[2012] UKFTT 430 (TC)

TC02112

Appeal number: TC/2011/4905 & TC/2011/4911

CORPORATION TAX – deemed charge under s 419(1) ICTA 1988 on loans to participators – whether money loaned under employee participation scheme - yes – whether a debt arose immediately on transfer of shares under scheme - yes - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

ASPECT CAPITAL LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE BARBARA MOSEDALE
JO NEILL

Sitting in public at Bedford Square, London on 1, 2 & 3 May 2012

Mr M Gammie QC, instructed by SJ Berwin LLP, solicitors, for the Appellant

Mr L Connell, HMRC Officer, for the Respondents

DECISION

1. Aspect Capital Limited ("the Company") appeals against assessments and closure notices totalling £3,153,915 raised in respect of years ending 31 December 2006, 2007, 2008 and 2009.

2. There was an issue whether the appellant had lodged its appeal for the later years in time but at the hearing HMRC said they raised no objection to the appellant being given permission to appeal out of time. As it was clear the appellants gave HMRC an early indication of their intention to appeal, in so far as the appeals were lodged late, we allowed an extension of time and proceeded to hear the appeals.

3. The amount at issue in this appeal was not before us: we are asked to determine the question of liability in principle, and if we find liability, to leave it to the parties to agree the correct amount of liability. Our decision is therefore one of principle only.

Findings of fact

4. Evidence on behalf of the Company was given by Mr Greenwold. Mr Greenwold was the Company Secretary for the Company and its Director of Legal and Compliance. He was also a participator in the employee participation scheme ("EPS") at the root of this appeal. That EPS comprised a Share Acquisition Agreement and a facility agreement.

5. It was a Mr Rockall, Mr Greenwold's predecessor at the Company, who set up the EPS and some of what Mr Greenwold said was hearsay based on conversations he had had with Mr Rockall and a half dozen or so of his colleagues at the Company. Nothing turns on our decision on this: we accepted Mr Greenwold's evidence as reliable.

6. In addition in evidence before us were the various documents comprising the EPS and communications between the parties.

7. Relying on this evidence we find the facts as set out below.

Outline of arrangements

8. Aspect Capital Limited is an investment manger based in London. As at 10 February 2012, Aspect had 140 employees. The Company had approximately 17,000,000 issued shares; 77% of which were held by the Company's directors or associated trusts, 20% were held by the Company's employees and the trustee of the Aspect Capital Limited Employee Benefit Trust Number 2 (the "Trustee") and the remaining 3% by other persons. The Trustee had acquired its shares from directors and departing employees. Shares awarded to employees under the EPS amount to 13.6% of the shares in issue. Sixty-one of the sixty-two employees eligible to participate in the EPS have done so.

9. The Company had established approved and unapproved share option schemes. For key employees who were 'up to the limit' (£30,000) on being awarded options under the approved share option scheme, the Company decided to introduce an alternative to the unapproved share option scheme. This alternative was referred to as the Employee Participation Scheme or EPS and was introduced in May 2006.

10. The idea behind the EPS was to give key employees ownership of shares in the company rather than merely options to acquire shares in the company. We were told and accept that the purpose of the EPS was to incentivise and help retain key employees.

11. Employees might be given the right to acquire shares under the EPS in the normal round of bonus awards at the start of the year, or when they joined the company or on an ad hoc basis at any time.

12. The right to acquire shares under the EPS was only offered to key employees ("the Employees"). The Employees had the right to decide whether or not to participate in the EPS. If they notified the Company that they wished to participate, the Company would then resolve to make the EPS awards subject to the Trustee agreeing to transfer the shares to the Employees.

13. If and when the Trustee agreed to transfer the shares to the Employees, the Company would enter into a Share Acquisition Agreement with each individual participating Employee.

14. At the same time, the Employee would have the right to enter into a facility agreement with the Company. This meant that the Employee did not have to immediately pay for the shares that he was acquiring. All of the 61 Employees who chose to take up the offer of shares under the EPS entered into a facility agreement. None of the Employees paid for the shares out of their own funds up front.

15. There were two different types of facility agreement. There was the facility agreement offered to UK employees which we refer to as the UK Facility Agreement. And there was the facility agreement offered to employees with US passports, which we will refer to as the US Loan Facility Agreement. The terms of the two agreements were not the same and we discuss this below. Mr Greenwold, as a US citizen, was a party to the US Loan Facility Agreement.

16. At the same time as entering into the Share Acquisition Agreement and one of the two facility agreements, the Employees also executed:

> (a) A deed of adherence to the Company's shareholders' agreement; and
>
> (b) A section 431(1) Income Tax (Earnings and Pension) Act 2003 election with the Company.

We mention this for completeness but these documents had no bearing on our decision.

17. Once the documents were signed, the Company paid the Facility Amount, less an amount equal to the stamp duty payable in respect of the transfer of the shares, to the Trustee. No sums were received by the Employee.

18. The Trustee signed the stock transfer form in favour of the Employee and the Company submitted the stock transfer form for stamping and paid any stamp duty to HMRC. On receipt of the stamped stock transfer form, the Company duly amended and updated its register of members.

19. Throughout these arrangements there was no communication between the Trustee and the employee, and there were no written agreements which both the Trustee and the employee signed.

20. We go on to consider the agreements in more detail.

Share Acquisition Agreement

21. There were various versions of the share acquisition agreement – a new one for each year – but neither party suggested nor do we find that there were any differences between them material to this appeal. We quote here from the 2007 version.

22. Its introduction provided:

> "INTRODUCTION
>
> (A) In order to incentivise and retain selected key employees who are not directors of the Company, the board of directors of the Company has resolved to allow certain employees, including the Employee, the opportunity to acquire a certain number of ordinary shares in the capital of the Company under the Aspect Capital Equity Participation Scheme.
>
> (B) The arrangement for the acquisition of the ordinary shares pursuant to this Agreement is an employee share scheme (within the meaning given in Section 743 of the Companies Act)
>
> (C) The Employee wishes to acquire ordinary shares in the Company and the Company wishes to facilitate such acquisition by the Employee by issue or transfer of the Shares upon and subject to the terms and conditions of this Agreement.

23. The operative terms in so far as relevant provided:

> 2.1 The Employee:
>
> (a) applies for the acquisition of Shares and at the Subscription Price….
>
> (b) undertakes to pay to the Company (the EBT or such person as the Company directs where the shares are transferred to the Employee) ….in cleared funds an amount equal to the Subscription Price for the Shares in payment in full of such Shares, such payment to be received into the Bank Account within three Business Days following the execution of this Agreement;

……..

> 2.2 The Company undertakes to the Employee that, within a reasonable time following the receipt …..of the Subscription Price…..the Company shall:
>
> (a) ….
>
> (b) either allot and issue as fully paid up that number of Shares as are due to the Employee pursuant to this Agreement, or procure the transfer of such Shares from the trustees of the EBT or from any other person …..

The "Bank Account" was a defined term and it was defined as:

> "the current account of the Company (in the case of a subscription for Shares) or (in the case of a transfer of Shares) the current account of the EBT or such other person as notified by the Company to the Employee, in each case as set out more fully in Schedule 1"

Schedule 1 gave the name of the transferor and its bank account details: in the examples show to the Tribunal the transferor was the EBT.

24. There were a number of issues surrounding the proper interpretation of this agreement:

- Was the Employee liable to pay for the shares under Clause 2.1(b) if, simultaneously, he entered into a facility agreement? As this can only be sensibly considered together with the UK Facility Agreement, we discuss this in paragraphs 41-47 below;

- Whether, if the shares were not issued, the Company was procuring the shares for the Employee on its own behalf or as agent for the Employee? Again the terms of the UK Facility Agreement bears on this and we discuss it below in paragraphs 48-63.

Terms of the UK Facility Agreement

25. The terms of the Facility Agreement are important as it is HMRC's case that this amounts to a loan to the Employees or at least creates a debt owed by the Employees to the Company from the moment that it was entered into.

26. As with the Share Acquisition Agreement, there was a new version of the UK Facility Agreement each year but neither party suggested nor do we find that there were any material differences for the purpose of this appeal. The changes appeared largely if not wholly to be concerned with how the value of the shares should be calculated on sale. We quote here from the 2007 version but there was no difference in wording of the material sections between the different year versions.

27. The UK Facility Agreement expressly provided that the Company's payment did not give rise to a creditor-debtor relationship between the Company and the Employee unless one of several specified "Contingent Events" occurred. On the

occurrence of a Contingent Event the facility was automatically converted into a debt. Its preamble was as follows:

> "INTRODUCTION
> (A) At the request of the Employee the Company has agreed to provide a facility to the Employee for the acquisition of ordinary shares in the Company under the Aspect Capital Equity Participation Scheme on and subject to the terms and conditions of this Facility Agreement.
> ……
> (D) It is the intention of the Parties that a debtor-creditor relationship will be established between the Parties in respect of the Facility only on the occurrence of certain events specified in this Facility Agreement and not prior thereto.
> ..."

28. The "Facility" was defined as "the facility granted to the Employee by the Company in clause 2 of this Facility Agreement". Clause 2 provided:

> "2. The Facility
>
> 2.1 Upon and subject to the provisions of this Facility Agreement, the Company agrees to provide the Facility up to the Facility Amount available to the Employee.
>
> 2.2 The Company undertakes that within a reasonable time following the execution of this Facility Agreement by the Parties, the Company shall provide the Facility Amount to the Employee (or shall transfer the Facility Amount on the Employee's behalf directly to the transferor of the Shares) in cleared funds PROVIDED THAT:
>
> (a) the Employee applies the entire Facility Amount only for the acquisition of the Shares (and Stamp Duty if applicable) or acknowledges the payment on his behalf of the Facility Amount by the Company to the transferor of the Shares, in either case pursuant to the Equity Participation Scheme and in accordance with the terms of the relevant Share Acquisition Agreement…..; and
>
> (b) the Employee undertakes to repay the Facility Amount to the Company following the Facility converting into a Debt on the occurrence of any of the Contingent Events specified in clause 3.5.
> ...
> 2.4 The Company shall not have any right of enforcing the repayment of the Facility from the Employee until and unless the Facility converts into a Debt on the occurrence of any of the Contingent Events specified in clause 3.5."

29. The Facility Amount was a specified amount in sterling in each Facility Agreement with each Employee and was the amount being the purchase price of the shares plus the stamp duty payable on the transfer of the shares to the Employee.

The Contingent Events

30. The UK Facility Agreement provided that the Facility converted into a debt on the occurrence of a contingency. We set out the provision in full in so far as relevant:

> “3 Repayment of the Facility Amount
>
> 3.1 The Employee may, at his own volition, at any time during the Facility Period, declare that the Facility Amount is a Debt that he owes to the Company and repay the Company the Debt in full provided that Employee may make such repayment of the Debt so declared only once a year on the last Business Day in the month of April or such other date or period that the Company may appoint and notify to the Employee provided that the declaration of the Debt and the repayment thereof are both made in the same Accounting Period.
>
> ...
>
> 3.3 The Employee may, at his own volition, at any time during the Facility Period, declare that the Facility Amount is a Debt that he owes to the Company and instruct the Company to set-off the entire Debt against any dividend or distribution declared in respect of the Shares, net of tax at the relevant rate, up to the outstanding balance of the Facility Amount, provided that the declaration of the Debt and such set-off against the dividend are both made in the same Accounting Period and on condition always that any such dividend or distribution shall on a net basis be at least equal to the Facility Amount.
>
> 3.4 The Employee may, during the Facility Period, declare that the Facility Amount is a Debt and may instruct the Company to setoff the entire Debt so declared out of any bonus payments (net of income tax and employee’s national insurance contributions) received by the Employee or that the Employee is entitled to receive from the Company or any of the trustees of the EBTs, provided that the declaration of the Debt and such set-off against the bonus payments are both made in the same Accounting Period and on condition always that any such bonus payment shall on a net basis be at least equal to the Facility Amount.
>
> 3.5 Notwithstanding anything contained in this Facility Agreement but subject to clause 3.6, the Employee shall not be under any obligation to repay the Company in respect of the outstanding balance of the Facility Amount until the Facility Amount automatically converts into a Debt on the occurrence of any of the following events (each a “Contingent Event”):
>
> (a) the cessation of the Employee’s employment with the Group for any reason whatsoever (excluding death);
>
> (b) the conclusion of a Trade Sale;
>
> (c) on the directors in their discretion providing written notification to the Employee that there is a reasonable likelihood of a successful IPO and confirming that such notification constitutes a Contingent Event or

failing such prior notification, then automatically on the date the Company's shares are initially traded on any exchange unless otherwise provided in writing by the directors of the Company;

(e) a Change of Ownership;

(f) the date on which the directors notify the Employee after having become aware that the Employee is in breach of the terms of the Share Acquisition Agreement;

(g) on the day on which the Employee completes a sale or disposal of any of the Shares; and

(h) on the directors in their discretion determining the Facility Amount to be a Debt provided that the directors shall only exercise such discretion in the event that the Net Profits of the Company for the preceding Accounting Period of the Company are greater than the sum of £100.

3.6 On the occurrence of any of the Contingent Events specified in clause 3.5, or any declaration of a Debt by the Employee in accordance with clauses 3.1, 3.3 and 3.4, a "creditor-debtor" relationship will be established between the Company and the Employee, but not prior thereto."

31. In summary, the Facility would become repayable by the Employee on the occurrence of the first of any of these events, which we will refer to as "the Contingent Events" or a "Contingent Event" in the singular. The most significant of the Contingent Events, in summary, were:

(a) The choice of the Employee to repay;

(b) Termination of the Employee's employment for any reason other than death;

(c) The sale or floatation of the Company;

(d) The sale of the shares by the Employee;

(e) The discretion of the Directors (but only when the Company had made a profit in the preceding accounting period).

In practice, the only Contingent Event which occurred during the years of assessment was the departure from their employment with the Company of some 22 Employees.

32. Under the Share Acquisition Agreement an employee leaving the Company was bound to sell his shares. He was deemed to have given a notice enabling the Company to redeem and/or to act as the employee's agent for the sale of the shares. In practice, the Company has not had to rely on this clause as the 22 leavers mentioned above have all cooperated in the sale of their shares. In all cases but one the shares have been sold to the Trustee. In that one exception the shares were transferred direct to another Employee under the EPS.

33. The Employee also had the right to sell his shares after the first three years: but in the event it appears that the only sales have been sales on termination of employment.

34. The Facility Agreement had a non-recourse provision so that an Employee's liability to repay was limited to the sale proceeds of his shares, unpaid dividends on them, termination payments and bonus payments from the Company.

35. The Share Acquisition Agreement contained terms which provided for the valuation of the shares in circumstances when they were sold by the Employee. In reality as it was a private limited company and because the Employees had to be signatories to the shareholders agreement, a sale of the shares was only likely to occur on one of the Contingent Events under the Facility Agreement, and in particular termination of employment.

Downside Protection

36. Where the value of the shares determined on the occurrence of a Contingent Event exceeded the costs of the shares to the Employee, the Trustee (being the purchaser of the shares) would pay the amount of the Facility to the Company to discharge it and would pay the balance to the Employee.

37. However, where the value of the shares determined as provided for in the agreements was less than the Facility Amount, the terms of the Facility Agreement provided that the Company would "pay" to the Employee a bonus equivalent to the grossed up amount of the difference in share cost and current value. No money would change hands as the Company would retain the net bonus in part re-payment of the facility: the trustee as purchaser of the shares would pay the valuation amount to the company. The net bonus and the payment from the trustee would discharge the facility.

38. The purpose of this clause was not in dispute: it was to protect Employees from a fall in value of the shares. Without the right to this bonus, they would be in a worse position than someone who was merely awarded share options. Employees can simply fail to exercise underwater share options: with the EPS the employees were the owners of the shares and were (for most practical purposes) committed to repaying the purchase price of them. The bonus protected them from falls in value of the shares. It was grossed up for tax and NIC as the bonus itself would be subject to tax. The provision (discussed below) which waived the loan in the event of insolvency also protected the Employees (to some extent) as the bonus clearly could not be paid in the event of insolvency.

Non Repayment Events

39. The Facility would never be repayable in three circumstances:

> "3.7 The outstanding balance of the Debt shall not be repayable by the Employee on the occurrence of any of the following events:

> (a) death;
>
> (b) Insolvent Liquidation of the Company; or
>
> (c) the waiver of Debt by the Company at its sole discretion with discretion the Company may exercise only in exceptional circumstances."

40. This provision is important to this case as part of the appellant's case rests on it as we explain below. When we refer to it again, we will call it, very clumsily but neutrally, the "Not Repayable Events Clause" and the three events on the occurrence of which the facility ceased to be repayable as the "Not Repayable Events".

Was there an obligation to pay under clause 2.1(b) of the Share Acquisition Agreement?

41. It was the appellant's case that the obligation on the Employee under clause 2.1(b) of the Share Acquisition Agreement to pay for the shares only applied to those Employees who decided to pay for the shares out of their own funds rather than enter in a facility agreement.

42. We cannot agree.

43. Firstly, there is no reason on the face of the Share Acquisition Agreement to restrict the obligation to pay to only to those employees who did not simultaneously enter into a facility agreement. On the face of the Share Acquisition Agreement, the liability to pay applies to all Employees who signed it.

44. Secondly, if the Employees who were a party to the Share Acquisition Agreement were not liable to pay for the shares, then the only possible interpretation of the Share Acquisition Agreement would be that the Company *gave* the shares to the Employees. Such an interpretation that was not put forward by either party and we find is not consistent with the documents.

45. Thirdly, what was the purpose of the facility agreement other than modify the effect of the Share Sale Agreement? The facility agreement only makes sense on the assumption that without the "facility" or financial accommodation it gave to the Employees, they would otherwise be liable to immediately pay for the shares transferred to them under the Share Sale Agreement.

46. In conclusion Clause 2.1(a) gave an obligation to the Employees to pay for the shares. If a facility agreement was not entered into at the same time, payment would be due within 3 days as stated in Clause 2.1(a). However, where both agreements were entered into at the same time, the two agreements must be seen as a single contract. In such a case, the combined effect of both documents was that the Employee had to pay for the shares but only on the occurrence of a Contingent Event and not within the 3 days provided for by Clause 2.1(a).

47. The real issue in dispute was whether these two agreements in combination created a loan or debt *before* one of the Contingent Events occurred.

Was company agent or principal in the purchase of the shares?

48. In all cases (save one where the Company paid an outgoing Employee) the shares were transferred direct to the Employees by the Trustee. There are two possible interpretations of the legal relationship between the Employee, Company and Trustee. Either the Company provided the Employee with the funds to buy the shares from the Trustee and acted on the Employee's behalf in agreeing the sale by the Trustee, *or* the Employee agreed to buy the shares from the Company and the Company agreed to buy them from the Trustee and merely directed the Trustee to transfer legal title direct to the Employee.

49. It was the appellant's case that the latter interpretation was the correct one. The Share Acquisition Agreement was between the Employee and the Company. The Trustee was not a party. The Trustee was not even bound to be the source of the shares, as the Company could have allotted new shares or (and in one case did) procure them from another source. There was no contract (nor indeed contact) between the Employee and the Trustee, says the appellant.

50. However, this does not tell us the answer to the question. While the Company would have acted as principal on the allotment of new shares, this does not tell us whether the Company acted as principal on the acquisition of the shares from the Trustee (and outgoing Employee). The Company could have acted as the Employees' agent in arranging the acquisition of the shares from the Trustee (or other vendor). The lack of contact between the Employees and Trustees/other vendor is not inconsistent with such a position.

51. We find the emails and other correspondence passing between the Company and Trustee are consistent with either interpretation. For instance, one email says:

> "Aspect would like to ask the EBT to (i) transfer shares to certain of these employees under the terms of the EPS….."

52. We consider the terms of the contract between the Company and the Employee. The Share Acquisition Agreement and UK Facility Agreement were entered into simultaneously and, clearly, although two separate documents, are all part of the same contract.

53. The terms of the Share Acquisition Agreement in clause 2.2 (see paragraph 23 above) were that the Company shall:

> "either allot and issue…. or procure the transfer of such Shares from the trustees of the EBT or from any other person ….."

54. This clause is neutral. The Company is to "procure" the shares: it leaves open whether the Company will procure them as agent for the Employee. However, clause 2.1(b) indicates that the Company is merely procuring the shares as agent because it says (quoted more fully in paragraph 23) that the Employee:

> “undertakes to pay the Company (the EBT or such person as the Company directs where the shares are transferred to the Employee)”

Our interpretation of this is that the Employee is promising to pay the Company if the shares are issued to him; but is promising to pay the Trustee (ie the EBT or Employee Benefit Trust) or other vendor if the shares are transferred rather than allotted to him. That this is the correct interpretation is bolstered by the reference to payment by the Employee being into the Bank Account: the Bank Account was defined as the bank account belonging to the EBT where the shares were to be transferred by the EBT.

55. Overall this clause suggests that the Company is only acting as agent and the liability to pay for the shares is between the transferor (the Trustee or other vendor) and the Employee and *not* between the transferor and Company.

56. The UK Facility Agreement was even clearer on this question. It provided (see clause 2.2 in paragraph 28 above) that the “facility” would be given to the employee by the Company or transferred:

> “*on the Employee’s behalf* directly to the transferor of the Shares.”(our emphasis)

If the monies are paid to the Trustee or other vendor *on behalf of the employee* then this clearly indicates that the Company has merely acted as the Employee’s agent in procuring the transfer of the shares. If the contract to purchase the shares was between the Company and the Employee, the Company would not be transferring the funds to pay for them on behalf of the Employee but *on its own behalf*, as it would be agreeing to buy the shares in its own right in order to satisfy its liability to sell the shares to the Employee.

57. That same clause went on to limit the Employee’s ability to use the “facility” for anything other than the acquisition of the shares and payment of stamp duty on that acquisition, and provided that the Employee:

> “acknowledges the payment on his behalf of the Facility Amount by the Company to the transferor of the Shares”.

The UK Facility Agreement uses the language of agency. Its implication is clear: the Company will make the Facility available to the Employee but only if the Employee agrees to use it for the purchase of the shares, and if the Company pays it to the transferor of the shares direct, then that payment is on behalf of the Employee.

58. So while there were no terms in either agreement under which the Company was expressly appointed the agent of the Employee to contract on his behalf to acquire the shares, the assumption underlying the both agreements is that the Company does act as the Employee’s agent in so far as the shares are transferred from a third party.

59. We were shown the Participant Booklet which was an explanation of the scheme produced for Employees. It expressly provided that the terms of the Share Acquisition Agreement and facility agreements took precedence over the booklet.

Nevertheless, we note that it was consistent with our interpretation of the two agreements in that it provided:

> "The EPS enables you to purchase equity in the company…Aspect will, in addition, offer a facility which will enable you to borrow money on an interest free basis necessary to pay for the ordinary shares."

60. The reason why it matters whether the Company contracted with the Trustee for the shares in its own right or merely as agent for the Employee is because the parties (putting aside the issue of timing which we address later) do not agree whether the UK Facility Agreement gave rise (or would give rise on a Contingent Event) to a loan or, in the alternative, a debt.

61. If the Employee agreed to buy the shares from the Company and the Company therefore acted as principal in agreeing to purchase them from the Trustee, then we do not see how on any interpretation that the outstanding Facility could be described as a loan. It would merely be the amount of consideration outstanding between buyer and seller under a contract of purchase. It would be a debt (whether arising immediately or on the occurrence of a Contingent Event). It would not be a loan.

62. On the other hand, if the Employee did not agree to buy the shares from the Company, but on the contrary the Company acted as the Employee's agent in buying the shares from the Trustee on behalf of the Employee, then the Facility looks more like a loan between the Company and Employee.

63. We find as a fact for the reasons given above that the relationship between the appellant and each Employee was one of agency: the appellant agreed with each Employee to purchase shares on the Employee's behalf from the Trustee using the appellant's money, which money the Employee agreed to repay at a later (uncertain) date. The question therefore arises whether the appellant made a loan to each Employee. If A agrees with B that it will purchase something on behalf of B with A's own money which B will repay at some later date, is that is a loan by A to B? We address this issue below in paragraphs 87-111, after dealing first with the second type of facility agreement.

The American Loan Facility Agreement

64. Aspect had a number of employees who were US citizens and subject to the US tax regime. We were told that because under the US tax regime, US citizens would be at a financial disadvantage if the amount they received under the facility was not received as a loan, the Company chose to offer its US employees a different facility agreement. This agreement explicitly provided that a loan was offered to the Employee and that a debtor-creditor relationship arose upon the parties entering into the facility.

65. Therefore, in contra-distinction to the UK Facility Agreement, the US Loan Facility Agreement provided in its Introduction:

> "(C) It is the intention of the Parties that a debtor-creditor relationship will be established between the Parties in respect of the Loan."

66. The contingent events which triggered the due date for repayment of the loan were very similar to the Contingent Events which converted the Facility into a debt in the UK Facility Agreement. These are summarised in paragraph 30-31 above.

67. Apart from being expressed to be a loan, there were two other main differences. There was no equivalent provision to clause 3.7 which in the UK Facility Agreement provided that the Facility would not be repayable on the occurrence of certain events ("Non Repayment Events" - see paragraph 39-40 above). Secondly, there was no provision for payment of a bonus to cover a possible shortfall of the price of the shares at purchase with their value on sale (downside protection -see paragraphs 36-38 above in relation to the UK Facility Agreement).

68. Indeed, because of these differences it was not immediately apparent to us why an US Employee would opt to participate in the EPS when he could instead chose the unapproved share option scheme. Mr Grimwold, who is a US citizen, indicated that he himself had nevertheless chosen the EPS over the unapproved share option scheme because it was his understanding that, were his employment to terminate, the Company was likely, although not contractually obliged, to pay a bonus to cover any shortfall. Nothing turns on this for this appeal.

Mortgage applications

69. We had hearsay evidence from Mr Greenwold that he considered one of the reasons the scheme was set up with the intention that no debt would be created at the outset was to protect Employees from having to declare the UK Facility Agreement when making mortgage applications. The perception was, he believed, that having to declare something out of the ordinary in financial terms could make it harder to obtain a mortgage offer. (We would expect them to be right on this but we had no evidence on the point and it does not matter). The Company's concern was that employees would be less willing to participate in the EPS if they perceived it might have a negative impact on a mortgage application.

70. Mr Greenwold's evidence was that Employees in practice did not record the facility agreement on any mortgage application. We asked if employees declared their ownership of the shares acquired under the EPS and in respect of which they had an outstanding Facility. Mr Greenwold was unable to answer this: he had re-mortgaged his own home since the time he joined the EPS but was unable to recall if he had put down his shares as an asset.

71. We do not consider this has any relevance to the appeals, however much of a concern it might be to a mortgage provider. Whether the Employees would be materially misleading any mortgage provider if they failed to declare that they were a party to one of the facility agreements would depend on what it was they were asked to disclose for the purpose of their application and, perhaps, whether they mentioned their ownership of the shares.

72. If the Employees failed to disclose on a mortgage application what should have been disclosed tells us nothing for the purpose of this appeal: we are concerned with whether, as a matter of law, the UK Facility Agreement gave rise to a loan or a debt and, if so, at what point in time. We are not concerned with what the Company or its Employees or any mortgage provider thought (or would have thought if they had known about the agreements) was the answer to this question.

73. The only potential relevance of the Company's concerns about mortgage applications is that it may be the explanation for why the UK Facility Agreement contained the recital (D) outlined in paragraph 27 above declaring that there was no debt until a Contingent Event occurred. However, as HMRC do not allege that this recital was incorporated for tax avoidance motives, we do not think it matters what the Company's motivation was, other than to note that it was not tax avoidance.

Employees' view

74. We also had hearsay evidence from Mr Greenwold that Employees did not consider themselves indebted to the company after joining the EPS. We had no evidence from UK Employees why this was so: it seems likely to us that they might rely on what the contract and participant booklet said but we think they would primarily take comfort from what was described as "downside" protection and which we have discussed above in paragraphs 36-38.

75. It is irrelevant. We are here to determine whether there was in law a loan or debt and if so when it arose. The views of the members of the EPS are not relevant.

The Accounts

76. In the Company's accounts for years ending in 2007 and 2008 the outstanding Facilities were described as "interest free loans". The accounts for 2009 and 2010 described them as "interest free facilities." We were told and accept that this change occurred after the Company gave its auditors more information about the terms of the facility agreements. The auditors' later view of the facilities as "facilities" rather than "loans" is immaterial: the question is whether it was correct.

Treatment under Companies Act

77. Loans to directors under the Companies Act must be approved by shareholders. Mr Greenwold's evidence is that "out of an abundance of caution" shareholder consent was obtained before allowing directors to participate in the EPS. Mr Greenwold said that the Company did not consider the facilities to be loans for the purpose of s 419(1) but the definition of loan for the Companies Act was not necessarily the same and it needed to protect its position. We read nothing into this. We are interested in what the law actually is, and our view of that cannot and is not influenced by the possibility that the appellant may have taken a view on the meaning of "loan" in the context of company law inconsistent with the view it now advances in a tax context.

78. Having established the facts, we now turn to consider the law.

The Law

79. Section 419 of ICTA 1988 provides:

> "(1) Subject to the following provisions of this section and section 420, where a close company, otherwise than in the ordinary course of a business carried on by it which includes the lending of money, makes any loan or advances any money to an individual who is a participator in the company or an associate of a participator, there shall be due from the company, as if it were an amount of corporation tax chargeable on the company for the accounting period in which the loan or advance is made, an amount equal to 25 per cent of the amount of the loan or advance.
>
> (2) For the purposes of this section the cases in which a close company is to be regarded as making a loan to any person include a case where—
> (a) that person incurs a debt to the close company; or
> (b) a debt due from that person to a third party is assigned to the close company; and then the close company shall be regarded as making a loan of an amount equal to the debt.
>
> (3) Tax due by virtue of this section in relation to any loan or advance shall be due and payable in accordance with section 59D of the Management Act on the day following the expiry of nine months from the end of the accounting period in which the loan or advance was made.
>
> (4) Where a close company has made a loan or advance which gave rise to a charge to tax on the company under subsection (1) above and
> (a) the loan or advance or any part of it is repaid to the company, or
> (b) the whole or part of the debt in respect of the loan or advance is released or written off, relief shall be given from that tax, or a proportionate part of it.
>
> Relief under this subsection shall be given on a claim, which must be made within six years from the end of the financial year in which the repayment is made or the release or writing off occurs.
>
> (4A) Where
> (a) the repayment of the whole or any part of a loan or advance occurs on or after the day on which tax by virtue of this section becomes due in relation to that loan or advance, or
> (b) the release or writing off of the whole or any part of the debt in respect of a loan or advance occurs on or after the day on which tax by virtue of this section becomes due in relation to that loan or advance, relief in respect of the repayment, release or writing off shall not be given under subsection (4) above at any time before the expiry of nine months from the end of the accounting period

> (4B) Schedule 1A to the Taxes Management Act 1970 (claims and elections not included in return) applies to a claim for relief under subsection (4) above unless—
>
> (a) the claim is included (by amendment or otherwise) in the return for the period in which the loan or advance was made, and
> (b) the relief may be given at the time the claim is made.
>
> (5) Where, under arrangements made by any person otherwise than in the ordinary course of a business carried on by him—
> (a) a close company makes a loan or advance which, apart from this subsection, does not give rise to any charge on the company under subsection (1) above, and
> (b) some person other than the close company makes a payment or transfers property to, or releases or satisfies (in whole or in part) a liability of, an individual who is a participator in the company or an associate of a participator, then, unless in respect of the matter referred to in paragraph (b) above there falls to be included in the total income of the participator or associate an amount not less than the loan or advance, this section shall apply as if the loan or advance had been made to him.
>
> (6) In subsections (1) and (5)(b) above the references to an individual shall apply also to a company receiving the loan or advance in a fiduciary or representative capacity.
>
> (7) For the purposes of this section any participator in a company which controls another company shall be treated as being also a participator in that other company."

What is not in dispute

80. The Company accepts that:

(1) it is a close company;

(2) its ordinary course of business does not include the making of loans;

(3) s420 ICTA does not apply; and

(4) the Employees who participated in the EPS were participators in the Company.

81. We consider that these concessions were well made, although revert to the issue in paragraphs 215-223 at the end of this decision. Each Employee, by virtue of his earlier participation in the approved share option scheme, was already a shareholder in the Company or was entitled to acquire shares in the Company. So even before a facility agreement was signed by the Employee, he was already a participator in the Company.

82. With regards the concession that the Company does not make loans in the ordinary course of its business, the appellant made this concession relying on the Court of Appeal's decision in *Brennan v Deanby Investments* [2001] STC 536. We agree with the appellant that the mere fact that the Company entered into a large number of facility agreements with its Employees did not make granting Facilities part of its ordinary course of its business. Carswell LCJ in the *Deanby* case said:

> (548 d) "….We do not consider that the making of loans on some eight occasions over a period of 14 years to one associate of a participator is capable of amounting to a business…If it did so amount, a company could make a series of loans to its participators and their associates, the very acts at which the provision is aimed, and then say that the lending of money was included in a business carried on by it. We cannot suppose that that accords with the intention of the legislature."

We consider that the appellant was right to make this concession.

83. In summary, therefore, what is in issue is whether the UK Facility Agreement involved the making of "any loan" or any "advances" by the Company to the Employees or in the alternative whether the Employee incurred "a debt" to the Company and if so at what point in time.

The Appellant's case in outline

84. The appellant's case is that:

(a) The EPS functions as an employee share incentive scheme enabling employees to acquire shares in the Company on particular terms. The Scheme does not have as its purpose nor does it involve the making of any loan by Aspect to individuals who are its participators as contemplated by section 419. (We deal with this in paragraphs 86-118.)

(b) At no stage is any money ever transferred to employees under the EPS and employees do not contract with the Trustee to acquire and pay for the shares that are transferred to them by the Trustee. The Company acts throughout in its capacity as employer to procure the transfer by the Trustee of shares that the Company has awarded to employees under the Scheme. (We dealt with this as a question of fact at paragraphs 48-63 and the implications of our findings as a matter of law are recorded at 114-118.)

(c) As between the Company and its employees (other than those few employees who are US citizens), the shares are acquired on terms that expressly do not involve the incurring of any debt or give rise to the relationship of debtor and creditor as between the Company and its employees at the time at which the shares are acquired. (We deal with this at paragraphs 193-203)

(d) Even if (notwithstanding the express terms of the Facility Agreement) it can be said that a debt is incurred at the time at which the shares are acquired in the sense that the Facility Agreement may give rise to a debt in the future if a relevant contingency occurs, the amount of the debt until such time as a contingency does occur is nil. (We deal with this at paragraphs 125-214).

The questions for the Tribunal

85. To decide whether the Facilities were caught by s 419(1) we divide the question up into the following:

- Whether a loan was made by the Company to an Employee;
- Whether an advance was made by the Company to the Employee;
- Whether the Employee incurred a debt to the Company;
- The time at which any loan, advance or debt arose.

"Makes any loan"

86. Putting aside the extended meaning of s 419(1) given to it by s 419(2) and 419(5), s 419(1) only bites if the company "makes any loan or advances any money" to the Employees, as the Company has conceded that its Employees were participators. So we need to determine what is a loan.

Dictionary definition

87. Mr Connell referred us to various dictionary definitions of "loan". In brief, all dictionaries had the common theme that a loan was the temporary grant of the right to use something, and in the context of money was money lent for a temporary or fixed period with or without interest.

88. Mr Connell accepted, as we find, that a loan is not the same thing as a payment (even deferred) in consideration for a supply.

89. HMRC's case was that the Company made a loan to the Employee when the Company transferred the money in payment for the shares to the Trustee. The question, as we have already stated in paragraph 63, therefore arises whether there was a loan if A paid C at B's request where B was liable to (re)pay to A the sum "loaned" .

The Potts *case*

90. The appellant considered that *Potts Executors v Inland Revenue Commissioners* [1950] AC 443 was the leading authority on whether a payment by A to C at B's request could be a loan from A to B. In that case, the owner and director of a company, Mr Potts, had an account with his company: he would be credited with fees and expenses to which he was entitled as director and debited with cash drawings and amounts paid out by the company on his behalf, in particular charitable subscriptions and income tax payments. The account was often overdrawn in the company's

favour. In 1939, Mr Potts sold his shares to a trust of which he was the settlor. Shortly afterwards the company paid a substantial sum of money to HMIT to discharge Mr Pott's surtax liability, leaving his director's account substantially overdrawn. After his death, HMIT assessed his estate for tax on the basis that the large payment of surtax to HMIT should be treated as paid to Mr Potts (the settlor) by the trustees of the settlement.

91. The case turned on the taxing provision contained in s 40 Finance Act 1938 and in particular whether a "capital sum" was "paid directly or indirectly" by the trustees to the settlor of the trust. The Act expressly provided that a capital sum included "any sum paid by way of loan". The court had to decide whether the sums paid on behalf of Mr Potts to HMIT by the Company were paid by way of loan by the Company and, if so, whether they were paid directly or indirectly to Mr Potts.

92. The Special Commissioners decided against the executors; the High Court reversed them. The Court of Appeal unanimously reversed the High Court, but the House of Lords, like the High Court, found in favour of the executors.

93. What is important for the Company's case are the reasons the five law Lords gave for allowing the appeal. (The reader should be aware that the Law Lords were inconsistent as between each other in designating the various parties by the letters of the alphabet A, B and C).

94. Lord Simonds did not find the transaction was one of loan. He said:

> "(page 454) …were the sums paid to the settlor by way of loan? I do not doubt that in certain contexts money paid at A's request to B may properly described as "paid to A": see eg *Parsons v Equitable Investment Co Ld* per Cozens-Hardy MR. The explanation of this is to be found in the judgment of Shearman J in *Stott v Shaw & Lee Ld:* '..if the legal or business or commercial effect of the transaction can be taken to be the same as that described in the bill of sale, then the courts will hold the consideration to be truly stated.'
>
> But this is not the way in which a taxing statute is to be read. I am not, in the construction of such a statute, entitled to say that, because the legal or business result is the same whether on the one hand I borrow money from the company and with it make certain payments, or on the other hand the company at my request makes certain payments on my implied promise to repay, therefore, it is immaterial what words are in the statute if that result is attained."

95. Lord Normand appeared to be of much the same view :

> (page 457) "…. In my view [the words of the statute] are apt to cover payments made as loans to third parties through whom the payment reaches the settlor himself, but they are not apt to cover payments made to third parties who are not accountable to the settlor and are entitled to retain the sums as their own moneys. This is a taxing Act and its terms are not to be enlarged by reasoning that the same final

> result is achieved as by a loan made to the settlor followed by a payment made by him to the third party."

Nevertheless, technically, Lord Normand's view was only obiter as he said on page 458:

> "I therefore hold that the payments made by the settlor's request to third parties were not payments made directly or indirectly to the settlor. It is not necessary to consider whether they were payments made by way of loans. But since the question was argued I will state my opinion. There is a real distinction between a loan to A to enable him to pay his creditors and a payment to A's creditors made for the purpose of discharging his debts…."

96. Lord Oaksey gave a short judgment from which it is clear his prime concern was that he thought that the tax charge imposed in this case was beyond that intended by the legislature:

> (page 460) "The object of the Act, in my opinion, was to tax a settlor who obtained payment of capital sums from the trustees of his settlement or from companies connected with the settlement for which he had not given full consideration in money or money's worth; it cannot have been the object of the Act to tax him in respect of payments for which he had given full consideration. In these circumstances it appears to me that if the words of the Act are fairly susceptible of a meaning which attains this object they should be given that meaning rather than a meaning which goes beyond the object of the Act and leads to admitted injustice.
>
> …In my opinion in the particular circumstances of this case the payments were not made by way of loan.
>
> The second question is whether even if the payments were made by way of loan they were paid directly or indirectly to the settlor. None of them was in fact paid to the settlor ….Having regard to the object of the statute I think the words 'paid directly or indirectly to the settlor' should be held to mean paid into the settlor's hands or into the hands of someone accountable to him.
>
> For my own part, I should also be prepared to decide the case upon the ground that the true construction …is that it refers only to sums paid by way of loan which are not paid for full consideration in money or money's worth and that in the present case the accommodation offered to the appellant was given for full consideration in money or money's worth."

97. Lord Morton dissented. He considered the sums paid were loans to the settlor and paid directly or indirectly to him

> (page 462) "….My lords, I think that the sums so paid out cannot accurately be described as anything other than loans to the settlor….
>
> (page 463)….That transaction can, I think, be accurately stated as follows: - The settlor said: 'Please pay my surtax; if you do pay it I promise to repay the sum on demand.' When the money was paid to

> the Inland Revenue, it seems to me that it was lent to the settlor just as much as if the company had been a bank and had granted him an overdraft of that amount."

98. Lord MacDermott was the last to give his judgment and gave no decided view on the issue:

> (page 465) "…Now I entertain little doubt that in certain circumstances it may properly be said that, if A out of his own moneys pays a sum to B for and at the request of C, A has paid the sum by way of loan, and by way of loan to C in the sense, and only in the sense, that he has thereby created the relation of lender and borrower between himself and C. But this is not to say that all transactions of that kind are loans….On the other hand, the kind of wider relationship to which I am referring my provide opportunity for transactions within it which are exceptional and beyond the normal scope of the relationship and which may properly be describable as loans and as nothing else….
>
> ….because, on the view I take of the rest of the case, it becomes unnecessary to do so, I do not propose to express any concluded opinion on this branch of the matter. I therefore proceed to the second question assuming, for the purpose, an affirmative answer to the first."

99. Reading of the decision of all five law lords therefore shows that one law lord considered that the relationship did create a loan (Lord Morton) while two reached the opposite conclusion (Lord Simonds and Lord Oaksey). Lord Normand expressed views very similar to Lord Simonds', but his decisions on the meaning of loan was obiter. Lord MacDermott did not express a concluded view on the point.

100. Lord Oaksey's view that there was no loan was "in the particular circumstances of this case" and those particular circumstances were that the anti-avoidance provision with which he was dealing was intended to catch gifts by trustees to settlors and not transactions at full value. In the *Potts* case the transaction was at full value as Mr Potts or his estate was liable to repay the amount paid out by the Company on his behalf. So Lord Oaksey's decision did not rest on a similar view to Lord Simond's that a payment to C by A on B's behalf could not be a loan by A to B.

101. Lord MacDermott considered that a payment to C by A on B's behalf could in some but perhaps not all circumstances be a loan by A to B but did not express a concluded view on the matter.

102. It is apparent that all the Lords were concerned that the anti-avoidance provision should be narrowly construed in order to prevent taxation in circumstances which were not intended by the legislature. Further, Lord Simonds (see the second paragraph quoted above) and Lord Normand (see paragraph quoted above) both considered tax legislation should be given a strict interpretation. However, more recent decisions of the House of Lords apply a purposive interpretation to tax legislation (such as *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51). It is notable that Lord Oaksey who wished to decide the case on a purposive interpretation of the legislation (see the third quoted paragraph above of his

decision) arrived at a decision in favour of the executors but not on the grounds that A discharging B's liabilities could not be a loan by A to B.

103. Therefore, it cannot be said that this case is binding authority that in some circumstances outside banking a payment of B's debt by A does not amount to a loan. Views of the Law Lords are highly persuasive but binding only where we can determine consistency amongst a majority.

104. Putting the view of the various Law Lords asides for the moment, it seems to us that where A agrees to pay money to C on behalf of B on terms that it is repayable by B to A, that is a loan by A to B. Any other conclusion leads to the result that a loan is not a loan simply by directing the creditor to pay the money to a third party. And if it is not a loan how else it is to be described?

105. In *Potts* only 2 out of 5 law Lords expressed a concluded view (and in one case it was obiter) that A (outside banking) discharging B's liabilities could not be a loan by A to B. It does not bind us and for the reasons given above we prefer the view of Lord Morton as expressed in the paragraphs from his decision cited above.

106. The appellant pointed out that s 419(2) was enacted in 1969 after and in response to the House of Lords' decision in *Potts.* In other words it was recognised by Parliament that what is now s 419(1) did not capture all the scenarios that they intended. However, that the law was changed in response to a perceived interpretation of "loan" does not mean that Parliament's apparent perception of the ratio of *Potts* was necessarily right. In any event, it is clear that 'loan' does not encompass every debt situation and this reason by itself provides good cause for the addition of s 419(2) as explained below.

107. We are also aware that our view of *Potts* does not accord with that recently expressed by the First-tier Tribunal in *MJP Media Services Ltd v HMRC* [2010] UKFTT 298 (TC) (not a case cited to us) at paragraph 90, a case in which we note that HMRC took the completely opposite view to the view advanced in this case on whether a payment by A to C at B's request is a loan by A to B. The Upper Tribunal in its decision expressed no view on this part of the case on appeal (see paragraph 41 of [2011] UKUT 100 (TC)).

108. We are indebted to Jonathan Peacock QC's article in the *Tax Journal* for 27 September 2010 (not mentioned to us in the hearing) on the First tier decision in *MJP Media* for bringing to our attention two decisions on the matter which were not brought to the attention of the Tribunal in *MJP*. Those cases are: *Parsons v Equitable Investment Co Ltd* [1916] 2 Ch 527 and *Re HPC Productions Ltd* [1962] Ch 466. Lord Cozens-Hardy MR in *Parsons* stated:

> "…a sum of money paid by the bill of sale holder at the grantor's request to a creditor or another person is properly described as a payment to her [the grantor]."

In *HPC Productions,* Plowman J decided in a case on the interpretation of the Exchange Control Act 1947 that the person at whose request the payment had been made to a third party had not borrowed the money as he did not receive it: nevertheless, Plowman J appeared to indicate that nevertheless it might still be a loan:

> "[the transactions in issue] would give rise to a claim for money paid at the request of [B], and that such a claim is generically and commercially different from a claim for money lent, though this of itself is not conclusive of the point I have to decide as the words 'borrow' and 'lend' might conceivably include both."

Conclusion on what a loan is as a matter of law

109. There is inconsistency in the authorities over whether in all, or at least some, cases where A (not being a bank) pays a sum of money to C at B's request there is a loan by A to B. Because of the lack of a majority view on this issue in the House of Lords's decision in *Potts,* we consider that we are not bound by authority but must consider the question for ourselves.

110. In so far as the interpretation of s 419 is concerned, we consider that Parliament would have and did intend such a situation to be within the meaning of "loan" because s 419 is an anti-avoidance measure and it would itself all too easily be avoided if a direct loan to B was caught but not the payment of a sum of money to a third party at B's request. The amendment to s 419 after the decision in *Potts* is consistent with this view in that the amendments were made because the legislature had concerns that the meaning the courts would give to "loan" was not as wide as intended.

111. In conclusion, we find as a matter of law that "loan" in s 419 includes a payment by A to C at B's request where there is a legal obligation on B to reimburse A the amount paid.

Application of law to facts of this case

112. If, by paying the Trustee, the Company discharged a liability of each Employee entering into the Share Acquisition Agreement, we would find that the Facility Agreement was a loan (subject to what we say below about <u>timing</u> and when a debtor-creditor relationship arose).

113. <u>Payment for the shares:</u>

114. We considered this question of fact in paragraphs 48-63 above and our conclusion was that the Company acted as agent for the Employee in arranging the transfer of the shares by the Trustee (or other vendor) to the Employee. Therefore, there was a loan by the Company to the Employee of the price of the shares, as by paying the Trustee ("C"), the Company ("A") was making a payment on behalf of and at the request of the Employee ("B").

115. <u>Payment of the stamp duty:</u> The Facility Amount comprised not just the price of the shares but included the stamp duty payable on any transfer. The Employee covenanted to use the Facility Amount only to acquire the shares and pay the stamp

duty if applicable (newly issued shares would not be subject to stamp duty). In practice, the Employee would have had no choice as the Company never made the funds available to the Employee, but paid the Trustee to transfer the shares to the Employee. It was also an assumption if not an express term that the Company would discharge the Employee's liability to stamp duty.

116. So similarly, in so far as the Company paid a small part of the Facility to HMRC, it was making a loan to the Employee.

117. We find the whole of the Facility was a loan within the meaning of s 419(1). Whether that finding disposes of the appeal, depends, though on *when* the loan arose. The terms of the UK Facility Agreement were that no debtor-creditor relationship arose until a Contingent Event occurred. If this provision is effective, that would mean the loan did not take place or the debt arise until the moment that it was due to be repaid which would in effect mean that there would be no tax charge under s 419(1) as the tax charge only exists between the date the loan is created to the date it is repaid: s 419(4) (subject to s 419(4A)).

118. Although the appellant argued its case before us on the basis this provision in the UK Facility Agreement was relevant to the question of *when* a *debt* was created, it seems to us equally applicable to the question (if the facility was a loan) of when the *loan* was created. However, as it was argued in respect of "debt" we deal with it below.

"advances any money"

119. For the sake of completeness, we mention that the second part of s 419(1) (ignoring the extension of it contained in s 419(2) and 419(5)) catches an 'advance' of any money by the close company to a participator. Was the facility amount also an advance?

120. We were referred to the case of *Bronestar Ltd v Priddle* [1961] 3 All E R 471. D was employed by P as a salesman on a salary and commission. P paid advances on the commission. On termination of the employment, P sued D to return the advances less the salary and commission actually earned up to his termination. It was held that D was liable to repay the excess of the advances over his entitlement to salary and commission.

121. In the course of his decision, Holroyd Pearce LJ approved the definition of an advance given in the County Court:

> (page 1301) " 'It seems to me that 'advance' means: 'I will pay now what I may have to pay in the future. I am paying before due time. If, after the advance, some event in the future upon which payment becomes due does not occur, you can recover it back.'"

122. We also think that the natural meaning of "advance" is that it is the bringing forward of something: in the context of money it is the bringing forward of a payment that would be made at some point in the future.

123. Is it possible, that while carrying this meaning as set out in *Bronestar v Priddle*, "advance" could nevertheless also encompass other situations? If we are wrong in saying that there is a loan where A pays C on B's behalf such that B owes A the amount paid to C, would it be correct to say that that situation is one of an advance? We think not. The natural meaning of "advance", and the one it was no doubt intended to carry in the context of s 419(1) where a company would ordinary be liable at some point to make payments of dividends and/or salary to its directors-cum-owners, is that it is the bringing forward of a payment that would otherwise have been paid later, as explained in *Bronestar.*

124. Therefore, we can see no way in which the sale of the shares to the Employee on terms that they can pay for them later could be described as an advance. Mr Connell for HMRC did not really suggest otherwise. The shares were not transferred to the Employees on the basis that they were advances of salary that they would earn. They were transferred to the Employees on terms that they would be paid for (albeit at a later date). The facility amount was not an advance.

Incurring a debt

125. Section 419(2) extends the meaning of "makes a loan" as it provides (as quoted more fully above) that:

> "…. the cases in which a close company is to be regarded as making a loan to any person include a case where—
> (a) that person incurs a debt to the close company; ….."

126. In HMRC's skeleton, although not in the earlier correspondence, their position was that s 419(2) and (5) were irrelevant. Just before the hearing they changed their minds again and reverted to the position that both these sub-sections applied. It was not suggested by Mr Gammie that these changes in position by HMRC had put the appellant at a disadvantage, and we proceed to consider these additional sub-paragraphs.

127. We have determined that the entire facility amount was a loan. The question of whether it was also a debt might therefore be thought irrelevant. However, we do go on to consider the matter, for a number of reasons:

(a) We were addressed at length on it;

(b) the meaning of "loan" in a third party context is not clear in the authorities so the HMRC's secondary case on the meaning of "debt" ought to be considered;

(c) it seems to us that the appellant's point on timing and in particular *when* the debt arose applies equally to a loan and therefore is directly relevant, as explained in paragraph 118, to the appellant's liability under s 419 in any event.

Meaning of debt

128. Both sides agreed, and we agreed with them that incurring a debt was wider in meaning than being the recipient of a loan. An obvious example was where the matter was non-consensual: if B stole money from A, B (apart from being guilty of theft) would owe A the debt of the money stolen. In no way could it be said that A had loaned the money to B.

129. In the case *Stephens v Pittas,* the major shareholder and director of a company was found to have misappropriated receipts belonging to the company. It was held that in the absence of consensus between the company and the owner, the misappropriation of funds by the owner was not a loan by the company to the owner. It was accepted by the parties to that case that the 1969 amendments which introduced s 419(2) and (5) meant that the company had a liability under s 419(1) as extended by s 419(2) for the misappropriations after that date as these were a debt the participator owed the company: the court held that there was no liability under s419(1) for misappropriations before that date. The misappropriations created a debt but not a loan.

130. Theft or misappropriation of funds is not the only situation in which a debt but no loan will arise. A common such situation is where goods or services are provided on credit. There is no loan as no money or other property passes in return for the goods or services supplied. But there is a debt as the customer owes the supplier the consideration for the goods or services supplied.

131. We did not understand either party to disagree with this analysis. In other words, even if a payment to C by A on B's behalf with the understanding B will repay A does not create a loan, both parties agreed, as we do, that it created a debt from B to A. The disagreement was *when* this debt relationship arose. The appellant's position was that nevertheless it was clear from case law that parties to a contract can agree something other than what would otherwise arise under law. And in so far as the UK Facility Agreement was concerned, the parties had agreed that there was no debt until a Contingent Event occurred.

Timing –when does the debt (or loan) arise?

132. So both parties were agreed that the Facility Agreement gave rise to a debt. Their difference was on timing. So far as we can see, the appellant's point on timing applies equally whether the UK Facility Agreement was one of loan or of deferred consideration for the supply of the shares (in other words, a debt). Where below we refer to debt, unless clear from the context our meaning is otherwise, we are referring to a liability under the UK Facility Agreement whether properly defined as a debt or as a loan.

133. HMRC was of the opinion that the debt arose at the moment that the agreements were entered into (or at least no later than when the Company paid the Trustee to transfer the shares to the Employee). Such an interpretation would give rise to an immediate liability to tax on the Company under s 419(1) as extended by s 419(2).

134. The appellant’s view was that the debt arose at the earliest when one of the Contingent Events first occurred, and if one of the Not Repayable Events in clause 39 occurred before a Contingent Event, then no debt ever arose.

Case law on the meaning of “debt”

135. We were referred to case law on the meaning of “debt”. The Court of Appeal considered the issue in the case of *O’Driscoll v Manchester Insurance Committee* [1915] 2 KB 499. In this case a doctor was owed money for work performed but under the particular terms of the agreement he might receive more or less than his bill for fees. The Court of Appeal held that despite the uncertainty in the amount that was owing to him, nevertheless a creditor of the doctor’s could attach the ‘debt’ owed by the insurance company to the doctor: the doctor was absolutely entitled to an unascertained sum. There was a debt.

136. Swinfen Eady LJ said:

> (page 512) “It is contended, however, that there cannot be a “debt” until the amount has been ascertained, and in support of this contention cases have been cited to us where it was attempted to attach unliquidated damages. But in such cases there is no debt at all until the verdict of the jury is pronounced assessing the damages and judgment is given. Here there is a debt, uncertain in amount, which will become certain when the accounts are finally dealt with by the Insurance Committee. Therefore there was a “debt” at the material date, though it was not presently payable and the amount was not ascertained. It is not like a case where there is a mere probability of a debt, as, for instance, where a person has to serve for a fixed period before being entitled to any salary, and he has served part of that period at the time the garnishee order nisi is served. In such a case there is no “debt” until he has served the whole period….”

137. In the same case, Bankes LJ put it as follows:

> (page 516) “The matter is well put in the Annual Practice 1915 page 808: ‘but the distinction must be borne in mind between the case where there is an existing debt, payment whereof is deferred, and the case where both the debt and its payment rest in the future. In the former case there is an attachable debt, in the latter case there is not.’ If, for instance, a sum of money is payable on the happening of a contingency, there is no debt owing or accruing. But the mere fact that the amount is not ascertained does not show that there is no debt.”

138. It is the appellant’s case that the Facility in their case was not a debt unless and until a contingent event happened: it was the case in their view that the “debt and its payment rest in the future” rather than an existing debt with deferred payment: there was a “sum of money” only “ payable on the happening of a contingency”.

Definition of credit

139. We were also referred to the case of *Grant v Watton* [1999] STC 330 by the appellant on the basis it considers it is authority for the proposition that there is no debt until a contingent event occurs. The facts of that case were that G was the director and owner of a service company which provided on-going services to a partnership of which G was a member. The fee was calculated annually but paid by the partnership from time to time.

140. Under s 160 ICTA G was to be taxed on "any form of credit" which he obtained by reason of his employment by a company. The High Court decided that the partnership (and therefore G) had been granted credit by the company because on the facts the services rendered by the company were payable from day to day but not paid until some time later.

141. Under s 419 ICTA it was also held that G had incurred a debt to the company.

142. In the course of his judgment, Pumphrey J gave a definition of "credit":

> (page 345 h) "…In my judgment, on the face of it, credit is granted where payment is not demanded until a time later than the supply of services or goods to which the payment relates. Credit is the deferral of payment of a sum which, absent agreement, would be immediately payable."

Looking at s 419(2) and in particular the words "incurs a debt" Pumphrey J said:

> (page 348 e) "in my judgment the word "incurred" is apt to describe the point in time at which the debtor became legally committed to some future expenditure albeit unascertained. If the debtor knows in respect of a service which he has received that he will have to pay for that service on some date in the future, if he has not already done so, I believe that in the ordinary sense of the words he has incurred a debt, albeit that the debt will not be due until that future date and although its quantum may not be capable of ascertainment because of the possibility of discharge or partial discharge between the date on which it is incurred and the date on which it becomes due and payable."

143. The Court of Appeal, in a very different factual situation, expressed very similar if not identical views in *Dimond v Lovell* [1999] 3 All ER 1. P hired a car from a hire company on terms that no hire charges were due to be paid until the hire company (on behalf of P) had successfully pursued the Defendant D for damages for causing an accident in which P's car had been damaged. P succeeded in proving negligence against D but D successfully disputed his liability to pay the hire charges on the grounds that the agreement between P and the hire company was unenforceable as an unauthorised credit agreement under the Consumer Credit Act.

144. So in the course of its decision the Court of Appeal had to determine the meaning of "credit". Sir Richard Scott VC said (with the concurrence of the other two Lord Justices) as follows:

> (page 11 c) "….If payment for goods or services or land is deferred after the time when, if nothing about the time of payment had been agreed, the payment would be due, the payer is being given credit. Such authority as there is supports this view."

145. The Judge referred to Pumphrey J's statement in *Grant v Watton* at page 345 h and quoted above in paragraph 142 and said he entirely agreed with it.

146. He went on to refer to the Recorder's view at first instance that no debt arose until the contractual due date of payment, which in the case only arose at the conclusion of the negligence action. He disagreed with this view and said:

> (page 12 e)"… the question whether there is a contractual deferment of debt cannot be answered simply by looking at the contractual date of payment. It is necessary also to ask when, but for that stipulation, payment would have had to be made. It is the difference between the two dates that constitutes the credit."

147. The case went to the House of Lords who determined the issue on the same grounds as the Court of Appeal. Lord Hoffman, giving a judgment with which 3 of the other Law Lords concurred, said:

> "….In the absence of credit [the hire company] would have been entitled to payment during or at the end of the hire. All the provisions about the pursuit of the claim were express or implied conditions that deferred the right to recover the hire and therefore constituted a granting of credit….."

148. The remaining Law Lord, Lord Hobhouse, agreed with the decision but commented that some contracts might defer the time of payment for reasons other than the grant of credit.

149. The Court of Appeal considered the meaning of "credit" again in the case of *Nejad v City Index Ltd* [2000] CCLR 7. In that case, the defendant offered the facility of betting on trends in indexes such as the FTSE 100 index. Clients could have credit or debit accounts. The appellant, N, was given a credit account which meant that he could place bets up to a certain amount of exposure without paying a deposit to cover his potential liability. Realised losses had to be paid within 5 days.

150. N made bets which led to a substantial liability to the defendant who sought to make him bankrupt. One of N's defences was that the contract was unenforceable under the Consumer Credit Act 1974 because the defendant was not licensed to grant credit. The question was whether the defendant had granted N "with credit of any amount". The Act defined credit as:

> "a cash loan, and any other form of financial accommodation…"

151. The conclusion of Rattee J in the Court of Appeal giving a judgement with which the other two Lord Justices concurred, was that the "credit account" merely allowed N to bet without giving the security of a deposit for any yet-to-be realised losses. No debt arose until the end date of the bet and then only if the index had moved in the opposite direction to the bet:

> "In my judgment that represents a fundamental difference between this case and the situation in *Dimond v Lovell.* In *Dimond v Lovell* there is no doubt, …., that 1st Automotive earned hire charges under the contract between it and the claimant by providing a hire car for the claimant's use. In the present case, on the other hand, the contract between the customer and City Index for which City Index earns some entitlement to payment by provision of the service. It is simply a contract that, if the relevant Stock Exchange Index is above or below a specified figure on a specified date, or on early closing of the contract in accordance with City Index's terms and conditions, the customer will pay or receive the appropriate amount of money. There may never be any indebtedness by the customer to City Index; all will depend on the movement of the relevant index."

152. Both Swinfen Eady LJ's views in *O'Driscoll* and Pumphrey J's views in *Watton v Grant* were approved by the Court of Appeal but distinguished on the facts.

153. The last case on the meaning of "credit" to which we were referred was *MacMillan Williams v Range* [2004] 1 WLR 1858. R, a solicitor, entered into a contract with a firm of solicitors under which she would be paid at the rate of one third of her paid bills. It was also agreed that she would be paid a monthly advance at a rate of £22,000 per annum. After a year R resigned and the appellant firm sued her for repayment of the advance to the extent it exceeded three times the value of her paid bills.

154. As with *Nejad* it was claimed that the contract was unenforceable under the Consumer Credit Act as involving the grant of credit by an unlicensed body. The Court of Appeal found otherwise: at the time the contract was entered into it was not known what R's billings would be and therefore it was not known whether the advances would be greater or lower than the amount to which R would be entitled. So it was not known at the time the contract was entered into whether it would involve the grant of credit. Ward LJ said, giving a judgment in which the other two judges concurred:

> [16] " ….the time at which to judge whether or not credit is being provided is the moment when the agreement is made. That must be so because the parties must know at the time of the agreement whether it falls within or outside the Act if they are to be able to comply with the form and formalities required by the Act. At the time this agreement was made it was not known whether there would be a surplus or a shortfall when the calculation came to be made at the end of two years or on the earlier termination the agreement. Thus, as it seems to me, one was unable to tell at the material time whether the supply of the benefit, assuming the monthly advances to be such a benefit, attracted a contractual duty of repayment in money which was being significantly deferred. Unless there was a debt, there was no credit.
>
> [17] In my judgment the correct principle is stated in the headnote of *Nejad v City Index Ltd…:*
>
>> 'where it is completely uncertain whether the arrangements between the parties will give rise to a debt at all, there is no

> 'credit' merely because those arrangements postpone any obligation to pay until such time as the future possible indebtedness has crystallised.'…..

> [23] In summary, I see the essential nature of this contract to be one where payment is made in advance of services to be rendered and that does not involve the notion of giving credit. In any event it is impossible to say that the time when the contract is made whether [R] would be the debtor or creditor at the time when the calculations came to be made and thus one simply does not know whether at the moment the parties' obligations were crystallised she would in fact have been provided with credit. …"

155. The appeal before us turns on what is a "debt". Nevertheless the cases on the meaning of credit are relevant because there can be no credit without a debt. We find the cases on the meaning of "debt" and "credit" all express a consistent and clear definition. Ascertaining whether there is credit is a two stage process. Firstly, the Tribunal or court must ascertain whether there is a debt. Secondly the Tribunal or court must ascertain whether the contractual date for payment of that debt is later than it would be if the contract were silent on the matter. If there is a debt *and* if the contract provides for a later date of payment than would arise under law then credit is granted.

Application of law to the facts of this case

156. The appellant's view of *Nejad* and *McMillan* and all the other cases cited above is that no debt arises until the contingent event occurs so that even if at outset it is probable that a contingent event will occur there is no debt. In particular it says:

> (1) a debt only arises when there is a current obligation to repay. It is not enough that an amount will be *probably* repayable. In this case, a Not Repayable Event could occur at any time and therefore at no point (until the occurrence of a Contingent Event *before* a Not Repayable Event) could it be said for certain that the money must be repaid to the Company;

> (2) the Facility only had to be repaid by the Employee on the happening of a Contingent Event and therefore until that time and applying Banks LJ's dictum in *O'Driscoll* ("If, for instance, a sum of money is payable on the happening of a contingency, there is no debt owing or accruing."), there was no debt. This analysis, says the appellant, is not altered just because it was very likely that a Contingent Event would occur.

> (3) The UK Facility Agreement specifically provided that no debt would arise until a Contingent Event occurred and the Tribunal should give effect to the unambiguous terms of a contract.

We deal with each of these points in turn.

(1) Uncertainty whether debt

157. The appellant points out that the Facility might never be repayable: the Not Repayable Events Clause (see paragraphs 39-40 above) provides three circumstances in which the Facility would not be repayable. In the appellant's view, unless and until a Contingent Event occurred *before* one of these three Not Repayable Events, there was no debt because it was not certain until that point that the Facility would be repayable.

158. Case law shows that if at the point that the agreement is entered into it is uncertain whether an amount will be payable, there is no debt. Take the example used in *O'Driscoll* of a chose in action (paragraph 136 above). A chose in action does not convert into a debt owed by D to P unless and until P successfully sues D and gets judgment in his favour. Take the facts of *Nejad.* It was not certain when the agreement for the credit account was entered into whether N would ever owe money to City Index: on the contrary if the bets had accurately predicted future movements of the index, City Index would have owed N money. Take the facts of *MacMillan.* At the date the employment contract was entered into, it was not known how much R would bill her clients and therefore it was not known if the firm's liability to R would be less than or exceed the amount it advanced to her each month.

159. However, we are unable to agree that, on a true analysis of these cases, there is any assistance in them for the appellant. Banks LJ's reference to a contingency in *O'Driscoll* was a contingency of the kind where the debt could only arise after the contingency had occurred (such as a judgment in favour of P, or N closing his bet in a loss making position). He said

> "If, for instance, a sum of money is payable on the happening of a contingency, there is no debt owing or accruing"

160. What we have in this case is the direct opposite: in this case a sum of money is payable <u>*unless*</u> a contingency occurs. We consider that there is a world of difference in law between a debt which has already arisen, which on the occurrence of a contingency will be waived, and a situation such as that contemplated by the Court of Appeal in *O'Driscoll* and found in *Nejad* and *MacMillan* where no debt had yet arisen at all and would only arise on the occurrence of a future uncertain contingency.

'Debt unless contingency' contrasting with 'no debt unless contingency'

161. It is not a question of semantics. There is a very real difference between a situation where a debt arises *now* but will be waived if a contingency occurs, and a situation where a debt does not arise *until* the contingency occurs. It is true that in both situations it is not predictable whether or not the "debtor" will ever be obliged to pay the "debt' because it is not known whether or not the contingent event will occur. But that is not the point. The point is whether at the point in time the question arises there is a current liability to pay a debt, even if the date of payment of it is deferred.

162. From the moment the Company completed its obligations under the UK Facility Agreement (when it loaned the money to the Employee by paying the Trustee for the shares transferred to the Employee), the Employee clearly owed the Facility Amount

to the Company albeit it was not yet due for payment. None of the Not Repayable Events had occurred. The Directors had not waived the liability, the Company had not gone into insolvent liquidation nor had the Employee died.

163. This was not the case with the hypothetical damages claim in *O'Driscoll,* or in *Nejad* or in *MacMillan.* In none of those cases was there a liability to pay a sum of money (albeit deferred) at the time the question was asked. Before judgment was given in the hypothetical claim in *O'Driscoll* it could not be said that D owed P (whatever the probability of success in the action); before the bet closed in *Nejad* it could not even be ascertained whether N would owe City Index or the reverse, and in *MacMillan,* on the day the contract was signed, it could not be ascertained that the advances would exceed three times R's billings for work which had not then even been undertaken. Certainly at that point it could not be said that R would owe the firm or the firm would owe R.

164. On the contrary, in this case although it is true that at any point one or other of one of these three Not Repayable Events might occur and at that moment the debt would be waived, but unless and until they did occur (and so far none have) the money was owed by the Employee to the Company.

165. Put simply, the Company had paid out the money under the Facility Agreement. This was not a gift so unless and until liability to repay it was waived and it became a gift, the Employee owed it to the Company.

Relevance of uncertainty?

166. The appellant's case in a nutshell is that a debt only arises at the point that it is certain that at any time in the future the debt will be payable and there are no contingencies which might occur following which it would cease to be payable. There is no authority for this proposition in the case law and a moment's thought will show that it cannot be right. The creditor always has the ability to waive the debt: right up to the moment it is paid the creditor might chose to waive the debt. It doesn't matter whether this possibility is provided for in the agreement. It is a contingent event that could occur at any moment (however improbable it is no doubt in most contracts of debt!). On the appellant's analysis, therefore, no debt could ever arise until the moment it was paid because there is always the chance the creditor could waive it.

167. The true analysis of the cases must be that whether there is a debt at any point in time must be addressed by considering the position at that particular time. If a debt has arisen at that point it is irrelevant that circumstances could later change and the debt might cease to be payable on the occurrence of an uncertain contingency at some point in the future.

(2) Not payable until Contingent Event

168. There is potential for confusion in the terminology used. The "contingency" referred to in the above passage was the possibility that a debt would be waived on the

occurrence of a Not Repayable Event. The Contingent Events, as defined in paragraphs 30-31, however, were the events which would trigger the Employees' liability to repay the Facility. At the hearing they were referred to as the Contingent Events, as none of them were certain to occur, and we stick with this slightly confusing terminology.

169. It was, as we have already mentioned, the appellant's case there was no debt until a Contingent Event occurred.

170. We have already determined that the possibility of a Not Repayable Event occurring one day in the future does not affect the question of whether a debt has arisen at a current point in time. Does the fact that repayment of the Facility was deferred until the occurrence of a Contingent Event alter our view?

171. The answer to this is straightforward: as we have already the stated, the test is whether a debt has arisen. If payment is contractually deferred beyond the time the debt would otherwise be repayable that is a grant of credit: it does not mean that the debt ceases to exist in the interim.

172. In view of the decisions in *O'Driscoll* and *Dimond v Lovell* this is the only possible interpretation of the situation in this case. If the appellants were right about this it would mean that the decisions in these cases were wrong. There was a current debt in *O'Driscoll* even though the parties had agreed a deferred date of payment. Similarly there was a grant of credit in *Dimond v Lovell* because a debt had arisen despite the agreed deferral of the date of payment.

173. Not only are we bound by these decisions but they are clearly right. The parties may agree that payment of a debt is deferred, but unless they agree that payment of the debt is entirely and permanently waived, it is still a debt.

174. The Contingent Events merely determined *when* the Facility would be repaid. They do not affect the legal position that a debt arose when the Company completed its obligations to each Employee under the UK Facility Agreement (which would have been when the Company paid the money to the Trustee).

175. We do not consider that this analysis is in any way affected by the very remote possibility that a Contingent Event might never occur, or (slightly more likely) that it would not occur before a Non Repayable Event occurred. In our opinion, unless it was certain that none of the Contingent Events could ever occur, such that the deferral of the debt until the occurrence of a Contingent Event was the same as the debt being written off, the position is that the debt arose on completion of the UK Facility Agreement the due date of payment of which was deferred.

What was the basis of the decision in Watton v Grant*?*

176. In *Watton v Grant* it was a finding of fact that in the absence of written contractual terms the arrangements between the parties were to be interpreted such

that the debt was payable day to day and *not* simply when the accountants had done the year-end calculations and worked out the exact amount of the debt.

177. As we have said, the appellant says that this implies (at the least) that the parties could have agreed that the debt was payable annually and no debt would have been created until that day arrived. This is one of the main authorities the appellant gives for its proposition that a debt is not incurred until a contingent event arises.

178. We are unable to agree that the case is authority for this. As is clear from the both extracts above from Pumphrey J's decision (see paragraph 139-142), a debt arises at the date the supplier completes his obligations under a contract for the supply of goods or services. The relevance of the contractual terms in *Watton v Grant* was that the judge was seeking to determine *when* the supply of services took place. The supply was a continuing supply of services so the answer to this was not immediately obvious. A contractual term requiring the supplier to provide services for a set period might mean that the contractor had only completed its contractual obligation at the end of that period as that is when the supplier has done what he agreed to do. But on the facts in that case, the Judge found that the supply was made from day to day. In other words, each day was a separate supply. Therefore the debt arose from day to day ((page 346 g-h and 347 a-b and "prima facie it is my conclusion that the services are rendered from day to day"):

> "The question, it seems to me, that has to be asked is therefore basically a question of fact. When would payment fall due in relation to the services provided by the service company? Here [counsel] argues…that the services were annual in nature. He suggests that there was ..one continuous supply which was not complete until the year-end. No liability to pay <u>therefore</u> arose until that date. On the facts found I do not believe this to be a possible conclusion. …the service company provided the services from time to time and was reimbursed in relation to them. I can see no basis for suggesting that it was agreed in advance that the company should provide prescribed services for a year….
>
> ….It seems to me to be a question of fact in each case as to the period over which a particular service was provided but prima facie it is my conclusion that the <u>services are rendered from day to day</u>……" (my emphasis)

179. To reinterate this point, as this case formed part of the backbone of the appellant's case before us, Pumphrey J did *not* rule that there was an immediate debt because the contract required the services *<u>to be paid</u> for day to day*: he ruled that there was an immediate debt because under the contract (as interpreted) the services were *<u>supplied</u> day to day*. The relevance of the contractual terms, implied or otherwise, was because the Judge was determining the date(s) the services were supplied: he was not determining the due date of payment (other than to say that the due date of payment was the same as the date performance was completed).

180. If the contract had been for a single supply of services over a period of time the implication of his decision is that the services would not have been provided and the debt would not have arisen until the supply was complete at the end of the year.

181. In Aspect Capital's case, however, there is no continuous supply of services and determining *when* the supply was made is straightforward. There was a one-off supply of a payment by the Company to the Trustee on behalf of the Employee. The Company had done what it had contracted to do no later than the date the Company paid the Trustee. On the authority of *Grant v Watton,* the debt arose no later than that time. The liability to repay the Company arose at the time that the Company had fulfilled its side of the bargain. It makes no difference that the due date for payment of that liability was deferred.

182. Contrary to the appellant's submissions, Pumphrey J was quite clear that deferring the date of payment did not defer the date on which a debt arose. As he said:

> "If the debtor knows in respect of a service which he has received that he will have to pay for that service on some date in the future, if he has not already done so, I believe that in the ordinary sense of the words he has incurred a debt, albeit that the debt will not be due until that future date…"

Partly paid shares

183. The appellant also referred us to cases on partly paid shares: *Whittaker v Kershaw* [1890] 45 Ch D 320 and *Re Russian Sprats* [1898] 2 Ch 149. These cases are authority that no debt arises in respect of partly paid shares unless and until a call is made on them by the company. The appellant sees these cases as supporting their proposition that a debt does not exist until the occurrence of a contingency without which it would not be payable.

184. The appellant's position is that if HMRC is right and a debt arises upfront and before the occurrence of one of the Contingent Events without which the debt is not repayable, then how do they distinguish partly paid shares? The share is partly paid from the moment it is issued, but only becomes a debt if and when the company makes a call on it.

185. It is clear to us the determination in those two cases of the position of partly paid shares was made by an analysis of the Companies Act 1862 (see page 326 of Cotton LJ's decision in *Whittaker v Kershaw).* The position for partly paid shares appears to be analogous with that of a chose in action: a chose in action is not a debt unless and until judgment is given in favour of the claimant. A partly paid share does not give rise to a debt unless and until a call is made.

186. But that has no impact on the position for contracts for goods and services, which is what is dealt with in all the cases outlined above in paragraphs 135-155. The ratio from those cases is clear: a debt for the consideration payable under a contract for goods or services arises on the date on which it would arise under application of

the law in the absence of any contractual provision delaying the date of payment. In other words, a debt arises at the moment the contract for goods or services is completed.

187. In this case, the Company provided a loan (or at least a financial facility). This was a contract for services (a loan or facility). Completion occurred no later than the moment the Company paid the money to the Trustee on behalf of the Employee. At that point a debt arose, albeit the due date of payment was indefinitely deferred.

Example of the neighbours' car

188. We mention, as something was made of it at the hearing, that Mr Gammie postulated an example which he considered to be analogous to the facts of this case. In his example, a person (B) agreed that he would give title to a car to his neighbour (A). He agreed he would make the car or buy the car from a third party. The consideration would be A's obligation to drive B once a week to the supermarket and wherever else he chose to go. But if A moved away, A would have to pay for the car.

189. Mr Gammie's point was that in his view no debt would arise unless and until A decided to move away.

190. We are unable to agree. The facts suggested by Mr Gammie are rather unlikely, we think, to arise in the real world. But assuming they did, clearly A owed B an obligation (to drive him when and where B wanted) from the moment he was given the car. It would not be true to say that A owned the car free of an obligation (even if "debt" would be an odd description). If A moved away this merely altered the consideration for the car from being an obligation to act as unpaid chauffeur to a financial obligation. A "debt" arose from day one: it just changed its nature on the occurrence of a contingency.

Summary

191. There are situations where no debt has yet arisen but may arise on occurrence of uncertain event (such as litigation which might lead to a judgment debt or a partly paid share where there might be a call to pay the balance.) But these situations are in contrast to a case, such as the one in this appeal, where the supplier under a contract has completed his obligations. In such cases a debt arises immediately even thought it may only be due for payment on a deferred date and even though it might be waived on the occurrence of a future uncertain event. In such a case a debt arises from the moment the contract for the goods or services is completed.

192. In reality what the appellant seeks to do is to combine the two concepts of deferred payment and the possibility of future waiver of debt and argue that this creates a situation where there is (as yet) no debt. But this cannot be done. Any debt can be waived at any time but that does not mean a debt is any less a debt: and the case law is clear that once a contract for goods or services is completed, a deferred date for payment creates credit, but does not mean the debt does not exist.

(3) Giving effect to the terms of the contract

193. The appellant cites *Seldon v Davidson* [1968] 1 WLR 1083 as showing that there is only a rebuttable presumption that a payment of money gives rise to obligation to repay. The appellant's argument is that the presumption is rebuttable and an express term, such as in this case, rebuts it.

194. We find the appellant is taking this case out of context. What the judge meant in *Seldon* was that it is presumed unless the contrary is proved that a transfer of money is not intended as a gift. As it is not the appellant's case that the Facility Amount was gifted to the Employee, this case is not on point.

195. Nevertheless, of course courts and tribunals must normally give effect to the terms which the parties have agreed (assuming that the agreement is not a sham or entered into through a misrepresentation).

Agreeing the legal effect of a contract

196. But it only applies to the obligations that the parties agree between themselves. The parties cannot determine how the law will apply to their agreement. A trite example shows this is right. A might agree to lend money to B. They might agree when the money must be repaid and what interest is payable in the meantime. They might agree a term that says "this is not a credit agreement". But if the legal effect of what they have agreed is that it is a credit agreement, an express term that it is not cannot affect the legal nature of what they have agreed.

197. This was put more succinctly by the Upper Tribunal in the recent case of *MJPMedia Services Ltd* (not cited to us) [2011] UKUT 100 (TCC). At paragraph 39 Mr Justice Arnold said:

> "…parties cannot make a transaction answer a description which it does not otherwise answer by saying that it does…."

198. And this is what we find has happened here. Ignoring the preamble to the UK Facility Agreement, the effect of the obligations that the parties agreed to in the Share Acquisition Agreement and UK Facility Agreement was that the Company would arrange for a transfer of shares to the Employee and loan the Employee the money to pay for them. As a matter of law, a debt once the Company had completed its obligations by paying the Trustee for the shares. At that point, therefore, a debt arose, albeit the contract provided that in the event of certain contingencies the debt would be waived and in any event it would not be repayable until the first of the Contingent Events arose.

199. The parties cannot agree that the legal effect of their agreement is something other than what in law it is. They cannot effectively agree that black is white. This was a contract which gave rise to a debt from the moment it was completed which was when the Trustee was paid. The Preamble in so far as it states otherwise is of no effect. While the parties' view of the legal nature of their agreement might be relevant if there was ambiguity over what they had actually agreed their obligations were, here there is no such ambiguity.

Rules of contractual construction

200. HMRC referred us to the case of *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 and the rules of contractual construction expressed by Lord Hoffman in that case. These rules are of no assistance here: what the parties agreed in the contracts in this case was quite clear. They agreed terms and obligations which as a matter of law amounted to the creation of a debt with deferred terms of payment and certain contingencies on the occurrence of which the debt would be entirely waived. They also agreed that as a matter of law this did not create a debt.

201. The operative terms of their agreement were therefore entirely at odds with the "introduction" or recital: the operative terms created a debt while the recital said that there was no debt. The law of contractual construction on this is quite clear: recitals cannot affect the application of clear operative terms. For this see the Court of Appeal's decision in *Leggott v Barrett* (not cited to us) (1880) LR 15 Ch D 306 at 311 per Brett LJ

> "…the recital may be looked at in order to determine what is the true construction; but if there is no doubt about the construction, the rights of the parties are governed entirely by the operative part of the writing or the deed."

202. The same point was made by a differently constituted Court of Appeal in *In Re Moon* (not cited to us) (1886) LR 17 QBD 275 at 286 per Lord Esher MR:

> "Now there are three rules applicable to the construction of such an instrument. If the recitals are clear and the operative part is ambiguous, the recitals govern the construction. If the recitals are ambiguous, and the operative part is clear, the operative part must prevail. If both the recitals and the operative part are clear but they are inconsistent with each other, the operative part is to be preferred."

203. In this case the Facility Agreement falls in the third of Lord Esher's above possibilities, so the operative part, creating a debt, takes precedence over the introduction or recital, which states that there is no debt. There are many other more recent cases applying this rule.

Legal vacuum?

204. Lastly, even assuming that the rules of statutory construction were not what they are, how could we give effect to the recital in preference to the operative parts? What the parties did in law was enter into an arrangement under which the Company procured shares for the Employee and loaned them the money to pay for them. Yet, says the introduction to the Facility Agreement, this did not create a debt. If not a debt, then what was the legal relationship created? As there can't be a vacuum, if the Employee did not "owe" for the money the Company paid to the Trustee, then this must mean that that payment was a gift to the Employee.

205. The appellant does not agree: it says it can't be a gift as ultimately a Continent Event is likely to occur and a debt arise. Until that time, they say, there was no gift

but the contract created no debt. We consider what the appellant seeks to do is create some sort of legal relationship unknown in law. Their case, no doubt, is that the legal relationship is whatever would have been created in the *Grant v Watton* case had the parties agreed that the services were rendered only annually. But as we have already said there is an unbridgeable gulf between these hypothetical facts of *Grant* and the appellant's case: in the hypothetical case in *Grant* the supply would have been incomplete until the annual accounts were rendered; in this case, the Company had completed its obligations under the contract for the procurement of shares and loan facility no later than the moment the Company paid the Trustee.

206. The company had completed its half of the bargain no later than the moment it paid the Trustee on behalf of the Employee. Under law a debt arose at that point. If the parties could displace that by contractual agreement, then, as there was no debt, then there must have been a gift. And tax would have to be paid on that basis. But they cannot and there was a debt from the moment the agreements were completed.

Summary

207. For the reasons given above we reject the appellant's case that the loan or debt did not arise until the occurrence of a Contingent Event. We find a debt arose no later than completion of the obligations of the appellant under the contract with each Employee, which was on payment by the Company to the Trustee.

US Loan Facility Agreement

208. The fallacy in the appellant's position is put into sharp relief by consideration of the US Loan Facility Agreement. The agreement had virtually the same Contingent Events which deferred the due date of payment of the debt. Yet its Introduction recorded that it did create a debtor-creditor relationship.

209. So if we were persuaded by the appellant's case that deferring the due date of payment meant there was no debt until a Contingent Event occurred, then either the US Loan Facility Agreement would similarly create no debt despite its recital *or* whether a debt was created as a matter of law would be an option for the parties to the contract to agree on. It would allow them to switch the legal effect of their agreement as a debt on or off at will depending on the recitals to their agreement.

210. As a matter of law they cannot do this for the reasons given above.

211. We find that the UK Facility Agreement was as much a debt as the US Loan Facility Agreement. Either way a loan under the US Loan Facility Agreement was within s 419(1), by its plain meaning or extended meaning within s 419(2).

Legal position quite different to accountancy position

212. Whether something is a receivable for accountancy purposes is a very different question to whether it is a debt for legal purposes. We understand that whether something is shown as a receivable in accounts will depend on whether it is more

likely to be paid than not. Whereas, on the rules as discussed above, we could envisage a receivable that is very likely to be paid but is not a debt (eg a chose in action that is virtually certain to be upheld in court) and a debt that is very unlikely to be paid (eg a debt where a waiver event is very likely to occur). The receivable would not be a debt and the debt would not be a receivable.

213. Therefore, it is irrelevant that the Facilities under the UK Facility Agreements were treated as receivables (more likely to be paid than not) by the auditors. We also are uninfluenced by whether or not the auditors described the facilities as loans or facilities. Even if, which must be unlikely, the auditors were seeking to describe the legal effect of the UK Facility Agreement, their view of the law is irrelevant to the Tribunal.

Conclusion

214. Agreeing a deferred time of payment does not mean there is no debt: it means that there is both a debt and credit: agreeing that a debt will be waived on a future contingent event and thus creating an uncertainty whether the debt will remain due does not alter its status as a current debt. Agreeing *both* deferred time of payment and waiver on future contingent events makes no difference: there is a current debt.

The purpose of s 419 ICTA

215. The appellant states that the object of s 419 is to prevent avoidance of tax by the device of companies making loans to participators which if left outstanding indefinitely would in effect amount to a distribution. Carswell LCJ said in *Brennan v Deanby Investment Co Ltd* said: at 548a-b:

> (548a-b) “The legislation includes provisions to counter avoidance of tax by the making of loans or advances of money to participators of close companies. Were it not for these provisions, participators could enjoy the use of the income of a close company free of tax if the company were to make loans to them instead of paying dividends or remuneration. The loans could then be allowed to remain outstanding indefinitely or could be waived or written off.”

216. It is the appellant’s case that this was neither the purpose nor the effect of the EPS. The purpose of the EPS was to incentivise the employees and reward long-term loyalty. HMRC did not dispute this: they accepted the EPS was a commercially motivated share incentive scheme. There was no suggestion that this method of incentivisation was adopted as a more tax efficient method of doing this than using unapproved share option schemes.

217. Indeed Mr Grimwold says that the company sees the scheme as very tax inefficient and, more importantly, as capital inefficient. This seemed to be because of the need to buy back the shares at a loss if the value fell.

218. The appellant’s position is that under the tax law as it stood they paid the intended amount of tax in respect of these arrangements and that s 419 was a penal

provision that was not intended to catch these sorts of arrangements. Its meaning should not be stretched to bring this sort of arrangement into charge.

219. On the face of it, motive is not relevant to the application of s419(1). However, it is well-established that a purposive interpretation should be given to tax legislation. This is from the report of the Appellate Committee in *Mawson*:

> [32]"The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found."

220. Where there is ambiguity the courts would normally construe tax legislation so that it is not easily avoided on the basis that such an interpretation is in accordance with the intention of Parliament. It must follow that where there is ambiguity in tax avoidance legislation, we should if possible construe any ambiguity so that the law does not have a reach beyond tax avoidance situations.

221. But this does not help the appellant. Firstly, here there is no ambiguity. We are not straining the meaning of s 419 but merely applying the normal meaning to "debt".

222. Secondly, were we to agree with the appellant's analysis of the law, it would be to render s 419(1) very easy indeed to avoid: a would-be tax avoiding close company would need only to loan or advance money or supply goods to its director-cum-shareholder on terms that (re)payment would be deferred until a contingent event and put in a recital that no debtor-creditor relationship was incurred until the contingent event in order to avoid liability under that section. We are certain that such a situation *was* intended to be caught by s 419. So ours is a purposive interpretation.

223. We note that the real reason why the appellant is likely to consider that its EPS was not the sort of thing Parliament intended s 419 to apply to is because the "participators" are merely employees without control of the company and therefore they are not and could not be intending to pay themselves the equivalent of a dividend but avoid ACT on it, which was the mischief at which s 419 was aimed. But the appellant has already conceded that the Employees were participators. We were not asked to consider the meaning of "participator". And we are not going to give a strained and unnatural reading of "debt" to compensate for a wide definition of "participator" resulting in situations being caught by the anti-avoidance provision which may not have been the object of the anti-avoidance legislation.

224. In conclusion, completion of the UK Facility Agreement resulted in both a loan by the Company to the Employee and a debt owed by the Employee to the Company. That debt arose on completion of the UK Facility Agreement. Therefore, in principle the assessments are upheld.

Liability under s419(5)?

225. Section 419(5) gives rise to liability under s 419(1) where there is both a loan or advance *not* within s 419(1) and a transfer of property (or giving of other value) to a participator. A loan or advance will not be within s 419(1) if it is not made to the participator. So s 419(5) is apt to capture a situation where the close company makes a loan or advance to a third party who then makes a loan or advance or transfers property to the participator in the close company.

226. We find it does not apply in this situation as no loan or advance was made by the Company to the Trustee (or anyone else) in connection with the transfer by the Trustee of the shares to the Employees. The Company paid (on behalf of the Employee) the Trustee for the shares that were transferred: but it did not loan nor advance any money to the Trustee.

Conclusion

227. It was accepted by the appellant that the US Loan Facility Agreement created a loan (or at least a debt) from the outset and s 419(1) with its original or extended meaning applied to impose a tax charge. In any event, we find that this was so for the reasons given above.

228. For the reasons explained above, we also find that the UK Facility Agreement created a loan (or at least a debt) from no later than the moment that agreement was completed which would have been no later than the date the Company paid the Trustee the money in consideration for the shares transferred to the Employee. This was caught by s 419(1) with either its original or extended meaning and a tax charge arose at that time.

229. We dismiss the appeal in principle. If the parties are unable to agree quantum, either party is at liberty to revert to the Tribunal for a ruling.

230. 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.

BARBARA MOSEDALE
TRIBUNAL JUDGE

RELEASE DATE: 29 June 2012