TC02967

Appeal number: TC/2012/08184

INCOME TAX – section 424 Income Tax (Earnings and Pensions) Act 2003- whether gain chargeable to income tax as employment income - whether shares disposed of by Appellant were conditional shares – yes - penalty under section 95(1)(a) Taxes Management Act 1970 - whether Appellant negligently delivered a tax return – yes – whether penalty under section 97AA(1)(b) Taxes Management Act 1970 for failure to produce documents – no reasonable excuse – appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PETER STRATTON **Appellant**

- and -

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

TRIBUNAL: JUDGE GUY BRANNAN
SONIA GABLE

Sitting in public at Norwich on 9 April 2013 and written submissions 3 June, 9 July and 2 August 2013

Guy Travers, Daniels Travers & Co, Accountants, for the Appellant

Philip Oborne, Presenting Officer, for the Respondents

DECISION

Introduction

1. This is an appeal against an amendment to the Appellant's tax return for 2006 – 07 made by a closure notice dated 5 March 2012. Essentially, the issue on the substantive point is whether a gain made by the Appellant on a disposal of shares in that tax year was taxable as employment income or whether it was chargeable, as the Appellant contends, to capital gains tax. The Appellant also appeals against a penalty notice (£340) dated 13 February 2009 issued under section 97 AA (1) (b) Taxes Management Act 1970 ("TMA") in respect of an alleged failure to produce documents and a penalty determination (£23,650) under section 95 TMA in respect of the alleged negligent submission of an incorrect tax return for 2006 – 07.

2. The original hearing of this appeal was on 9 April 2013. We heard evidence from the Appellant and he was cross examined by Mr Oborne for HMRC. In the course of that hearing we decided, with the agreement of the parties, that both parties needed to clarify their submissions. Accordingly, on 15 April 2013 we issued Directions which permitted HMRC to amend its Statement of Case and for the parties subsequently to make sequential written submissions.

3. Our decision is, therefore, based on the evidence produced for the original hearing and the written submissions made by the parties. We do not consider this to be an ideal procedure, although we consider that the result and the process have been fair and just. Nonetheless, both parties should examine the events leading up to this hearing (e.g. the correspondence between the parties, the review process, the Statement of Case and the submissions made at the original hearing) and reflect on the shortcomings which made the extended process of written submissions necessary. We consider that both parties were at fault in failing to crystallise the issues which needed to be addressed at the hearing on 9 April 2013.

The facts

4. As noted above, the Appellant gave evidence at the hearing and was cross-examined by Mr Oborne for HMRC. The written evidence was contained in a bundle of documents and correspondence.

5. We find the following facts.

6. The Appellant joined General Healthcare Group PLC ("GHG") (which was under a different name) in January 1988 and was, at all material times, an employee of GHG.

7. In 2001 the Appellant acquired 250 T shares ("the shares") in GHG.

8. Since September 2000 GHG had been owned by investment funds advised by BC Partners. GHG was owned as to approximately 90% by the BC Partners-advised

funds and 10% by management. The Appellant's shareholding was part of that management stake.

9. The Appellant had been offered the opportunity to acquire the shares by a letter from the Chief Executive of GHG dated 29 June 2001 following the satisfactory completion of six months employment with GHG. In fact, the Appellant had already been employed for some years by the GHG group but GHG required that he complete six months in a new role within the group in Norfolk before being eligible to acquire the shares. The Appellant completed an application form dated 12 July 2001 and paid £6,725 for the shares.

10. On 16 July 2001 the Appellant executed a Shareholding Deed ("the Deed") between the Appellant, General Healthcare Employee Trust Limited (the employee trust from which the Appellant would acquire the shares, hereinafter referred to as "the Trustee") under which the Appellant acquired his shares and which recorded the terms on which the Appellant did so. There is some dispute about the exact date in 2001 on which the Appellant acquired the shares. The Appellant argued that the date was 9 August 2001 whereas HMRC considered that the Appellant acquired the shares on 16 July 2001 pursuant to the Deed. We do not think that anything turns on this point but we prefer HMRC's view as being more consistent with the documents.

11. The Recitals to the Deed stated that the Articles of Association of GHG were "not sufficiently specific as to the appropriate and intended allocation of any gain on the shares… in a number of respects." The relevant provisions of the Deed were as follows.

12. Clause 3 (Cessation of New Shareholder as a Shareholder –Purpose of this Agreement):

> "The Parties agree that the provisions of Clauses 4, 5, 6 or 7 (as appropriate) of this Agreement shall apply upon the New Shareholder [the Appellant] ceasing to be a shareholder, dependent on whether the New Shareholder ceases to be a shareholder as a result of: –
>
> 3.1 His or her becoming a Bad Leaver
>
> 3.2 His or her becoming a Good Leaver
>
> 3.3 An Exit
>
> 3.4 Either 3.1 or 3.2, above but in circumstances where the 'A' Director exercises his discretion under Article 11. B .3

13. The expressions Bad Leaver, Good Leaver and Exit were defined in the Articles of Association of Association of GHG. However, we were not provided with the Articles of Association of GHG. In our experience, a "good leaver" will usually be an employee whose employment terminates either by reason of death, disability or, in some cases, redundancy. A "bad leaver" will usually mean an employee who leaves in circumstances justifying summary dismissal. Furthermore, we have no details of the 'A' Director's discretion.

14. Clause 4 (Cessation of New Shareholder as a Shareholder in Circumstances where a Bad Leaver) provided:

> 4.1 In the event that the New Shareholder is a Bad Leaver (and the 'A' Director has not exercised his discretion under Article 11.B. 3) then the New Shareholder shall transfer the T Shares… to the Trustee and receive from the Trustee –
>
> (a) for each T Share the lower of (i) the Purchase Price plus Indexation thereon, and (ii) the Relevant T Ordinary Value at the Departure Date, and
>
> (b)…
>
> 4.2 Such sum shall be paid to the New Shareholder by the Trustee within the timescale set out in Article 11 .5.
>
> 4.3 Subject to receipt of such sum from the Trustee, neither the company nor the Trustee shall be under any further obligation to the New Shareholder in relation to his or her holding of shares… in the Company.

15. The Purchase Price was defined by Clause 1 as:

> The price per share to be paid by the New Shareholder to the Trustee for each of the T Shares to be transferred to the New Shareholder, such price being specified in the Schedule.

16. In fact, there were two Schedules to the Deed. Schedule 1 provides the definition of Purchase Price as: "250 T shares at a Purchase Price of 90p per share."

17. Clause 5 (Cessation of The New Shareholder as a Shareholder in Circumstances where a Good Leaver) provided:

> 5.1 In the event that the New Shareholder is a Good Leaver (and the 'A' Director has not exercised his discretion under Article 11. B. 3) then the New Shareholder shall transfer the T Shares… to the Trustee and shall receive from the Trustee: –
>
> (a) for each T Share
>
> (i) the amount paid by the New Shareholder for such share, (as set out in Schedule 1 to this Agreement),
>
> plus
>
> (ii) an amount or value (which may be nil) calculated in accordance with Schedule 2,
>
> and
>
> (b) …
>
> 5.2 The sums referred to in 5.1. (a) (i)… shall be paid to the New Shareholder within within [sic] the timescale set out in Article 11.5.

18. Clause 6 (Cessation of the New Shareholder as a Shareholder as a Result of An Exit) provided:

> 6.1 In the event that the New Shareholder is a shareholder immediately prior to the date of an Exit, the New Shareholder shall when required by the Trustee whether prior to or at Exit transfer the T Shares… to the Trustee.
>
> 6.2 The New Shareholder shall in respect of his or her T Shares receive (i) the par value plus (ii) such portion of the Exit Value as is equivalent to the amount that would have been paid to the New Shareholder under clause 5.1 above, in the event that the New Shareholder was a Good Leaver as at the date of the Exit, (less their par value) SAVE THAT the discount of 12.5% referred to in PART A of Schedule 2 shall, (in the event that the shares held by the New Shareholder fall within the scope of that part of that Schedule), be nil.
>
> 6.3…
>
> 6.4 Subject to receipt of such sums from the Trustee, neither the Company nor the Trustee shall be under any further obligation to the New Shareholder.

19. Schedule 2, paragraph 3, provided:

> For the purposes of the calculations required to determine the amounts payable to a T Only Shareholder [which included the Appellant] the following shall apply: –
>
> 3.1 the Net Exit Value shall be apportioned between the holders from time to time of the T Shares;
>
> 3.2 such apportionment shall be made on a proportionate basis, with each T Only Holder receiving the relevant proportion (in his or her case) of the Net Exit Value;
>
> 3.3 the relevant proportion in each case shall be calculated in accordance with paragraphs 3.4, 3.5, 3.6 and 3.7 below.
>
> 3.4 First there shall be determined the increase in the Net Enterprise Value of the Company during the period that the T Shareholder held the shares. This shall then be divided by the aggregate of the increases in Net Enterprise Value of the company [sic] during all periods of T Only Holding, in order to determine the relevant proportion of the Net Exit Value payable to each T Only Holder.
>
> 3.5 The increase in Net Enterprise Value during the period of holding of a T Only Holder shall be determined by deducting the Net Enterprise Value at the start of the period of holding from the Net Enterprise value at the end of the period of holding.
>
> 3.6 PROVIDED ALWAYS that (i) increases in Net Enterprise Value shall be reduced by 12.5% in the case of all T Only Holders, save for the Holder immediately prior to an Exit; (ii) where the Net Enterprise Value declines during the period of holding of any T Only Shareholder, then the relevant increase shall be zero; and (iii) where a

> T Only Holder is a Bad Leaver, then any amount due in respect of his or her period of holding shall be due to the Trustee.
>
> 3.7 The Net Enterprise Value shall be calculated in respect of any point in time by taking EBITDA for the immediately preceding 12 months and multiplying this by the Exit EBITDA Ratio, and then from this some deducting (i) the redemption value (together with any declared but unpaid dividends) of any then outstanding Reference Shares in issue and (ii) the value of any of the net debt of the Company at that time (including inter-alia amounts outstanding pursuant to the Certificates of Accrued Value, Deep Discount Bonds, and the A Loan Notes).

20. On 24 April 2006 GHG was sold to a consortium for approximately £2.2 billion. The consideration was payable in cash and, as regards management's shares, was paid to management's solicitors, Pinsent Masons, which in turn paid it to members of management.

21. As part of the sale process, GHG produced a "Briefing Paper to Management Shareholders" dated May 2006 in respect of the "Sale of shares in General Healthcare Group." This outlined the terms of the sale and also outlined the tax consequences of the transaction for Management shareholders. The description of the tax consequences was entitled "Tax Overview". This contained the following disclaimer:

> "Neither the Company, senior management, Pinsent Masons or Deloitte are providing tax advice to non–institutional shareholders generally, or to individual managers. Therefore it is the responsibility of each of you to obtain your own tax advice."

22. The Briefing Paper then contained an additional disclaimer:

> "However, set out overleaf is an outline summary of certain of the tax issues arising and the potential tax treatment. Please note this is only intended as a brief summary and illustration to enable each management shareholder to assess the possible tax impact for them and that each management shareholder should consider their own position in relation to tax issues arising from the sale of their shares…. It does not take account of various reliefs such as the annual exemption which may be available to mitigate the gain in part."

23. The Briefing Paper then dealt with the tax treatment for holders of different classes of shares acquired before 16 April 2003 (which included the Appellant). The Briefing Paper stated as follows:

> "**T Shares only:** These shares are taxed under the conditional share regime. The full amount of the gain will be subject to income tax at the shareholders marginal rate, which will be paid under the PAYE system, and national insurance contributions. The amount of PAYE and employees national insurance contributions will be deducted from the consideration to be received by such Shareholders and paid over to HMRC by GHG."

24. In addition, the bundle of written evidence included a document headed:

Sale of General Healthcare Group

NOTES TO REMITTANCE ADVICE

25. This document stated that the:

> "Remittance Advice and attached notes set out the payments that are to be paid to you in respect of the sale of GHG. It does not constitute legal, financial or tax advice to you: whether by GHG; its senior managers; Pinsent Masons; Deloitte or otherwise. You are recommended to seek your own personal tax and-or financial advice in respect of the sale of GHG before completing the Remittance Return."

26. Paragraph 3.3 dealt with the tax position of "individuals holding T only shares (as having interest in T only shares) that were acquired before 16 April 2003 i.e. the position that applied to the Appellant. Paragraph 3.3 stated:

> "Your shares are taxable under the "conditional shares" regime and as such the full amount of the gain on sale (i.e. the amount over and above what you paid) is subject to income tax and national insurance contributions ("NI"). This tax and NI will be deducted from the amount you receive and will be paid over to HMRC by the company."

27. Paragraph 4 of the Remittance Advice contained the following statement, so far as material:

> "Tax Reporting
>
> You will report your gain on yourself-assessment tax return the 2006/7 which is due (together with the tax not collected under PAYE) on 31 January 2008."

28. On 10 May 2006 the Appellant surrendered the 250 T shares to GHG and received a payment of £382,748. GHG deducted income tax and NIC from the sum of £382,748 under the PAYE Regulations.

29. On 20 November 2007 the Appellant filed his self-assessment income tax return for the year ended 5 April 2007 declaring the income of £382,748 but claiming a deduction of the same amount, thereby reducing the PAYE chargeable income to nil and resulting in a refund claim in respect of the £153,099.24 of income tax deducted by GHG. Instead, the Appellant declared a capital gain of £95,894.25 (after taper relief) in respect of his disposal of the shares in his return.

30. HMRC wrote to the Appellant on 18 June 2008 informing him that HMRC intended to enquire into his return for the year ended 5 April 2007 and, in particular, into his disposal of the shares.

31. Also on 18 June 2008 HMRC wrote to Daniels Travers requesting information relating, inter-alia, to the deduction claimed against the deduction of PAYE, the calculation of the gain arising on the shares and related supporting documentation.

32. Daniel Travers replied on 23 July 2008 enclosing the original form P60 and the first page of the Remittance Advice which set out details of the pre-tax consideration paid. The letter noted that:

> "… the sale proviso [sic] document is deemed confidential and not for publication or disclosure, relating to the deemed tax treatment of the consideration the shares as being disposed of them GHG Ltd.
>
> It may have been a more accurate declaration in the SA return if no additional PAYE income was shown, as our client's contention, despite any agreements made in writing with his employer, was that the consideration of £382,748 was for the disposal of his 250 T shares and taxable as a capital gain.
>
> … No expenses have been claimed, only the base costs of the shares sold.
>
> There is no contract of sale as such as the company is treating the proceeds as taxable under PAYE. The facts however confirm that our client surrendered the shares and certificate to GHG Ltd and received monies as a *direct result* of no longer owning the equity securities themselves."

33. HMRC replied by letter on 27 August 2008. HMRC reiterated their request for sight of the documents relating to the acquisition and disposal of the Appellant's shareholding. HMRC referred to the copy of the first page of the Remittance Advice which Daniel Travers had sent in their letter of 23 July 2008 and noted that Section 3 of that document referred to: "Section 3 – Anticipated Tax Treatment" and in relation to the shares stated "See attached Tax Notes". HMRC requested sight of these pages from the Remittance Advice as they appeared to relate to tax advice given to the Appellant. HMRC also requested further elaboration of the Appellant's contention that no income tax charge arose in respect of the disposal of the shares. HMRC warned that the documents and information requested could be made subject of a notice under section 19A TMA 1970 and also warned that because, in their view, the Appellant had negligently submitted an incorrect return a penalty could be imposed by virtue of section 95 TMA 1970.

34. No reply having been received to their letter of 27 August 2008, HMRC wrote again to the Appellant on 19 November 2008 serving a section 19A TMA 1970 notice requesting, within 30 days of the date of receipt:

> "1. All the documentation relating to the acquisition and disposal of your shareholding in General Healthcare Group to include the Tax Notes referred to under Section 3 "Anticipated Tax Treatment" of the Remittance Advice.
>
> 2. The reason you feel that no income tax charge arises in respect of these shares and the legislation which supports this.
>
> 3. A history of your shareholding in General Healthcare Group.
>
> 4. A copy of the contract for the sale of the shares."

35. Daniel Travers replied on 24 November 2008:

> "Our client is currently seeking legal advice as to the implications/legality of your request for the sale documentation associated with the sale of the GHG shares.
>
> We would respectfully request in the circumstances that your deadline for the production of the information requested be extended to the New Year."

36. In their reply letter dated 1 December 2008, HMRC agreed to postpone penalty action until 9 January 2009. No further communication from the Appellant or Daniels Travers having been received, on 9 January 2009 HMRC issued a penalty determination notice under section 100 (1) TMA 1970 in respect of the penalty arising under section 97AA (1) (a) TMA 1970 in the amount of £50 in respect of the Appellant's failure to comply with the section 19A (2) notice to produce information and documents.

37. A further penalty determination in the amount of £340 regarding a penalty arising under section 97AA (1) (b) TMA 1970 in respect of the Appellant's continuing failure to comply with the section 19A (2) notice was sent to the Appellant on 13 February 2009.

38. Daniels Travers replied to these letters and notices on 1 March 2009. They explained that the delay in dealing with this matter was due "in the main to continued illness in this office." The letter continued:

> "…similarly, our client has only very recently received legal advice as to the implications/legality of your request for the sale documentation associated with the sale of the GHG shares, and in view of the strict 'confidentiality' clause in his employment contract."

39. The letter of 1 March 2009 enclosed the Remittance Advice (including the tax guidance). We note that the first page of the Remittance Advice enclosed with Daniels Travers' letter of 28 July 2008 was the first of seven pages – the other pages contain the tax guidance. As regards the reason why the Appellant considered that no income tax charge arose in respect of the disposal of the shares, Daniels Travers' response was:

> "This has been covered in previous correspondence, our client deems that the shares were simply sold and the monies received payment [sic] for those shares, a capital gain by definition."

40. The Letter also noted that the contract of sale of the shares had never been received by the Appellant.

41. As regards the question of penalties, the letter of 1 March 2009 also stated:

> "We appreciate that the penalty notices have been issued in this case and would submit that our client' s employment position was put into question so he sought legal advice that took some time to obtain and thereafter our offices were blighted with illness, which aggravated the delay.

> It is submitted that these delays were not of our clients making and in the circumstances he should not be penalised in this way."

42. In a letter dated 11 March 2009 from HMRC to Daniels Travers, attention was drawn to the tax guidance contained in the Remittance Advice and in particular to paragraph 3.3 (set out in paragraph 26 above). HMRC took the view that this demonstrated that the Appellant had been negligent when he submitted his self-assessment return on a different basis. Accordingly, the penalty under section 95 (1) (a) TMA 1970 was levied on this basis.

43. Travers Daniels replied on 17 March 2009 pointing out that:

> "…our client's version of the events of the sale of the T shares and the receipt of monies therefrom is a matter that he is entitled to proffer, as he is entitled to interpret the Taxes Acts.
>
> The fact that a 'document' [we understand is to be a reference to the tax guidance contained with the Remittance Advice] states otherwise does not make it necessarily a fact, perhaps you will bear this in mind in future and adjust the tone of your language in your letter as it does you no credit."

44. On the subject of the penalty levied under section 95 TMA 1970 the letter of 17 March 2009 stated:

> "As clearly stated in the documents provided, the advice given at point 3.3 was not direct tax advice and the shareholders were advised to seek advice on their personal tax position on the sale of the said shares.
>
> We would therefore contest [sic] that the decision by our clients to show the share proceeds as a capital transaction was as a result of a different interpretation of what actually happened rather than negligence on the part of our client."

45. In relation to the sections 97AA TMA 1970 penalty, Daniels Travers argued that they had provided HMRC with the requested documents once they were available. The letter continued:

> "As we have already advised you, our client was legally required to seek advice regarding the implications of providing you with a copy of the documents relating to the share sale since the original documents were subject to a confidentiality clause.
>
> The documents were provided as soon as our client had received confirmation that he was legally allowed to."

46. HMRC responded on 24 March 2009 seeking clarification of the Appellant's "version" of events referred to by Travers Daniels and to the interpretation of the Taxes Acts also referred to therein.

47. Travers Daniels replied on 14 June 2009 stating:

> "It is our contention that the original advice supplied by this firm to our client was based on the facts supplied, and that the *sale*, (he owned

> them, no longer does and received monies for them) of the shares fell to be taxed under TCGA 1992, and that as such the tax treatment of this transaction by his employer was incorrect.
>
> Since our client was required to submit a 2007 self-assessment income tax return, it was agreed that it would be possible to recover the income tax deducted from HM Revenue & Customs, and so no action was taken against his employer."

48. As regards the Section 95 TMA 1970 penalty, Travers Daniels argued that the Appellant had not been negligent. A reasonable taxpayer would expect the sale of shares to be the realisation of capital and therefore subject to the capital gains tax regime. Apparently, the Appellant's position on his 2007 tax return was based on advice received by Daniels Travers which in turn was based on the information provided by the Appellant.

49. In relation to the section 97AA TMA 1970 penalty, Daniels Travers, in the same letter, again referred to the confidentiality obligation which prohibited the Appellant from providing the original sale document. In addition, they noted that the Appellant was still employed by GHG at that time and was "not only concerned about his future employment but the repercussions of his fellow ex-shareholders." He therefore sought legal advice before handing over the sale documentation.

50. In a letter dated 22 July 2009, HMRC again asked Daniels Travers to explain the reasoning behind the Appellant's contention that the sale of the shares was not subject to income tax and why the "conditional shares" legislation (section 427 ITEPA 2003) did not apply.

51. Notwithstanding the reminder letter from HMRC on 28 September 2009, Daniels Travers did not reply until 9 November 2009. That letter stated:

> "Our client was approached by the company to purchase 250 T shares in GHG, these would be his without condition he was assured [sic], as he duly paid for them.
>
> He was also reassured that these would form part of any company sale and he would be paid in proportion to his shareholding. No mention of any "conditional shares" and tax treatment thereon was provided upon acquisition or at any time until the share sale briefing paper in May 2006.
>
> The GHG company sale was announced in May 2006.
>
> The briefing paper was the first mention of the "conditional share" treatment and the company's proposed taxation under PAYE.
>
> On pages 2 and seven of the main briefing paper and page 1 of the "Notes to Remittance Advice" it was stressed that 'it was your own responsibility to obtain tax advice', before each deemed tax treatment narrative by the company.
>
> …

> Our client views the 'conditional share' description as cosmetic, as he simply received monies by virtue of purchasing, owning and then selling the T shares.
>
> …
>
> For the 'conditional share' legislation under section 427 ITEPA 2003 to apply the employment-related shares are 'restricted shares' if there is a contract, agreement, arrangement or condition that imposes any of the three types of restriction and the market value of the shares or interest is less than it would otherwise have been. "

52. Unfortunately, Daniels Travers appeared to be referring to a version of the legislation which was substituted by section 140 Finance Act 2003 but which did not affect any shares acquired before 6 April 2003 i.e. the provision which Daniels Travers seem to have in mind did not apply to the shares owned by the Appellant. We set out in an Appendix to this Decision the correct version of the relevant provisions of ITEPA 2003 which applied to the acquisition and disposal of the shares by the Appellant.

53. The correspondence between the parties continued, but we do not think it necessary to set out any further extracts from it. The reason why we have quoted extracts from the correspondence at such length is because, at the hearing, the Appellant claimed that he had not seen the tax guidance contained in the notes to the Remittance Advice. Instead, the Appellant claimed that he had only seen the first page of the Remittance Advice and not the notes attached thereto.

54. The Appellant was challenged on this point by Mr Oborne in cross-examination. Mr Oborne asked the Appellant when he had decided that the sale of the shares would be subject to capital gains tax and not income tax. The Appellant replied that the decision was made "when I got the proceeds." The Appellant explained that he had earlier sold shares in GHG which had been subject to capital gains tax. The documents had recommended him to get tax advice which he did this was reasonable and not negligent. Mr Oborne asked exactly where the Appellant had been recommended to obtain tax advice. The Appellant replied that he had been recommended to do this in "various documents." The Appellant claimed that the documents (presumably the Remittance Advice and the Briefing Paper) produced by the GHG did not prompt him to seek tax advice. The Appellant said that he always sought tax advice.

55. We are unable to accept the Appellant's evidence that he had not received or seen the tax guidance attached to the Remittance Advice in May 2006. In the first place, at no time in the correspondence – during which it was plain that HMRC attached importance in relation to the alleged negligence of the Appellant to the tax guidance contained in the notes to the Remittance Advice – did Daniels Travers or the Appellant claim not to have seen this advice in May 2006. Indeed, the letters written by Daniels Travers (e.g. the letter of 9 November 2009) seem to proceed on the assumption that the Appellant did see this advice but that he was at liberty to take a different view.

56. Moreover, in cross-examination Mr Oborne, the Appellant's reference to "various documents" seemed to us an unmistakable, if accidental, reference to the guidance attached to the Remittance Advice.

57. It therefore seems to us that the Appellant was fully aware that GHG considered that the shares were "conditional shares" and that the gain on their sale would be subject to income tax but decided not to follow this advice.

58. Why the Appellant decided not to follow GHG's advice is a matter of speculation. The Appellant's evidence was that he had previously acquired another parcel of shares in GHG in 1997, which he sold in 2000 and which was taxed on a capital gains tax bases. He therefore expected the shares which are the subject of this appeal to receive a similar tax treatment. The Appellant, however, gave no further details regarding this earlier disposal of shares.

59. Daniels Travers said that they had advised the Appellant on the basis of information which he had made available. Exactly what information had been made available we do not know. However, we note that in the course of the correspondence with HMRC Daniels Travers seemed unwilling to engage with HMRC in relation to the legislation relating to "conditional shares" contained in ITEPA 2003. Moreover, when Daniels Travers eventually did address this issue in their letter of 9 November 2009 they appeared to be basing their views on legislation which did not apply at the time of the disposal of the Appellant's shares in GHG. Indeed, in correspondence Daniels Travers seem to assume that the fact that the Appellant had owned shares and had disposed them for a consideration "by definition" resulted in capital gains treatment. In other words, the effect of the "conditional shares" provisions of ITEPA 2003 was either simply ignored or overlooked.

60. The Appellant' evidence was that he always sought tax advice. He could not remember exactly what he had asked Mr Travers to verify. The Appellant “suspected” that he had presented his affairs to Mr Travers and had asked him to advise. In cross-examination Mr Oborne asked the Appellant whether he had asked GHG why they had deducted PAYE from the proceeds of the disposal of the shares. The Appellant replied that "there are times when you pick a fight and times when you don't."

Discussion

Amendment to the 2006 – 2007 tax return: the substantive issue

61. The statutory provisions contained in sections 422 – 424 ITEPA 2003 are set out in an appendix to this decision. References to statutory provisions in this section of our Decision are to ITEPA 2003 unless otherwise specified.

62. Broadly, these provisions apply where an employee acquires a beneficial interest in shares as a director or employee of the company and the interest is acquired on terms that make it "only conditional" (section 422 (1)). An individual so acquires an interest in shares if he does so pursuant to a right conferred on or an opportunity offered to him by reason of his office or employment (section 423 (1)).

63. We considered that it was plain on the facts of this appeal that the Appellant had acquired the shares in GHG pursuant to an opportunity offered to him by reason of his employment. The letter from the Chief Executive of GHG dated 29 June 2001 makes it clear that the Appellant was offered the opportunity to acquire shares because he had completed six months employment. The Appellant, in his evidence, stated that he understood the shares in GHG to be freely transferable and could be held by persons other than employees. We have to say that we considered the Appellant's evidence on this point be very vague and unspecific. Whatever the circumstances of the acquisition of shares by other persons may be, it is clear to us from the evidence of the letter of 29 June 2001 that the Appellant acquired his shares by reason of his employment with GHG.

64. Section 424 sets out the circumstances in which an interest in shares is "only conditional". Section 424 provides, so far as material, that:

> "(1) …an interest in shares is "only conditional" for so long as the terms on which the person is entitled to it–
>
> (a) provide that if certain circumstances arise, or do not arise, there will be a transfer, reversion or forfeiture as a result of which that person will cease to be entitled to any beneficial interest in the shares, and
>
> (b) are not such that, on the transfer, reversion or forfeiture, that person will be entitled to receive in respect of the interest an amount that is equal to or more than its market value at that time.
>
> (2) But a person is not to be regarded as having an interest in shares which is only conditional by reason only that one or more of the following is the case–
>
> (a) the shares are unpaid or partly paid and may be forfeited for non-payment of calls, in a case where there is no restriction on the meeting of calls by that person;
>
> (b) the articles of association of the company require the shares to be offered for sale or transferred, if that person ceases to hold a relevant office or employment;
>
> (c) that person may be required to offer the shares for sale or transfer them on ceasing, as a result of misconduct, to hold a relevant office or employment…."

65. We should draw attention, as did HMRC in their submissions, that subsection (1) (a) provides that shares will be "only conditional" if the terms of entitlement provide that "if certain circumstances arise" there will be a transfer, reversion etc. Secondly, the exclusion from subsection (1) contained in subsection (2) (b) only applies if the specified requirement is contained in the articles of association of the company. It does not apply if the specified requirement is contained in another document. Thirdly, the exclusion contained in subsection (2) (c) is not limited to the specified requirement being contained in the articles of association.

66. In this case, Clause 4 of the Deed deals with circumstances in which the Appellant was required to transfer his shares as a Bad Leaver. We agree with Mr

Travers's submission that section 424 (2) (c) appears to exclude Clause 4 of the Deed from having the result that the Appellant's shares were, for that reason alone, "only conditional". However, for the reasons set out below, we consider that the other provisions of the Deed had the effect that the Appellant's shares were "only conditional."

67. Clause 5 of the Deed provides that where a shareholder is a "Good Leaver" then the shareholder "shall transfer" the shares. Clause 5 also provides that a shareholder, as a "Good Leaver" should be paid an amount provided for by Schedule 2, which provided for a 12.5% discount in the Net Enterprise Value. No evidence was presented which would enable us to determine whether Net Enterprise Value would constitute "market value" for the purposes of section 424 (1) (b) (as defined by section 434 (1) i.e. the amount that might reasonably be expected to be obtained from a sale of the interest in the open market). In other words, the Appellant (on whom the onus of proof lies) has failed to demonstrate that the requirements of section 424 (1) (b) have not been met. For this reason, we consider that Clause 5 has the effect that the Appellant's shares were conditional shares for the purposes of section 424.

68. Similarly, in relation to Clause 6 which deals with the situation of an Exit, a shareholder is paid the same amount as under Clause 5 except that there is no 12.5% discount. Again, there was no evidence before us that the amount payable to a shareholder would be equal to or in excess of market value. Accordingly, the Appellant has failed to establish that the second limb of the definition of conditional shares contained in section 424 (1) (b) has not been satisfied.

69. Both Clauses 5 and 6 are part of a document other than the articles of association of GHG with the result that the exception to 424 (1) contained in subsection (2) (b) does not apply.

70. Mr Travers referred to the fact that Clause 5.1 referred to the "A Director not having exercised his discretion" under Article 11.B .3 [of the Articles of Association]. Mr Travers argued that none of the provisions of Clause 5 were binding because they could be lifted at the discretion of the A Director. Since we were not provided with the Articles of Association of GHG is not clear to us in what circumstances the A Director could exercise this discretion or whether there were any limitations on its exercise. In any event, we consider Mr Travers's argument to be plainly wrong. The requirement in Clause 5 that the shareholder should transfer its shares in the specified circumstances was binding unless and until the discretion (such as it was) with exercise. There was no evidence whatsoever that the A Director had exercised the discretion in this case.

71. Moreover, Mr Travers argued that Clause 6 of the Deed also had a similar provision concerning the discretion of the A Director to that found in Clause 5. If so, we were unable to find it in the documents before us. We therefore considered Mr Travers to be mistaken in this regard. Even if the same discretion existed in relation to Clause 6, the conclusion reached in the preceding paragraph in relation to Clause 5 would apply equally.

Penalty under section 95 Taxes Management Act 1970

72. Under section 95 TMA 1970 a person who negligently delivers or makes an incorrect return is liable to a penalty not exceeding the aggregate of £50 and, in summary, the difference between the amount of tax shown on the return and the amount of tax that should have been paid. The penalty is subject to HMRC's powers of mitigation, pursuant to which the penalty of £23,650 was set at 20% of the extra tax due.

73. The issue, therefore, was whether the Appellant had been negligent in making a return which showed the proceeds from the sale of the GHG shares as a capital gain rather than as an amount chargeable to income tax.

74. Negligence in the context of section 95 TMA 1970 involves an objective test. In our view, negligence for the purposes of section 95 TMA 1970 is the same as "negligent conduct" in the context of discovery assessments under section 29 Taxes Management Act 1970. In that context, negligent conduct should be judged by reference to the reasonable taxpayer. The test was explained by Judge Berner in *Anderson (deceased) v Revenue and Customs Commissioners* [2009] UKFTT 206 at [22] (cited with approval by Judge Bishopp in the Upper Tribunal in *Colin Moore v Revenue and Customs Commissioners* [2011] UKUT 239 (TCC) at [13]):

> "The test to be applied, in my view, is to consider what a reasonable taxpayer, exercising reasonable diligence in the completion and submission of the return, would have done."

75. In approaching the question whether the Appellant had been negligent in making his self-assessment return for 2006 – 2007 we have applied the test set out by Judge Berner.

76. One initial point we should make is that it was clearly incorrect for the Appellant's return to claim a deduction of an expense equal to the amount which had been subjected to PAYE. No expense has been incurred. In correspondence Daniels Travers accepted that this was incorrect. Even if the proceeds of sale were taxable on capital gains basis, a more appropriate treatment, in our view, would have been for the Appellant to have shown on his return a nil amount in respect of the amount chargeable to income tax in respect of the disposal of his shares (which would have resulted in a refund of income tax deducted under PAYE), possibly with a "white space" disclosure, together with a return of the capital gain.

77. In our view, the return was negligently made by the Appellant. As we have already observed, Daniels Travers seemed either reluctant or unable to engage with HMRC in correspondence in relation to the relevant ITEPA 2003 provisions discussed above. Indeed, insofar as Daniels Travers explained the rationale behind the position taken by the Appellant in his tax return, it seemed to ignore the relevant provisions of ITEPA 2003 altogether. Moreover, when Daniels Travers did eventually consider the relevant provisions it appears that they were working from a version of the legislation which did not apply to the Appellant's disposal of his GHG shares. Indeed, in reviewing the correspondence between HMRC and Daniels Travers, it is hard to avoid the conclusion that the applicable ITEPA provisions had not been

considered by the Appellant's advisers when they return was submitted. The failure to consider the application of the "conditional share" provisions of ITEPA 2003 was negligent.

78. We have already found that the Appellant did in fact receive the tax guidance contained in the notes to the Remittance Advice at the time that he disposed of his shares. He was, therefore, aware that the proceeds of sale of his GHG shares would be subject to income tax. Moreover, in preparing the Appellant's tax return it was clear to Daniels Travers that GHG had taken the view that the proceeds of the disposal would chargeable to income tax – hence the need, in their view, to manufacture the deduction of an amount equal to the taxable income which was subjected to PAYE. At no stage, however, did either the Appellant or Daniels Travers seem to query GHG or discuss amongst themselves why it was that PAYE had been deducted. Instead, the Appellant on the advice of Daniels Travers took the view that a capital gains treatment was appropriate.

79. Of course, the tax guidance contained in the Remittance Advice was not binding on the Appellant. He was entitled to take his own view as to the correct tax treatment. It seems to us, however, that there was no reasonable basis for the view taken by the Appellant in his tax return. We will deal, in a moment, with whether it was reasonable for the Appellant to rely on the advice of Daniels Travers. Subject to that point, the arguments put forward on behalf of the Appellant in favour of a capital gains tax treatment for the proceeds of sale seem to be wholly without foundation. We accept that the detailed formulation by HMRC of the terms of the Deed and the application of the particular provisions of ITEPA 2003 left something to be desired, but even so it was plain which provisions HMRC considered to be applicable and no sensible argument was put forward in correspondence by the Appellant or his advisers as to why they did not apply. Indeed, we suspect that the application of these provisions were simply overlooked by the Appellant and his advisers, notwithstanding the terms of the guidance contained in the Remittance Advice.

80. For these reasons, we consider that the Appellant's return was negligent. Although the point was not raised by either party at the hearing or in the subsequent written submissions, we consider that we must also address the question whether the Appellant, by relying on the advice of Daniels Travers that the proceeds of sale of his GHG shares were subject to capital gains tax rather than income tax, had a reasonable excuse for the purposes of section 118 (2) TMA 1970. We should note that it is for the Appellant to satisfy us on the balance of probabilities that a reasonable excuse for the negligent return existed.

81. It is arguable that the concept of negligence – i.e. the requirement for the negligent submission of a return – for the purposes of section 95 TMA 1970 excludes the defence of reasonable excuse contained in section 118 (2) TMA 1970. Even if that is not correct, in our view, the Appellant has failed to satisfy us that he had a reasonable excuse for the following reason.

82. It is certainly true that there are circumstances in which incorrect advice given by a tax adviser to a taxpayer can constitute a reasonable excuse for the filing of an

incorrect return (see, for example, in relation to the rather different provisions of paragraph 18 Schedule 24 Finance Act 2007, *Hanson v HMRC* [2012] UKFTT 314 (TC)). Where, on advice, a taxpayer has an arguable case that the tax claimed by HMRC is not due, reliance by the taxpayer on that advice will not normally be regarded as negligent for the purposes of penalty proceedings even if it turns out that the advice was incorrect. However, it cannot be correct that in cases where there is no reasonable basis for the advice or the advice was based on a simple failure to consider the relevant statutory provisions, reliance on such defective advice can constitute a reasonable excuse for the purposes of section 118 (2) TMA 1970. Otherwise, a mistake of law or ignorance of the law could constitute a reasonable excuse – a consequence which Parliament cannot possibly have intended.

83. For this reason, to the extent it is relevant, we consider that the Appellant did not have a reasonable excuse for the purposes of section 118 (2) TMA 1970.

Penalty under section 97 AA TMA 1970

84. Our understanding was that the Appellant was no longer contesting the penalty of £340. In their written submissions of 2 August 2013, Daniels Travers noted that they were no longer "contending" this penalty, by which we understood that the penalty was no longer being contested.

85. In case we are wrong in our understanding, we should make it clear that, in our view, this penalty should be upheld. In our view, any reasonable excuse for the failure to provide the required documents expired on 9 January 2009. The Appellant and his advisers failed to request any further extension of time from HMRC.

Decision

86. For the reasons given above, we dismiss the appeal against the amendment to the Appellant's self-assessment tax return for the year 2006 – 07. We also dismiss the appeal is against the penalties under sections 95 and 97AA TMA 1970.

87. 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.

GUY BRANNAN
TRIBUNAL JUDGE

RELEASE DATE: 15 October 2013

APPENDIX

Relevant statutory provisions

422Application of this Chapter

(1) This Chapter applies where–

(a) a person ("the employee") acquires a beneficial interest in shares in a company as a director or employee of that or another company, and

(b) the interest is acquired on terms that make it only conditional.

(2) In this Chapter–

- "the employee´s interest" means the beneficial interest in shares acquired by the employee as mentioned in subsection (1);
- "the employer company" means the company as a director or employee of which the employee´s interest is acquired;
- "the shares" means the shares mentioned in subsection (1)(a);

and "director" and "employee" have the extended meaning given by section 434(1).

423 Interests in shares acquired "as a director or employee"

(1) For the purposes of this Chapter a person ("E") acquires an interest in shares "as a director or employee" of a company if E acquires the interest in pursuance of–

(a) a right conferred on, or opportunity offered to, E by reason of E´s office or employment as a director or employee of the company;

(b) a right or opportunity assigned to E, having been conferred on or offered to some other person by reason of E´s office or employment as a director or employee of the company; or

(c) an assignment, the interest having been acquired by some other person by reason of E´s office or employment as a director or employee of the company.

(2) The references in subsection (1) to a right or opportunity conferred or offered by reason of E´s office or employment include–

(a) one so conferred or offered after E has ceased to hold the office or employment, and

(b) one that arises from the fact that shares–

(i) which E acquired as a director or employee (or is treated as so acquiring by virtue of this paragraph), or

(ii) in which E so acquired an interest,

were convertible shares.

(3) A person who–

(a) has acquired an interest in shares which is only conditional, convertible shares or an interest in convertible shares,

(b) acquired that interest or those shares as a director or employee of a company, or is treated by virtue of this subsection as having done so, and

(c) as a result of any two or more transactions–

(i) ceases to be entitled to that interest or those shares, and

(ii) becomes entitled to another interest in shares which is only conditional or to any convertible shares or to an interest in convertible shares,

is to be treated for the purposes of this Chapter as if the interest or shares mentioned in paragraph (c)(ii) were also acquired as a director or employee of the company.

(4) Subsection (3) also applies where the interest or shares mentioned in subsection (3)(c)(ii) were acquired by a person connected with the first-mentioned person.

(5) Nothing in subsection (3) or (4) affects the rights or opportunities included by virtue of subsection (2)(b).

(6) In this section "convertible shares" has the same meaning as in Chapter 3 of this Part (convertible shares) (see section 435(2) and the definition of shares in section 446(1)).

424 Meaning of interest being "only conditional"

(1) For the purposes of this Chapter an interest in shares is "only conditional" for so long as the terms on which the person is entitled to it–

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

(b) are not such that, on the transfer, reversion or forfeiture, that person will be entitled to receive in respect of the interest an amount that is equal to or more than its market value at that time.

(2) But a person is not to be regarded as having an interest in shares which is only conditional by reason only that one or more of the following is the case–

(a) the shares are unpaid or partly paid and may be forfeited for non-payment of calls, in a case where there is no restriction on the meeting of calls by that person;

(b) the articles of association of the company require the shares to be offered for sale or transferred, if that person ceases to hold a relevant office or employment;

(c) that person may be required to offer the shares for sale or transfer them on ceasing, as a result of misconduct, to hold a relevant office or employment;

(d) in the case of an interest in a security, the security may be redeemed on payment of any amount.

(3) In subsection (1)(a) the references, in relation to the terms of a person´s entitlement, to circumstances arising include references to–

(a) the expiry of a period specified in or determined under those terms,

(b) the death of that or any other person, and

(c) the exercise by any person of a power conferred on that person by or under those terms.

(4)For the purposes of subsection (1)(b) the market value of the interest is to be determined as if there were no provision for transfer, reversion or forfeiture.

(5) In subsection (2)(b) "articles of association" includes, in the case of a company incorporated under the law of a country outside the United Kingdom, any equivalent document relating to the company.

(6) The references in subsection (2)(b) and (c) to a person ceasing to hold a relevant office or employment are to that person ceasing to be an officer or employee of the company in question, or of one or more group companies or of any group company.

(7)For the purposes of subsection (6)–

(a) a company is a "group company" in relation to another company if they are members of the same group, and

(b) companies are taken to be members of the same group if, and only if, one is a 51% subsidiary of the other or both are 51% subsidiaries of a third company.

427Charge on interest in shares ceasing to be only conditional or on disposal

(1)This section applies if–

(a)the shares cease, without the employee ceasing to have a beneficial interest in them, to be shares in which the employee´s interest is only conditional, or

(b)in a case where the shares have not so ceased, the employee sells or otherwise disposes of the employee´s interest or any other beneficial interest in the shares.

(2)The taxable amount determined under section 428 counts as employment income of the employee for the relevant tax year.

(3)The "relevant tax year" is the tax year in which the shares cease to be shares in which the employee´s interest is only conditional, or in which the sale or other disposal takes place.

(4)Subsection (2) is subject to section 494 (approved SIPs: no charge on removal of restrictions).

428Amount of charge

(1)The taxable amount for the purposes of section 427 (charge on interest in shares ceasing to be only conditional or on disposal) is–

MV - DA

where–

- MV is the market value of the employee´s interest immediately after it ceases to be only conditional or, as the case may be, at the time of the sale or other disposal, and
- DA is the total of any deductible amounts.

(2)For the purposes of subsection (1) each of the following is a "deductible amount"–

(a)the amount or value of any consideration given for the employee´s interest;

(b)any amount that constitutes earnings from the employee´s employment under Chapter 1 of Part 3 (earnings) in respect of the acquisition of the employee´s interest;

(c)any amount that is treated as earnings from the employee´s employment under Chapter 8 of Part 3 (taxable benefits: notional loans in respect of acquisitions of shares) in respect of the acquisition; and

(d)if the employee´s interest was acquired by the exercise of a share option, any amount that counts as employment income of the employee under section 476 (charge on employee on exercise etc. of option) in respect of the exercise.

(3)If, not later than the event referred to in section 427(1)(a) or (b) occurred in relation to the employee´s interest, a different event occurred in respect of the shares by virtue of which an amount counts as employment income of the employee under–

(a)section 449 (charge on occurrence of chargeable event), or

(b)section 453 (charge on increase in value of shares of dependent subsidiary),

that amount is a "deductible amount" for the purposes of subsection (1).

(4)The references in subsection (3) to an event include the expiry of a period.

(5)Section 541(2) (effects of the EMI code on other income tax charges) also provides that an amount is to be regarded as a "deductible amount" for the purposes of subsection (1).

434Minor definitions

(1)In this Chapter–

- …
- "market value", in relation to an interest in shares, means the amount that might reasonably be expected to be obtained from a sale of the interest in the open market;