.

33. Mr. Forster told us that following a discussion sometime in 2005 he had agreed with Matthew Jenner that his participation in the scheme would be rewarded by extra money for the business of Plumbing.

34. We believe that the letters from Plumbing to Mark Jenner and the other participants, and the option and assignment agreements entered into by Plumbing and signed by Mr Forster, were signed by him as part of a package which assured his Bathrooms business extra funding to use as he saw fit. He was not overly concerned with understanding their content or import but would not have knowingly put his name to an untruth. These documents should therefore be seen as part of the package and not read simply according to their terms. Thus the egregious statements in the letters to Mark Jenner that the options were being offered or transferred to Mr Jenner by reason of his employment should not be read as meaning that such was the case; instead any such transfer of the options should be seen as for the purpose of the scheme, and by reason of the need to deliver options to the participants.

The participants

35. Each participant was sent a copy of Mr Bretten's tax opinion. They should be taken as understanding the economic effect of the preordained steps in the scheme.

The tenders for the shares.

36. We make our findings of fact in relation to the tenders for the shares later in this decision.

The market value of the B shares acquired.

37. The terms of the B shares are set out above. They were in our view clearly worth less than £1 each when issued and decidedly worth less than £10,000 at that time. They were worth less than £1 when sold by the participants.

Loans by SHL to Bathrooms.

38. When the participants subscribed for the B shares in SHL they paid slightly more than the related amounts which SHL used to redeem the Preference shares held by Europoint. Thus Mr. Myers paid £6,001,200 and the related Europoint shares were redeemed for £6 million. This left SHL with a modest cash surplus. Taking all the Rounds of the scheme together these surpluses totalled some £57,800. The accounts of SHL show that these monies had been lent to Bathrooms. The related accounts of Bathrooms did not break down the figure therein for creditors, but the increase in creditors in the 12 months in which the transactions took place was not inconsistent with the loan of £57,800 having been made to it by SHL.

39. There was no documentation of the terms of any loan and Dr. Masters could not provide any details of it. We have recorded that Mr. Forster told us that he had agreed with Matthew Jenner that his participation in the scheme would be rewarded by extra money for the business of Plumbing. The amount was about £58,000 and had probably been agreed towards the end of 2005. He said he intended to use the additional funds to pay off creditors and to invest in new stock (plumbing stock was expensive). He was not aware of any formal terms and conditions attaching to any loans from SHL.

40. Mr. Brennan suggested that there was no loan to Bathrooms. We disagree. The accounts provided evidence of payments to Bathrooms which we accept. The payment could only have been by way of gift or loan. If by way of gift it would not have affected the figure for creditors in Bathrooms' accounts. We accept that loans between group companies are often made informally and find nothing unusual in a lack of documentation in this case. We accept that the monies may have been regarded as a fee for Bathrooms (or Mr. Forster's) participation. But we find that Bathrooms received this sum as a loan from SHL and it was used in its business.

The results the schemes were intended to deliver.

41. The appellants contend as follows:

(1) Section 144ZA TCGA 1992 applies to the exercise of each appellant's option. Accordingly, for CGT purposes the cost to each appellant of acquiring the B shares was the exercise price, that is the amount of consideration which, under the terms of his option, was payable by him as a result of the exercise the option (sections 144ZA (2)(b), (4) and (4A) (b) TCGA 1992). The result is unaffected by section 144ZB. That section does not apply by reason of section 144ZB (2)(a) TCGA 1992 since each of the options was a "securities option" (as defined in section 420(8) ITEPA 2003) and one to which Chapter 5 Part 7 ITEPA 2003 applies (under section 471(1) and (3) ITEPA 2003).

(2) Further or alternatively, in relation to Round 2, the B shares acquired by each of Messrs Price and Lucas were both "employment related securities" (as defined in subsections 421B(1), (3) and (8) ITEPA 2003 and for the purposes of section 149AA(1) TCGA 1992) and were "convertible securities" (as defined in section 436 TA 2003 and for the purposes of section 149AA(1) TCGA 1992). Accordingly for CGT purposes the consideration for the acquisition of those shares in each case is taken to be equal to the actual amount given for them.

(3) Consequently each appellant suffered an allowable loss for CGT purposes on disposing of the B shares that he had previously acquired on exercising his option.

(4) Since SHL was a "qualifying trading company" (as defined in section 576 (4) TA 88) for the purposes of section 574 TA 88 each appellant can set the allowable loss against his taxable income.

Discussion

42. In the following sections of this decision we address, in the context of the progress through the relevant statutory provisions, the issues which arise. In addressing each of those provisions we bear in mind the obligation to construe them purposively with a realistic view of the facts.

43. Mr Ewart cautioned us against too liberal an approach to the CGT options provisions. He said that they were a precise mechanical code like the insurance provisions in *Mayes v HMRC* [2011] STC 1269 and not open to broad purposive construction. They applied in non commercial and non arm's length situations and their object was not to tax an economic gain but to prescribe a defined result.

44. In *Mayes*, Proudman J had held that the insurance policy legislation at issue did not seek to tax real or commercial gains: it made no sense to say that the legislation must be applied to transactions by reference to their commercial substance. The Court of Appeal agreed. Mummery LJ said that the essence of the Ramsay principle was to give the legislation a purposive construction to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction answered to the statutory description. In the case of the life insurance provisions the statutory requirements were removed from the kind of case where the focus was simply on an end result. The payments made fitted the statutory description: they were genuine legal events with real legal effects fitting the intended operation of the statute.

45. We agree with Mr Ewart that the CGT options provisions, by prescribing particular amounts as the base cost of assets acquired pursuant to options do not permit a shortcircuit to the simple question of whether an economic loss has been made. But there remains the need at each stage in the analysis of each provision to ask what was the intended effect or nature of each particular concept used by the statute and whether the transaction realistically viewed answered to it. Thus for example section 144ZA(4A) provides a definition of exercise price which is clearly directed at the formal terms of the option agreement, whereas in section 38 an enquiry of a different nature is directed into whether expenditure was wholly and exclusively on the acquisition of an asset. It depends on the provision in question.

Options and non arm's length transactions

46. Section 17 TCGA provides:

> **17** (1) Subject to the provisions of this Act, a person's acquisition or disposal of an asset shall, for the purposes of this Act be deemed to be for a consideration equal to the market value of the asset-
>
> > (a) where he acquires or, as the case may be, disposes of the asset otherwise by way of a bargain made at arm's length, and in particular…
> >
> > (b) where he acquires or, as the case may be, disposes of the asset wholly or partly for a consideration which cannot be valued, or in connection with his own or another's loss of office or employment or diminution in emoluments or otherwise in consideration for or recognition of his or another's services or past services in any office or employment…

47. The relevant parts of sections 144 to 144ZA TCGA provide:

> **144** (1) Without prejudice to section 21, the grant of an option ... is the disposal of an asset (namely the option) but subject to the following provisions of this section as to treating the grant an option as part of a larger transaction.
>
> ...
>
> (3)The exercise of an option by the person for the time being entitled to exercise it shall not constitute the disposal of an asset by that person, but, if an option is exercised, then the acquisition of the option (whether directly from the grantor or not) and the transaction entered into by the person exercising the option in exercise of his rights under the option shall be treated as a single transaction and accordingly -
>
> > (a) if the option binds the grantor to sell, the cost of acquiring the option shall be part of the cost of acquiring what is so, and ...
>
> **144ZA**(1) Subject to section 144ZB, this section applies where --
>
> > (a) an option is exercised, so that by virtue of section 144(2) or (3) the grant or acquisition of the option and the transaction resulting from its exercise are treated as a single transaction, and

(b) section 17(1) ("the market value rule") applies, or would apply but for this section, in relation to

(i) the grant of the option,

(ii) the acquisition of the option (whether directly from the grantor or not) by the person exercising, or

(iii)the transaction resulting from its exercise.

(2) If the option binds the grant or to sell -

...

(b) The market value rule does not apply for determining the cost to the person exercising option of acquiring what is sold, except, where the rule applies for determining the costs of acquiring the option, to that extent (in accordance with section 144(3)(a)).

...

(4) To the extent that, by virtue of this section, the market value rule does not apply for determining an amount of value, the amount of value to be taken into account is (subject to section 119A [increase in expenditure by reference to tax charge in relation to employment related securities]) the exercise price.

(4A) In subsection (4) "exercise price", in relation to an option, means the amount or value of the consideration which, under the terms of the option is -

...

(b) payable (if the option binds the grantor to sell),

as a result of the exercise of the option (and does not include the amount or value of any consideration for the acquisition of the option (whether directly from the grant or not)).

48. Before turning to section 144ZB we consider the effect of these provisions in the absence of that section. We do so because the appellant maintains that s 144ZB does not affect the operation of s 144ZA. It is therefore necessary to consider whether s 144ZA applies in the absence of s 144ZB.

49. It will have been seen that s 144ZA applies only if one of the transactions in s 144ZA(1)(b) is subject to section 17 – the market value rule. Of the three it is (iii), the transaction resulting for the exercise of the option which, given the discrepancy between the amount paid and the value of the SHL shares acquired, gives rise to the primary supposition that s 144ZA(1)(b) is satisfied.

50. *Mansworth v Jelley* [2003] STC 53 CA, (and in the High Court [2002] STC 1013), concerned the operation of the predecessors of section 17 and section 144 in the context of an option granted to an employee. At each stage it was held that the transaction to which section 17 should be applied was the grant of the option and its exercise taken as a whole, and that that transaction was not only not a bargain at arm's length but also one by reason of employment. As a result the acquisition cost of the

shares was to be treated as at market value at the time of exercise. It was to some extent in response to this decision that sections 144ZA to ZD were added to TCGA.

51. In the High Court there was initially some argument as to whether or not the acquisition of the option was otherwise than by reason of a bargain at arm's length, the Revenue having argued that the language only required a transaction between two parties. But the point was conceded and Lightman J concluded ([9]) that he "must proceed on the basis that the acquisition by the taxpayer of the options was an acquisition of an asset otherwise than by way of bargain made at arm's length.". But he did consider the construction of the words a "bargain at arm's length" at [13]:

> "The formula of words connotes more than a transaction: it connotes a transaction between two parties with separate and distinct interests who have each agreed terms (actually or inferentially) with a mind solely to his own respective interests."

52. In the Court of Appeal the issue did not arise. Chadwick LJ [31] regarded it as "beyond dispute that (taking the transaction as a whole) the acquisition of the shares was an incident of the taxpayer's employment".

53. Lightman J's formulation of the test was in the context of a transaction between two parties. There was no need to consider its application when more than two parties were involved. But it seems to us that a bargain at arm's length may conceivably be made between more than two parties (and indeed that may be implicit in the examples considered by Chadwick LJ at the end of his judgment ([33])). Thus one may test whether or not a single transaction under which A transfers an asset to B, B transfers an asset to C and C pays A is or is not a bargain at arm's length; in such a case the question posed by the statute is whether in coming to that bargain each party acted with a mind to his own separate and distinct interests. Further in the case for example of the transfer of an asset there could be an arrangement between more than two parties in which some acquisitions or disposals were at arm's length and some were not. Thus A might agree on arm's length terms with B that he would pay B £x and B would transfer an asset to C. In such a case B's disposal would not fall within section 17, but C's acquisition might or might not depending on any arrangement between A and C.

54. We note that section 17 uses the word "bargain" rather than "contract". That indicates that a binding contract is not a prerequisite of a bargain at arm's length.

55. It seems to us that having regard to the scheme as a composite whole each party to the scheme acted in his or its own separate and distinct interests. Thus:

(1) Bathrooms (Mr Forster's business) received additional cash for lending its business to the scheme;

(2) Plumbing received a few pounds for executing a few documents which affected it very little;

(3) SHL received a surplus on each Round (£1,200 in relation to Mr Myers) from its participation;

(4) SHL's director Dr Masters, obtained the ability to enable his clients to participate in the scheme;

(5) Hambros made arrangement fees in respect of each of the (very short term) loans it made;

(6) Gioventura made what on its own would be regarded as a non commercial loan to the trustees but did so in the sure expectation that it would receive an amount equivalent to the loan in the form of share subscriptions from Europoint, and, as a result of its participation, it benefitted from the few thousand pound which each set of trustees paid to settle outstanding liability on the loans it had made to them (£1,500 in Mr Myers' case).

(7) Mr Mark Jenner received £300 for each direction he made;

(8) Europoint owned Gioventura. The participation of Europoint and Gioventura secured for Gioventura the benefit described above, and for Europoint the added value of its subsidiary;

(9) The trustees were entitled to remuneration as trustees;

(10) Each participant obtained in respect of his outlay (£6m), the benefit of the trusts of which he was a beneficiary, and, in return for the expense of the sums which ended up in the pockets of all the above, obtained the ability to present himself as having obtained an allowable loss.

56. Each party (other than the participants) thus received a monetary recompense for the effort of signing bits of paper or taking the vanishingly small risk that the money would not go round as planned. Each party acted in the scheme as a whole and in its or his own part in it with regard to his or its own separate and distinct interests.

57. Thus if one regards the whole scheme as a bargain, it was at arm's length, and if one considers Mr Myers' payment to SHL of £6m it too was at arm's length having regard to the benefits that payment created, in particular the value in his trust.

58. There was no evidence that the other participants in the scheme were contractually bound to play their part, or that Mr Myers knew precisely when and what each of them would do. But it would be wholly unrealistic to regard the receipt of the benefit under the trust as not being part of the transaction under which he subscribed for the shares, or to regard him as simply laying out £6m for some practically worthless shares.

59. On this basis we would find that the grant of the options, the acquisition of the options by the participants, and the exercise of the options were transactions by way of a bargain at arm's length. Therefore we find that section 17(1)(a) does not apply. Section 17(1)(b) specifies a separate set of circumstances in which the market value rule applies. It is clear that none of the transactions were: (i) for a consideration which could not be valued, or (ii) in connection with the loss of employment or diminution of emoluments. But a question arises, in view of the terms of the letter from Plumbing to Mr Jenner, as to whether the options were acquired or disposed in recognition of Mr Jenner's service with Plumbing. It was, however, clear to our minds that they were not: they were in fact acquired and disposed of for the purposes of the scheme and not

in recognition of Mark Jenner's service with Plumbing. Accordingly section 17(1) does not apply to any of them. As a result the condition in section 144ZA(1)(b) is not satisfied. That means that section 144ZA does not apply and section 144 is left unaffected. If that is right then the question arises as to what was the acquisition cost of the SHL shares under the single transaction comprising the acquisition of the option and the transaction entered into by the person exercising the option; in that investigation section 17 would not apply.

60. Section 38 TCGA provides:

> **38**(1) Except as otherwise expressly provided, the sums allowable as a deduction from the consideration in the computation of the gain accruing to a person on the disposal of an asset shall be restricted to-
>
> > (a) the amount or value of the consideration in money or money's worth given by him or on his behalf wholly or exclusively for the acquisition of the asset, together with the incidental costs to him of the acquisition… .

61. The question is thus what amount was given "wholly and exclusively" for the SHL shares by the participants? In the "single transaction" to which section 144 requires attention Mr Myers paid £1 for the option and £6m odd when exercising the option, but he did so pursuant to a single scheme under which as a result of his payment he was to be a beneficiary of a trust endowed with assets available to benefit him (and his relatives) of £6m. It is not realistic in our view to regard him as paying £6m in the expectation or with the object that all he would get was the virtually worthless shares in SHL. In the context of the scheme he was not giving £6m wholly or exclusively for the SHL shares. The most that he could be said to be giving for them was their £600 redemption value; the rest of the £6,001,200 was given for the benefits arising under the trust and the fees of the other parties to the scheme in giving him the chance of claiming an allowable loss.

62. Mr Ewart says that in *Barclays Mercantile Finance v Mawson* [2005]AC 684 ("BMBF") the House of Lords recognised that in determining whether expenditure had been "incurred on" equipment the question to be asked was whether that expenditure had been incurred to acquire the machinery or plant [39], not what had happened to the money paid. The object of section 38 (Mr Ewart made the same point in relation to 149AA) is to give a deduction for the amount the taxpayer gives to acquire the asset; what happens to the monies thereafter is not relevant. He says that in *Tower MCashback LLP v HMRC* [2011] AC 457 where a scheme operating in relation to equivalent statutory provisions was held not to have succeeded, the distinction made with BMBF was that although there had been a loan to the taxpayer "there was not in any meaningful sense an incurring of expenditure of the borrowed money in the acquisition…It went in a loop…the borrowed money did not go to [the taxpayer] even temporarily;"([from 75 and 77]). By contrast Mr Ewart says Messrs Myers, Price and Lucas did receive the money and did spend it.

63. It seems to us that whilst the analysis in BMBF indicates that £6m may not be treated as given for the redemption of the Preference Shares by SHL, it does not answer the question of whether in fact the £6m was given for something else as well

as the shares. In BMBF there was no analogue of the competing benefit of the trust in this scheme. Whilst the money passed into, and out of, Mr Myers account, and he remained liable for borrowing incurred to be able to use that money, he cannot be said to have given it wholly and exclusively for those shares.

64. On this basis we would dismiss the appeals (subject in the case of the Round 2 appellants to the discussion of section 149AA below). But if we are wrong and it is impermissible to have regard to the scheme as a whole in determining whether section 17 applies we now turn to consider the argument on this basis: namely that because the exercise price of the option was significantly higher than the open market value of the SHL shares acquired, the transaction resulting from the exercise was not a bargain at arms length with the result that section 144ZA (1)(b)(iii) was satisfied.

65. Absent the application of section 144ZB the result of this would be that the "amount to be taken into account" would be the exercise price. The reference in section 144ZA(4) to the amount to be taken in to account refers to the amount which would otherwise have been determined by section 17, namely the amount of the consideration for his acquisition – his base cost. This amount, the "exercise price", is defined by section 144ZA(5) to be:

> " the amount of the consideration which under the terms of the option is-
>
> …(b) payable
>
> as a result of the exercise of the option".

66. It seems to us that these words are intended to direct attention to the formally agreed "terms of the option" and do not permit consideration of whether the amount payable or paid was in fact paid under the option or for the shares: this by contrast to section 38 is language with a narrower aim. As a result this amount is £6,001,200 or its equivalent.

67. Before we move on to consider section 144ZB we should first mention one further issue. Section 144ZA applies only where section 144 requires the option and the "transaction resulting from its exercise" to be treated as a single transaction. That phrase appears to have the same meaning as "the transaction entered into by the person in exercise of his rights under the option" in section 144(3). We considered whether the acquisition of the SHL shares was properly to be treated as "resulting from the exercise" of rights under the relevant options, and whether the "transaction entered into" was not simply the exercise of the option but the scheme as a whole. In form the shares were issued following the giving of notice under the options, but it might be said that in substance the issue of the shares resulted from SHL's agreement to participate in the scheme. If the SHL shares were regarded as not resulting from the exercise of the options sections 144 to 144ZA would not apply, and the base cost of the shares would fall to be determined under section 38. That would take us back to our conclusion on that section above.

68. The appellants say that there was no agreement between SHL and the appellants to issue the shares absent the options. The success of the scheme depended on the options. SHL only agreed to issue the shares if the options were exercised.

69. HMRC say that the answer depends upon whether the words "transaction resulting from its exercise" pose a legal or a factual question. They say it is open to the tribunal to conclude that as a factual matter the issue of the shares resulted from the scheme although on a restricted dissecting legal analysis the acquisition of the shares resulted from the options.

70. We concluded that the issue of the shares could properly be described as coming "from" both the scheme as a whole and from the exercise of the options. The statutory language does not require that the exercise of the options is the only source of the transaction. If the options had not been essential to the scheme it might have been possible to have come to a different conclusion: for if another separate cause for the issue of the shares predominated, it could be possible to say that the shares resulted from that cause and not the option. We therefore concluded that the SHL shares could be considered to have resulted from the exercise of the option for the purposes of these provisions.

A Securities Option to which Chapter 5 applies.

71. Sections 144ZB -144ZC provide:

> **144ZB**(1) This section applies where-
>
> > (a) section 144ZA would apply but for this section in relation to an option, and
> >
> > (b) the exercise of the option is non commercial (see section 144ZC)
>
> (2) But this section does not apply if-
>
> > (a) the option is a securities option within the meaning of Chapter 5 of Part 7 of ITEPA 2003 (see section 420(8) of that Act) to which that Chapter applies or would, apart from section 474 of that Act, apply (see section 471 of that Act), or…
>
> (3) Where this section applies, neither section 144ZA nor the following provisions of this section 144 shall apply in relation to the option-
>
> > …and (b) in subsection (3), the words from " and accordingly" to the end of that subsection;
>
> but subsection (4) or (5) below shall instead have effect (subject to subsection (6) below).
>
> …
>
> (5) If the option binds the grantor to sell-
>
> > (a) the consideration for the sale, and
> >
> > (b) the cost to the person exercising the option of acquiring what is sold,
>
> shall be deemed for the purposes of tax in respect of chargeable gains to be the market value, at the time the option is exercised, of what is sold…

144ZC (1)…(2) For the purposes of section 144ZB, the exercise of an option which binds the grantor to sell is non-commercial if the exercise price for the option is greater than the open market price of what is sold.

(3) In this section "exercise price" [has the same meaning as in 144ZA(4A)]

72. HMRC contend that 144ZB applied to the exercise of the option because the conditions in subsection (1) were satisfied: (a) 144ZA would otherwise apply and (b) the exercise was clearly non-commercial the meaning of 144ZC because the amount payable under the option was greater than the open market value of the SHL shares. They accept that 144ZB does not apply if "the option is a securities option" within the meaning of Chapter 5 Part 7 and to which that Chapter applies, but they say that the option was not a securities option. Accordingly they say that 144ZB does apply with the result that the acquisition cost is to be deemed the market value of the SHL shares, some £600 odd.

73. For the reasons set out above we accept for these purposes that section 144ZA would otherwise apply. On our construction of "exercise price" we conclude that the exercise was non-commercial within the meaning of section 144ZC. Thus the question is whether or not the option was a "securities option" to which Chapter 5 applied.

74. Section 144ZB(2)(a) specifies two requirements for an option to be a securities option: (a) that Chapter 5 applies to the option – as to which one is directed to section 471 ITEPA, and (b) that the option be a securities option within section 420(8) ITEPA. We consider these two requirements in turn.

(a) Section 471 ITEPA

75. Section 471 ITEPA 2003 provides:

471 (1) This Chapter applies to a securities option acquired by a person where the right or opportunity to acquire the securities option is available by reason of the employment that person or any other person.

(2) For the purposes of subsection (1) "employment" includes a former prospective employment.

(3) A right or opportunity to acquire a securities option made available by a person's employer, or a person connected with a person's employer, is to be regarded for the purposes of subsection (1) as available by reason of an employment of that person unless --

(a) the person by whom the right or opportunity is made available is an individual, and

(b) the right opportunity is made available in the normal course of the domestic family or personal relationships of that person…

(5) In this chapter --

"the acquisition", in relation to an employment related securities option means the acquisition of the employment-related securities option

pursuant to the right or opportunity available by reason of the employment,

"employment" means the employment by reason of which the right or opportunity to acquire the employment-related securities option is available ("the employee" and "the employer" being construed accordingly) and

"employment related securities option" means a securities option to which this Chapter applies.

76. HMRC say that Mr Myers should not be treated as acquiring the option by reason of employment.

A Right or Opportunity Acquired by reason of employment.

77. By virtue of section 5 ITEPA, since Mark Jenner was a director of Plumbing and thus an office holder he is to be treated as an employee of Plumbing, and Plumbing as his employer. Thus, as a result of subsection 471(3), a securities option made available to him – for whatever reason – is to be treated as being made available by reason of his employment.

78. Mr Ewart says that in this way subsection (3) concludes the issue. The opportunity to acquire the option became available by reason of Mark Jenner's employment. My Myers acquired the options in circumstances where the right to acquire it became available by reason of its having been available to Mr Jenner, and therefore in circumstances in which it became available by reason of Mr Jenner's employment.

79. In this approach Mr Ewart relies on the drafting of (1) and (3) which direct attention, not to whether the acquisition was by reason of someone's employment, but to whether the opportunity to acquire became available by reason of an employment.

80. Mr Brennan regards Mr Ewart as relying on too literal an approach to these provisions. He says that their object is to identify a sufficiently close link between the option acquired and the relevant employment to justify a benefit charge. That purpose is not met by treating the options as falling within section 471.

81. We start by noting that Mr Myers never obtained a "right" to acquire the options. The most that can be said is that he was offered the opportunity to acquire them. There are however several possible descriptions of that opportunity:

(i) it was the opportunity which had been offered to Mr Jenner, (if in a closely timetabled operation such as this it can be said that there was first offered an opportunity to Mr Jenner which he had not already renounced, and we note in this regard the letter of 15 March from which it appears that Mr Jenner had decided to transmit the right before it was offered.);

(ii) it was the opportunity which Mr Jenner made available to Mr Myers, and arose by virtue of Mr Jenner's direction;

(iii) it was the opportunity afforded to Mr Myers for the purposes of the scheme; being created by SHP and transmitted to him through the acts of Plumbing and Mr Jenner in pursuance of the scheme.

82. Ignoring for the moment the provisions of subsection (3), and taking subsection (1) on its own, the opportunity could only be said to have been available to Mr Myers by reason of employment if (i) is the proper description of it for the purposes of these provisions. But we do not believe it is a realistic view of the facts for those purposes; and, even if it were, it would not in our view be correct to say that the "reason" for that opportunity was Mr Jenner's directorship; that directorship was a step in the scheme but not the reason for granting the opportunity. If you ask "why was the opportunity granted?" the answer is "for the scheme", not because Mr Jenner was a director. The statements made in the letter from Plumbing cannot change that.

83. We now turn to the effect of subsection (3). It seems to us that subsection (3) is intended to have a wide effect. It is intended to avoid having to ask the factual question "did this come from the employment" when an employee gets something made available by his or her employer. The carve out for individuals providing domestic benefits (such as a birthday present for a son working in his mother's business) shows how wide the deeming is intended to be.

84. But it does seem to us that some constraint on a wholly literal construction is intended. For example: A large bank will have employees. If that bank made available to a customer an option, it would on a literal construction of (3) make that option available by reason of any of its employees' employment – since it is made available "by a person's employer". If that is the case the customer's acquisition of the option would fall within (1) even though there is no real link to employment and the customer's exercise of the option would be taxable under section 476. If subsection (3) is read in this way then the effect of (1) and (3) could be achieved simply by saying that the Chapter applies if an option is made available to anyone by a person who employs someone. That is plainly not their purpose.

85. That purpose seems to us to be the provision of an automatic link to employment if the recipient of the opportunity is an employee, and in other cases the requiring of an investigation as to whether or not there is in fact a link between the employment and the opportunity. As a result we regard (3) as limited to the making available of an opportunity to an employee by that employee's employer (or person connected with that employer).

86. This calls attention to the identification of the relevant right or opportunity. Subsection (1) refers to "the" right or opportunity to acquire; subsection (3) to "a" right or opportunity. They need not be the same. Thus if the right or opportunity under which a person acquires is not the same right or opportunity as that made available to an employee then (1) will not be switched on by (3), although the more general question will remain under (1) as to whether in fact that person received the opportunity by reason of the employment.

87. Thus if, for example, one spouse is offered options by her employer and asks that the offer be made to the other, there will be no question that (3) and therefore (1)

apply to the right or opportunity to acquire the options: the opportunity offered to the acquiring spouse is the same as the opportunity offered to the employee. But if the non employed spouse obtains an opportunity to acquire an option in the ordinary course of managing his investments, that opportunity will not be treated as having been, or have been, available by reason of his wife's employment at the bank.

88. In this case we have rejected the description of Mr Myers' opportunity as being the same as that available to Mr Jenner or the reason for that availability. None of the other possible descriptions of that opportunity permit the conclusion that it was available by reason of an employment.

89. We therefore conclude that the opportunity to acquire the options was not available by reason of the employment of a person, and thus that Chapter 5 did not apply to them. In case we are wrong we go on to consider the effect of section 420(8), and in particular the retrospectively inserted provisions.

(b) Section 420(8).

90. Section 420(8) ITEPA 2003 includes the following definition:

> "securities option" means a right to acquire securities *other than a right to acquire securities which is acquired pursuant to a right or opportunity made available under arrangements the main purpose (or one of the main purposes) of which is the avoidance of tax or national insurance contributions ...*

91. The italicised words were inserted by an amendment made by section 92 FA 2006 which provided: --

> "(5) This section has effect in relation to options acquired on or after 2nd of December 2004; but subsection (4) also has effect in relation to an option acquired before that date where something is done on or after that date as part of the arrangements under which it was made available.".

92. "Securities" is defined to include shares in any body corporate wherever incorporated. The options plainly provided a right to acquire securities within the meaning of the section.

93. HMRC said that the acquisition of the option to acquire the SHL shares was clearly part of an arrangement the main purpose of which was the avoidance of tax. There is no dispute that that was the main purpose. Thus they say the options are not securities options. That conclusion, by reason of section 92(5), they say applies both to Mr Myers and the other two appellants.

94. The appellants do not dispute that if the inserted words are taken literally then they will apply to disqualify the options. But they say:

> (1) the italicised words should be construed as not applying to the options since they do not fall within the mischief targeted by their insertion;

(2) applying the italicised provisions would cause unjustified interference with the appellants' property rights;

(3) legislation should not fit by accident; and

(4) that, in relation to the Round 1 option, the inserted provisions cannot apply retrospectively.

We consider these arguments in turn. The first three apply to all the appellants; the last only to Mr Myers. In our discussion of the first three issues below we do not consider the retrospectivity point.

95. (1) Construction by reference to the mischief addressed

96. Mr Ewart took us to the Press Notice which accompanied the 2006 Budget. PN3 explained that "schemes designed to avoid the payment of income tax and national insurance through the use of options" would be closed with retrospective effect in accordance with the Paymaster General's announcement in 2004 that "if further contrived schemes involving the avoidance of tax and NICs on employment remuneration emerged the Government would legislate to close them down…if necessary [with effect from the date of this statement]". The Budget Notes on the Finance Bill 2006 contained specialist technical information and described the amendment to section 420 as countering schemes which use options to deliver employment reward and avoid the payment of income tax and NICs.

97. Mr Ewart says that these publications indicate the mischief at which the amendment was aimed: it was not aimed at avoidance of tax on non employment income. Section 420, construed in the light of that mischief, should be taken as if the words "on employment income" were added at the end of the inserted words.

98. We accept that such materials can be aids to construction, and that their use for that purpose is not dependent on some ambiguity; and also that, if there is found in Explanatory Notes a clear assurance by the executive to Parliament about the meaning of a clause, or the circumstances in which a power will not be used, that assurance may in principle be admitted against the executive (reflecting the decision in *Pepper v Hart* [1993] AC 593); although it is not permissible to treat the wishes and desires of the Government about the scope of the statutory language as reflecting the will of Parliament. The object is to see what is the intention expressed by the words enacted.

99. Mr Brennan says that if Mr Myers had intended to use the loss partly against his employment income then even Mr Ewart's added words would not have saved him even though the scheme was not promulgated by his employer; if he used the loss partly against employment income and partly against, say, interest income would the words treat only part of the options as not being securities options? He says that the later parts of the CGT options code are intimately linked with the income tax code for options, and Parliament must have intended the inserted provisions to apply for the purposes of that code too.

100. We agree. Although the published material indicates the mischief at which the provision was aimed there is nothing in that material or in the words of the statute

which suggests that it was Parliament's intention that the inserted words should not apply for the purposes of the cross reference from the CGT options provisions.

(2) Applying the italicised provisions would cause unjustified interference with the appellants' property rights.

101. The appellants say that provisions of this nature, and particularly those which may have a retrospective effect, (whether the precise words of section 420(8) or the deeming of section 92) should be construed restrictively because such a construction is required by section 3 Human Rights Act 1998:

> "So far as it is possible to do so, primary legislation ... must be read and given effect in a way which is compatible with the Convention rights."

102. Those rights include those in Article 1 of Protocol 1: the right to the peaceful enjoyment of possessions, and not to be deprived of possessions except in the public interest and subject to conditions provided for by law. The second paragraph of the Article provides that this provision shall not impair the right of states to secure the payment of taxes.

103. In *National Provincial Building Society United Kingdom* (1998) 20 5EHRR 127 the European Court of Human Rights said:

> "80. According to the court's well established case law, an interference, including one resulting from a measure to secure the payment of taxes, must strike a "fair balance" between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights. The concern to achieve this balance is reflected in the structure of Article 1 as a whole, including the second paragraph: there must therefore be a reasonable relationship of proportionality between the means employed and the aims pursued."

104. Mr Ewart says that it would not be striking a fair balance to deprive the appellants of their right to tax relief by applying legislation in a manner that was not intended by its enactment which therefore could not be part of the general interest of the community.

105. It seems to us that this argument attributes to Parliament the limited intention expressed by the Government in the published material. But the words used in the enactment contain no such limitation. If, as we believe to be the case, Parliament intended the inserted words also to have effect in relation to any connected provisions relying on them, then the deprivation of property visited upon persons affected by the change is of the same nature as the deprivation occasioned to any group of taxpayers as the result of any change in tax legislation. Such changes must be devoid of reasonable foundation before they can be said not to be justified. We can see no reason for applying that epithet to this change.

(3) Legislation should not fit by accident.

106. Mr Ewart quotes Bennion on Statutory Interpretation (fifth edition) section 169:

> "Where facts arise that were not forseen by Parliament, but which the words of the enactment accidentally fit, it may be necessary to depart from the literal meaning of the words in order to give effect to the imputed intention."

107. It seems to us that this principle may have effect where the effect of the statute, particularly when coupled with the passage of time and change in society, is manifestly not what was intended by its framers. That is different from having an effect which was not expressly acknowledged in explanatory material, and reflects a link between two related taxing provisions. We do not think it can be said that interaction of the two codes was not intended by Parliament.

(4) Retrospectivity: that, in relation to the Round 1 options, the inserted provisions cannot apply retrospectively.

108. In *Secretary of State for Social Security v Tunnicliffe* [1991] 2 All ER 712 at 724 Staughton LJ said:

> "In my judgement the true principle is that Parliament is presumed not to have intended to alter the law applicable to past events and transactions in a manner which is unfair to those concerned in them, unless a contrary intention appears."

109. Mr Ewart says that the inserted provisions bear unfairly on Mr Myers since the acquisition of the option fell outside the ambit of the warning given by the Paymaster General in 2004 that retrospective legislation would be introduced to counter avoidance of tax and NIC on employment income.

110. But the words of section 92(5) make it plain that Parliament intended the inserted words to have retrospective effect. There is no room for any general presumption against retrospectivity even if the change is unfair because the contrary intention appears in the legislation.

111. However there remains the question of whether the retrospective change was in contravention of Mr Myers' Convention Rights.

112. In *R(on the application of the Federation Tour Operators and others) v HM Treasury* [2008] SDC 547 Burnton J said:

> [104] Although a literal meaning [of article 1] would suggest that legislative provisions for the payment of taxes are outside the ambit of [the article], the jurisprudence of the European Court of Human Rights establishes they are not: they are subject to the rights of natural and legal persons concerned by the first paragraph. It follows that such laws must also satisfy the requirement of proportionality between legitimate aim and means … It is for the government to demonstrate that a measure that engages [the article] satisfies the requirement of proportionality …

113. That case related to air passenger duty. The Government had increased it. It was not disputed that in relation to flights which had yet to be booked, the increase was

defensible; the concern lay over the effect of the change in relation to passengers who had booked flights before the announcement of the future increase. Burnton J noted that the object of Article 1 was primarily to guard against arbitrary confiscation of property, and that a wide margin of appreciation should be afforded to the legislature in determining what was in the public interest. He held that in order to challenge the measure successfully it must be shown that the legislature's assessment was devoid of reasonable foundation. He concluded:

> [154] The hurdle for the claimants on [article 1] is very high. They must demonstrate that the decision to increase [Air Passenger Duty] with effect from October 2007 without any concession in relation to bookings made before the announcement of the increase was "devoid of any reasonable foundation". While that decision is open to criticism ... and with a retrospective effect, and it may have been adhered to under a mistaken view of the difficulties exempting tour operators existing bookings, it is impossible to conclude that the measure was devoid of reasonable foundation.

114. *R(on the application of Huitson) v HMRC* [2011] STC 1860 concerned a retrospective amendment of a double tax relief provision. The claimant had challenged the lawfulness of HMRC's enforcement of the amendment as being in violation of his rights under Article 1. The claimant had used a tax avoidance scheme which took advantage of a double tax agreement between the UK and the Isle of Man. The retrospective amendment of the double tax provision rendered the scheme ineffectual by depriving it of its potential tax advantages.

115. The Court of Appeal summarised the judgment of Kenneth Parker J in the High Court:

> [37] The crunch question was whether, on Convention principles, the retrospective effect of section 58 imposed an unreasonable burden on the claimant and thereby fails to strike a fair balance between the various interests involved ... the judge concluded that the challenged legislation, even though retrospective, did strike a fair balance: it was proportionate and compatible with [article 1].

116. The High Court had held that the new provision did not impose an unreasonable burden on individual taxpayers, that it provided a benefit to the general community, and that the provision had a legitimate aim. It was within the area of discretionary judgment for Parliament to legislate with retrospective effect to ensure a fair balance between the interests of the general body of taxpayers and those who sought to benefit from the scheme.

117. The Court of Appeal dismissed the appeal. It held that the judge was not wrong to conclude that these particular retrospective provisions were proportionate and compatible. The liability of the claimant under the retrospective provisions to pay UK income tax that he would have had to have paid had he not participated in the tax avoidance scheme was no more unjustified interference with his enjoyment of his possessions than the ordinary liability that his fellow residents in the UK were under

to contribute towards the cost of providing community and other benefits for the purposes of life in a civil society ([94]).

118. Mr. Brennan accepted that the prospect of any tax relief is property to which Article 1 can apply. Accordingly if retrospective legislation is disproportionate or unjustified (or otherwise devoid of reasonable foundation) that could be a breach of the Convention rights which would require the relevant legislation to be construed "so far as possible" in accordance with Convention rights.

119. Thus the issues are (1) whether the retrospective nature of section 92 is proportionate and justified and not devoid of reasonable foundation; and (2) if it is not, whether section 92 can be construed so as to avoid the interference with article 1 rights.

120. Mr. Ewart says that the warning given to taxpayers of the operation of retrospective legislation was limited to schemes to avoid income tax and NIC on employment remuneration. Further that intention was the mischief behind the enactment of section 92. Striking a fair balance between the general interest of the community and the appellants' Article 1 rights requires that section 92 and section 420 (8) be construed so that, at the very least prior to its enactment, it applied only to arrangements to avoid tax on employment income.

121. Mr. Brennan said that in the light of the warning given about retrospective legislation the action taken by the UK and in enacting section 92 was justified and proportionate. The provisions of the securities option regime and ITEPA interlocked, and were part of a single code. The way the pieces of the jigsaw fitted together meant that the application to TCGA was relevant to the Paymaster General's announcement. The Paymaster General did not say "only employment income" and it was implicit that associated avoidance under the connected TCGA option code was also targeted. In the light of that warning the provisions did not depart from what was justifiable nor from a fair balance between the interests of the general body of taxpayers and the right (if that is what it was) to engage in artificial and otherwise pointless tax avoidance transactions.

122. We accept that retrospective legislation is repellent. It breaches the legal certainty that one may reasonably expect from the state. Although Parliament is not constitutionally prevented from retrospective legislation, there must be some legitimate expectation that it will exercise that power only where justified and in a proportionate manner**.**

123. *Huitson* is authority for the proposition that it is within the area of a state's discretionary judgment to enact retrospective tax avoidance provisions. This provision is precisely aimed at such avoidance and in that sense is justified by the justifiable aim of countering such avoidance. The provision provides a benefit to the general community at the expense of those who seek to avoid tax. The balance between that benefit and burden would be unfairly or disproportionately struck if the provision was unfair to those whom it deprived of property in taking tax. Whilst it bears more heavily on those who were not within the scope of the Paymaster General's 2004

warning, those who rely on the detail of particular provisions which are associated with provisions within the scope of that warning must reasonably be taken to have had some apprehension that a retrospective change could affect them (and indeed Mr Bretten's opinion alludes to this possibility although he considers it unlikely). Further, for the reasons we set out elsewhere, it seems to us that any expectation that the scheme would apply must have been subject in any event to some doubt. Taking these factors together we conclude that the effect of the retrospective provision did not bear disproportionately on those affected by it.

124. That leaves the question as to whether, if we are wrong in this conclusion, conforming interpretation of section 92 and section 420 (8) is possible. Mr. Brennan argued that it was not. The words of section 420 were clear: the spirit of the legislation was to prevent tax avoidance; limiting that to employment tax avoidance went against the grain. Further if a taxpayer intended to use a loss from the scheme against say both trading income, capital gains and employment income, how could one set limits on the application of section 420 (8)?

125. Mr. Ewart's reply to the last point is we think correct. If the requisite moulding is a limit to the targeted avoidance to that one of tax on employment income then if any purpose or arrangement is to avoid such tax the options would not be securities options. If no part of the arrangement relates to employment income tax then the options will not be prevented from being securities options.

126. We find Mr. Brennan's first point more difficult but we feel that limitation to employment tax avoidance would not have gone against the grain.

Round 2: convertible securities

(a) Does section 149AA apply?

127. Section 149AA TCGA provides:

> (1) Where an individual has acquired an asset consisting of employment related securities which are-
>
> (b) convertible securities or an interest in convertible securities,
>
> the consideration for the acquisition shall (subject to section 119A [not relevant here]) be taken to be equal to the aggregate of the actual amount or value given for the employment related securities and [any amount taxed as earnings].
>
> (4) In this section "employment related securities" has the same meaning as in Chapter 3 of [Part 7 ITEPA].

128. Chapter 3 of Part 7 ITEPA includes section 421B which mutatis mutandis is in materially identical terms to section 471. The same arguments arise in relation to it as did in relation to section 471. We have set out our conclusions on them above.

129. There is no equivalent in Chapter 3 of Part 7 to the anti avoidance provision retrospectively introduced in section 420(8). Thus that provision cannot prevent the SHL shares from being convertible employment related securities

130. However, for the reasons discussed above in relation to section 471 we find that the SHL shares were not employment related securities, and thus were not employment related convertible securities. We proceed to consider whether they were convertible securities in case that conclusion is wrong.

131. Section 436 ITEPA defines convertible securities for this purpose:

> For the purpose of this Chapter securities are convertible securities if-
>
> (a) they confer on the holder an entitlement (whether immediate or deferred and whether conditional or unconditional) to convert them into securities of a different description,
>
> (b) a contract, agreement arrangement or condition authorises or requires the grant of such an entitlement to the holder if certain circumstances arise, or do not arise, or
>
> (c) a contract, agreement arrangement or condition makes provision for the conversion of the securities (otherwise than by the holder) into securities of a different description.

132. The appellants say that the deed poll was an "arrangement" within (b) which authorised the grant to the shareholder of a right within (a), namely the conditional entitlement to convert them into £1 promissory notes.

133. So far as is relevant the Deed Poll executed on 3 April 2006 by SHL provided:

> " A Holder may request that he ... be granted the right to convert each and every of the Shares held by him into a one year promissory note ("the Note") having a face value equal to the par value of the relevant share (i.e. £1). This right is referred to as the "Conversion Entitlement". ...
>
> "If the company receives such a request, the company hereby undertakes to grant the Conversion Entitlement within 30 days of receipt of the request. The Conversion Entitlement will be granted by way of a letter addressed to the Holder ... which letter will set out the details of the Conversion Entitlement, including the fact that the conversion will be contingent on the matters set out below. ...
>
> "At any time after receiving the above-mentioned letter, the Holder ... may exercise the Conversion Entitlement by giving 30 days (exercise) notice to the Company in writing, subject to the paragraph below.
>
> "As will be set out in the above-mentioned letter, the conversion of the Shares into Notes will be conditional on a majority (75%) of the holders (if any) of the Preference Shares ... consenting to the conversion during the 30 days exercise notice period".

134. We have assumed that such conversion is possible as a matter of BVI law. Neither party suggested otherwise.

135. Mr Brennan and Miss Shaw say that the shares themselves did not confer entitlement to conversion: the appellant was right not to rely upon section 436(a). We agree. Section 436(a) speaks of "the shares" conferring rights on the holder; that may be contrasted with the effect of holding the shares (which is to benefit from the deed poll). In relation to section 436(b) HMRC say:

> (1) that the deed poll was not a contract, agreement or arrangement within section 436(b). It was a document made solely by SHL: SHL could not make an arrangement with itself;
>
> (2) section 436(b) speaks of "the grant of ... an entitlement ... if certain circumstances arise"; by contrast they say that what SHL bound itself to grant was a contingent entitlement because the right to convert was contingent upon the consent of the 75% of the Preference Shareholders. They say that there is a difference between the contingent grant of an entitlement (potentially within section 436 (a)) and the grant of a contingent entitlement (not within section 436 (a));
>
> (3) that a right conditional upon the consent of the preference shareholders, a right dependent upon someone else's whim, is not the type of condition with which (a) is concerned: what is required is an objective condition;
>
> (4) that the B shares were redeemable at £1: the conversion right was illusory.

136. We address each of those arguments in the correspondingly numbered sections which follow.

(1) "Arrangement"

137. Although a deed poll might be described as a contract under seal, it has none of the elements of bargain which are fundamental to the idea of a contract under English law. We did not think it could be described as a contract. We are less clear that it is not an "agreement" for it is the consent (or agreement) by the signatory to be bound by the formality of his deed, and "agreement" is in clearly intended to be wider than "contract".

138. But notwithstanding Mr Brennan's protestations to the contrary we consider that the deed poll did constitute an arrangement – in so far as something which was a cog in the machine of a greater arrangement could itself aspire to that name. The deed poll was entered into solely by one person but it had effect to confer rights on third parties.

139. Nor in this case were the third parties unaware of the bounty bestowed on them – it had been arranged by Matthew Jenner whose knowledge and understanding must be attributed to those for whom he was attorney.

140. An "arrangement" is clearly intended to be a wide concept. Elsewhere in the Taxes Acts it has been used broadly: a scheme or arrangement to avoid tax (section 137 TCGA), and indeed in the provisions of the insert to section 420(8). We see no

reason to restrict its meaning in section 436 to something which is between two or more parties; and the language of that section, as it widens from contract to agreement, and from agreement to arrangement, suggests to us that this deed poll was an arrangement.

(2) Contingent entitlement or contingent grant

141. In relation to this argument we start by expanding section 436 (b) to replace "such an entitlement" by the words of section 436 (a):

> "a[n] arrangement… authorises or requires the grant of an entitlement (whether immediate or deferred and whether conditional or unconditional) to the holder if certain circumstances arise."

142. The condition imposed by the deed poll that the right to convert to be subject to the assent of 75% of the Preference shareholders (assuming for the moment that that is a condition – see (3)) means that the entitlement is:

> an entitlement (whether ... conditional or unconditional).

143. The question is therefore whether the effect of the deed poll is that at that entitlement is "authorised or required to be granted ... if certain circumstances arise". Mr. Ewart says that the fact that the deed poll requires the grant of the Entitlement only if the holder makes a request for conversion satisfies this phrase - the circumstances are the request from the holder.

144. It seems to us that there is no difference between having a right to something, and having a right to a right to something. If A grants B the right to X if B asks for that right, that is the same as B having that right. One does not transform a right into a right-if-circumstances-arise by making that right subject to asking for it.

145. Thus we do not regard the requirement in the deed poll that the holder requests the Conversion Entitlement before it is formally granted as satisfying the words "if circumstances arise". We accept that the precise way in which the Conversion Entitlement is to be exercised is not spelt out in deed poll and would be described in a letter which the company undertakes to produce. But that letter can do no more than set out administrative details. The right exists: the entitlement had been granted

146. We therefore find that the deed poll did not authorise or require an entitlement "if certain circumstances arise".

(3) A Condition

147. Mr Ewart responds to this argument by saying a condition simply requires something objectively verifiable. Something in the power of someone else is properly regarded as a condition.

148. We agree. We see no reason for restricting "condition" to a circumstance which is not within the control of a third party. Thus, as Mr. Ewart suggested, a contract

which took effect only if planning permission was granted would properly be regarded as giving rights subject to a condition.

(4) An Illusory right

149. Although the B shares were redeemable, they were redeemable from 12 months after issue and only if a "surplus" (undefined but presumably of share premium or profit) was available from which to redeem them. The deed poll potentially secured additional rights.

150. We could not be sure that there was no intention to rely upon the deed poll in the wider scheme. The Round 2 purchasers under the tender mechanism may well have preferred the possibility of a promissory note to the uncertainty of the availability of a redemption after 12 months.

151. We conclude that the right was not wholly illusory.

Conclusion on section 436

152. We find that the B shares in SHL were not convertible securities because they did not satisfy the condition in 436(b) that the arrangement authorised the grant "if certain circumstances arise".

(b) The Application of section 149AA

153. If we are wrong and the SHL B shares fell within section 436, the question arises as to what acquisition cost is specified by the section. If this section did apply the base cost of Mr Price's and Mr Lucas' SHL shares would be the actual amount or value "given for" the securities. Mr Brennan argued that this was not the analogue of Mr Myers' £6,001,200, but realistically only £1,200: either because that would be the net amount left behind in SHL after the expected redemption of the Preference Shares, or because the £6m was in fact given for the benefit under the trust.

154. It seemed to us that Parliament's use of two different phrases in section 38 and section 149AA might indicate a difference between amounts given "wholly and exclusively" for the acquisition of an asset and the amount "given for" an asset. In the context of this scheme we have concluded ([64 to 66]) that the option exercise price was not paid wholly and exclusively for the shares; the question is thus whether it may similarly be concluded that the option exercise price was not "given for" the SHL shares.

155. It seemed to us that section 149AA was concerned with what had to be paid to get the shares, whereas the words of section 38 permitted attention to other purposes for which a payment might also be made. Thus we concluded that it was possible to say that £6,001,200 was given for the shares.

(c) Section 149AA or the option rules?

156. If the SHL shares were convertible securities within section 149AA that section would require the consideration for their acquisition to be equal to the actual amount of the consideration given for to those shares. If that amount is the amount actually paid by the participator to SHL (the analogue of Mr. Myers' £6 million), then this may give a different result from that which applies under sections 144 to 144ZD. If that is the case which provision should prevail?

157. The legislative history is relevant. Section 144ZA and section 149AA were both inserted into TCGA by FA 2003. Sections 144ZB to ZC (and ZD, which is not relevant to this appeal) followed later and were inserted by FA (No 2) 2005.

158. HMRC say that if ZB applies it should take precedence over section 149AA because it was inserted later. Mr. Ewart says that where there is a conflict between provisions the more specific takes precedence. Since 149AA relates specifically to employment-related restricted or convertible securities, and ZB to ZD apply more generally to the acquisition of anything pursuant to an option infected by non-commercial or non-arm's-length terms, section 149AA should prevail where it applies.

159. We think Mr. Ewart is right. After FA 2003 it seems to us that section 144ZA coupled with section 144 had a general effect in relation to option transactions of a wide nature. The specific provisions of section 149AA would have applied in precedence. The effect of the insertion of ZB to ZC was to modify that general scheme, and in our view they should not be regarded by reason of their later enactment as prevailing over section 149AA.

160. As a result if (contrary to our view) section 149AA applied it would in our view take precedence both over the effect of the application of section 144ZB, if that section applied, and over the operation of section 144, if on our interpretation, that section applied unaffected by sections 144ZA to ZC.

Transmutation into an income loss.

161. Section 574 TA 88 provides:

> (1) where an individual who has subscribed for shares in a qualifying trading company incurs an allowable loss (for capital gains tax purposes) on the disposal of the shares of any year of assessment, he may, by notice given within 12 months from 31 January next following that year make a claim for income tax relief on --
>
> > (a) so much of his income for that year as is equal to the amount of the loss ...
> >
> > (b) so much of his income to the last preceding year is equal to the amount ...
>
> but relief shall not be given [twice]..
>
> (3) For the purposes of this section -

(a)an individual subscribes to shares if they are issued to him by the company for consideration of money or money's worth ...

162. But section 575 provides

(1) Sections 573 and 574 not apply unless the disposal is -

(a) by way of bargain made at arm's length for full consideration ...

163. As a result, in the context of this scheme, two conditions arise for consideration:

(1) was SHL a "qualifying trading company"; and

(2) was the disposal of the SHL shares pursuant to the tender arrangements a bargain made at arm's length for full consideration?

164. We consider these under the corresponding numbered headings below.

(1) A Qualifying Company

165. The provisions of sections 574 TA 88 are involved and complex. No purpose would be fulfilled by setting them out in detail here. For present purposes it is enough to record that the effect of section 576 is that SHL would, for the purposes of section 574, be a "qualifying trading company" if it were an "eligible trading company" for the continuous period from its acquisition of Bathrooms to and including the date of the relevant disposal of the B shares (section 576(4)(a)(i) and (b)(i) (the period from incorporation to acquisition being a period in which it was not an excluded company)).

166. SHL would be an eligible trading company throughout that period if it was the parent company of the trading group (section 576(4A) and section 293(2)(a)).

167. SHL would be the parent company of trading group if:

(1) Bathrooms was a "qualifying subsidiary". It is not disputed that it was; and

(2) if all the activities of the business of SHL and Bathrooms were "taken together" and "regarded as one business", no substantial part of it would consist in activities carried on otherwise than in the course of trade (section 293(3A)(c) and (3B)(b)).

168. HMRC say that while Bathrooms' activities were trading, those of SHL were not. Those activities consisted of the issue of options and the issue and redemption shares for the purposes of the scheme. Taking the two sets of activities together a substantial part was otherwise than in the course of a trade. The amounts of money involved, the dealings with the banks and the complexities of corporate governance were truly substantial.

169. Mr. Ewart says that Dr. Masters spent very little time or effort in the business: the real time and effort was spent in running Bathrooms' business. The effect of Dr.

Masters' activity was to realise a margin (which we shall call a profit) which was kept by SHL and lent to Bathrooms for the purposes of its trade: SHL was raising money for the purposes of trade and that should be regarded as being in the course of trade.

170. Although the sums of money which passed through SHL were substantial, its activities in relation to it were not: it occupied little time or effort. Although a legal mind may be needed to understand the relevant documents considerable effort is also needed for selling plumbing supplies. The profit made by SHL (£1200 in the case of Mr. Myers) was not insubstantial by comparison with the annual profits of Bathrooms' business, but we accept that that profit was used for the purposes of that business on being lent to Bathrooms; we accept that making that profit was for the purposes of the trade even thought it accrued from participation on the scheme.

171. Overall we concluded that the activities associated with Dr. Masters were not a substantial part of the business comprising all the activities taken together.

172. We conclude that SHL was a qualifying trading company.

(2) The Tender Mechanism: was the disposal of the SHL shares pursuant to the tender arrangements a bargain made at arm's length for full consideration?

173. Matthew Jenner was given a power of attorney by the participants to arrange for the sale of their SHL shares. In Round 1 he decided that the sale should take place before the budget on 22 March, and in Round 2 before the end of the tax year on 5 April. There was therefore a tight timetable for the sales. He told us that one of the tenderers had some financial experience: we believe they were all likely to have been financially literate.

Round 1 (Mr Myers)

174. In pursuit of these aims Mr Jenner gave advance warning to between 7 and 9 colleagues, acquaintances and friends that he would be inviting them to tender for some shares. On 20 March he sent them an Invitation to Tender Document which sought offers for Mr Myers' SHL shares. The document explained the nature of the rights attaching to the shares and gave some detail of the financial situation of the company. It did not describe the dividend rights on the shares but indicated that interest earned on the money representing their nominal value would be sufficient to pay "interest" on them. The document set a deadline of 6pm on the same day, 20 March, for the submission of offers. Acceptance would be communicated by 9.30am on 21 March.

175. Offers were received from three people for all 600 shares at between 87.5p and 35p per share, and from two people for 300 shares at 50p per share.

176. On 21 March Scott Clark signed a purchase agreement for all 600 shares at 92p per share. His offer had been for 87.5p per shares. Mr Jenner said he had spoken to him after his offer and talked him up.

Round 2 (Messrs Lucas and Price)

177. For this Round a single invitation to tender was issued on 4 April 2006 in respect of the shares of all the Round 2 participants. The deadline for receipt of offers was the same day. Acceptance would be communicated on 5 April. The document was sent to six people.

178. We did not have details of the offers made but saw no reason to doubt an assertion in a statement made to Mr Price that offers had been received of between 80p and 92p per share.

179. Agreements were made with Tomas Wanless and Trevor Clark (Scott Clark's father) for the sale of Mr Price's and Mr Lucas' shares at 92p per share.

Discussion

180. Section 574 applies only if the sale of the shares was "by way of bargain made at arm's length for full consideration".

181. We adopt Lightman J's touchstone of a bargain at arm's length as requiring that the parties act in their own separate and distinct interests.

182. Mr Brennan said that these were collusive transactions. Those to whom Mr Jenner sent the documents must have understood the sub text: "These shares are worth next to nothing – I want to sell them quickly – can you help me out?"

183. It is clear that those recipients who replied must have known that this was part of a game in which a speedy response was required. Most people would be likely to put a document such as they received on one side to consider at leisure unless it promised a vast return. Since all it promised was a modest gamble (the maximum gain could not have been much greater than £1 per share after financing costs), those who acted must have done so with some intention of obliging NT Advisors.

184. The rights of the shares and the financial situation of SHL meant that a purchaser would have some prospect of receiving £1 plus a modest dividend in about 12 months' time. We think it likely that those who offered would have had a strong suspicion that SHL would not engage in any real (risky or otherwise) business ventures in the future. Thus a purchase of shares for 92p would not have been a highly risky gamble on a profit of 8p-plus-a-dividend in 12 months, although the lack of any knowledge of the dividend rights on the shares would have made the risk in relation to the dividend element greater

185. Thus it is possible that purchaser acted with regard to his own interests in this bargain – both in the expectation of a corresponding favour from NT Advisors at some future date and in taking a modest gamble on a modest risk on the shares.

186. We had no direct evidence of the particular interest of the purchasers which they may have required in these transactions. On balance however it seems to us that such evidence as there is indicates that the purchasers were likely to have acted in their own interests without the intention of bestowing any benefit on the sellers.

187. As for the sellers, we had no doubt that what, through their attorney, they wanted was a quick sale of the shares. They knew they were practically and comparatively worthless and would have been content to get whatever Mr Jenner could persuade the purchasers to part with. They were acting through him in their own separate interests.

188. We conclude that the sales were by bargains made at arm's length

189. The statutory words also require that the bargain be for "full consideration". In our view 92p per share was at least full consideration for these shares. Although unlikely there was no guarantee that the director SHL would not embark on some risky venture which would deprive it of the funds to redeem the shares. Indeed we tend to the view that 92p may have been more than full consideration. There was no discussion before us as to whether or not something sold for more than it was worth was or was not sold for full consideration.

Summary

190. We find (using Mr Myers' figures, and save as noted as appropriately modified for the other two appellants) :

(1) That the SHL shares were acquired in a bargain made at arm's length (paras 49-59). Section 144ZA does not apply. The acquisition cost was £600 (paras 60-63).

(2) But, if we are wrong, then section 144ZB applies because:

(a) The options were not available by reason of the employment of a person (paras 77-88);

(b) The options were not securities options within section 420(8) because of the words inserted into that provision by FA 2006 (paras 89-125).

(3) Thus, subject to the effect of s 149AA in relation to the 2nd and 3rd appellants, the CGT loss which arose under the option provisions to Mr Myers, is limited to the difference between the base cost of £600 and £552.

(4) Section 149AA takes precedence over the option rules (paras 155-159) but the SHL shares were not convertible securities (para 151) and were not employment related (para 129).

(5) Section 574 applies to make any capital loss available against income because:

(a) SHL was a qualifying trading company (paras164-171);

(b) the sale of the SHL shares was at arm's length (paras 179-187).

But such loss is limited to the difference between the CGT base cost, as determined above, and the sale price.

Conclusions

191. We conclude that each appellant's loss available for offset against other income should be reduced to that determined in the preceding paragraph.

Right of Appeal

192. 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.

CHARLES HELLIER
TRIBUNAL JUDGE

RELEASE DATE: 23 May 2013