TC02516

Appeal number: TC/2010/09001

INCOME TAX – tax avoidance scheme designed to obtain a tax deduction in respect of a manufactured overseas dividend treated as an annual payment within section 349 ICTA with no counteracting tax charge – paragraph 4(1) Schedule 23A ICTA and regulation 2B(3) Income Tax (Manufactured Overseas Dividend) Regulations 1992 SI 1993/2004 – whether scheme defeated by the **Ramsay** *principle – held, yes – alternatively whether the annual payment deductible notwithstanding an express provision in regulation 2B(3) that no deduction of tax was required on making the payment – held, no –* **Earl Howe v CIR** *and succeeding cases applied – alternatively whether the charge to basic rate tax under section 3 ICTA restricts relief for any deduction for such an annual payment to relief at the higher rate(s) of income tax – held, no – appeal dismissed*

FIRST-TIER TRIBUNAL
TAX CHAMBER

ANDREW CHAPPELL **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN WALTERS QC
TYM MARSH

Sitting in public in London on 12, 13, 14 and 15 March 2012

G R Bretten QC and Harriet Brown, Counsel, instructed by NT Advisors LLP, for the Appellant
D Goy QC and Aparna Nathan, Counsel, instructed by the Solicitor for HMRC, for the Respondents

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DECISION

Introduction

1. This is an appeal against an amendment made to the self-assessment in the tax return for the year 2005/06 made by the appellant, Andrew Chappell ("Mr Chappell") by which the respondents ("HMRC") sought to cancel the effect of a charge on income claimed by Mr Chappell as a deduction from his total income in that year. The deduction claimed amounted to £303,123, reducing Mr Chappell's total income from £553,321 to £250,198 and giving rise to a claim for repayment of income tax of £131,039.48. The effect of the amendment is to reduce the claim for repayment of income tax to £9,793.38.

2. The deduction which Mr Chappell claims arises from his participation in what Mr Bretten QC, leading counsel appearing for him, frankly acknowledged was a tax avoidance scheme with no underlying commercial purpose whatever. Mr Chappell's participation in the scheme was notified to HMRC in the tax return in which he claimed the deduction. At all times, so far as the Tribunal is aware, Mr Chappell and his advisers have been entirely open with HMRC about the nature of the scheme and Mr Chappell's participation in it.

3. The nature of the scheme is that by reason of various transactions which Mr Chappell entered into (and which HMRC acknowledge were not sham transactions) Mr Chappell claims to have made what are in law annual payments within section 349(1) Income and Corporation Taxes Act 1988 ("ICTA") and that this has the effect in law of reducing his total income as claimed.

4. The particular transactions which Mr Chappell claims are annual payments were the payment of 'manufactured overseas dividends' (as that term is defined by paragraph 4(1), Schedule 23A to ICTA) ("MODs") of £303,123 in total to a company called Barsbury Limited ("Barsbury").

5. HMRC have identified 305 taxpayers who have participated in this scheme and therefore the Tribunal apprehends that this appeal will have a significance wider than merely in relation to Mr Chappell's tax affairs.

6. The direct cost to Mr Chappell of his participation in the scheme was £18,000, which was applied in certain disbursements and fees to Dominion Fiduciary Services Group ("DFSG"), a promoter of the scheme. That was the amount of the cheque he wrote. It is, however, a feature of the scheme that Mr Chappell in law entered into other transactions with a far higher monetary value than £18,000, including of course the MODs of £303,123. The scheme itself, by a series of circular payments which we will describe, provided the funds to effect these other transactions on behalf of Mr Chappell.

7. Mr Goy QC, for HMRC, mounted his main challenge to the effectiveness of the scheme on two alternative bases. First, he made a broadly-based *Ramsay* attack to the effect that transactions involved in the scheme which were necessary

to enable Mr Chappell to claim that it was effective to achieve the deduction claimed were not transactions of the type that come within the meaning of the relevant statutory language. (In referring to this issue as 'the *Ramsay* attack', we do not forget that the burden of proof is on Mr Chappell to show that he is overcharged by the amendment to his self-assessment.) Secondly, Mr Goy contended that even if the *Ramsay* attack failed the annual payment which Mr Chappell claimed to have made did not give rise to the deduction claimed because (as was common ground) it was not an annual payment that was or could be made under deduction of basic rate income tax. We refer to this contention as 'the technical annual payment contention'. Finally, and almost by way of a postscript, he argued that even if the *Ramsay* attack and the technical annual payment contention failed, Mr Chappell was nevertheless not entitled to relief at the basic rate on income tax (22% in 2005/06) because he was chargeable under section 3 ICTA to tax at that rate in any event. We refer to this argument as 'the section 3 ICTA argument'. Were HMRC to win the appeal on the section 3 ICTA argument but not on either the *Ramsay* attack or the technical annual payment contention, Mr Goy recognised that Mr Chappell would be entitled to a deduction in respect of the MOD so far as the computation of his liability to income tax at the higher rate is concerned. The higher rate in 2005/06 was 40%, and so the deduction would be an amount of 18% of the MOD.

8. The *Ramsay* attack, the technical annual payment contention and the section 3 ICTA argument were all stoutly resisted by Mr Bretten and we deal with each in turn below, setting out the statutory provisions relevant to each issue.

9. As to evidence, besides a large bundle of documents, we received Witness Statements (with exhibits) from Mr Chappell and 6 other witnesses called by Mr Bretten (all of whom were cross-examined by Mr Goy) as well as from Mr Anthony Stewart, the Officer of HMRC with charge of the appeal, who was called by Mr Goy, but not cross-examined by Mr Bretten. We also received Witness Statements from two persons who were presented by Mr Bretten as experts in foreign law (the laws of the British Virgin Islands ("BVI") and the Isle of Man, but as Mr Goy took no point on foreign law and did not require to cross-examine either of these witnesses they did not appear. No reference was made to their evidence at the hearing (beyond noting that it had been given) and we make no further reference to it in this Decision. We set out the relevant evidence and our findings of fact when dealing with the *Ramsay* attack. The other two issues are issues of law.

10. When dealing with the *Ramsay* attack we also explain the Appellant's analysis which in Mr Bretten's demonstrates an entitlement to the deduction claimed.

The documents entered into by or on behalf of Mr Chappell

11. Mr Chappell endorsed (on 14 July 2005) a Letter of Engagement dated 27 July 2005 written to him by Mr Benjamin Cooke of DFSG, with an address in Jersey, accepting that the terms of engagement set out in the letter fully recorded the agreement between Mr Chappell and DFSG.

12. DFSG were engaged by Mr Chappell to provide 'tax implementation services' in respect of 'tax planning involving securities'. DFSG charged a 'non-contingent fee' of 6% of the 'Sheltered Amount' which is defined in the Letter of Engagement as 'the amount of interest type payments made by [Mr Chappell] as envisaged under the Planning'. The 'Planning', if successful, would allow Mr Chappell to claim a loss for income tax purposes for the tax year 2005/06. The Schedule to the Letter of Engagement indicated that the Planning involved 'arrangements using stock lending of securities', and DFSG promised to 'loan' Mr Chappell a copy of the combined instructions and Opinion of leading tax Counsel in respect of the Planning. DFSG also undertook *inter alia* to liaise with lawyers and/or financial institutions to assist Mr Chappell in seeking third-party funding if required, to 'project manage' the implementation of 'the Planning' and provide documentation for its implementation where necessary, and to assist Mr Chappell in claiming a tax refund for 2005/06 '(although no guarantee [was] given that such a refund [would] be obtained)'.

13. Mr Chappell wrote an (undated) letter to Mr Stuart Gower, then at SG Hambros Bank & Trust (Jersey) Limited ("SGH"), at an address in Jersey, regarding SGH's rôle in the 'proposed transactions' – namely that Mr Chappell would 'amongst other things, seek to enter into a custodian agreement' with SGH, a global master stock lending agreement with Barsbury Limited ("Barsbury"), with respect to certain loan notes ("the LNs"), a letter of credit agreement with Heathvale Limited ("Heathvale"), securing in favour of Heathvale his rights in the custodian agreement, a tender document offering the LNs for sale to potential third-party buyers and 'certain sale and purchase agreements with potential third party buyers to sell and purchase the [LNs]'. The letter went on:

> 'For the avoidance of doubt, it is hereby noted that there is no guarantee on my part that I will enter into all or any of [the documents mentioned above, called 'the Transaction Documents'] and further the execution of the transaction documents is subject to me finding suitable third parties and mutually agreeing prices for any sale or purchase'.

14. The letter stated that Mr Chappell had consulted with DFSG, who had explained to him the content of the transaction documents, the nature of the transactions contemplated therein and SGH's rôle in the transactions. He had also considered Counsel's opinion in relation to 'the planning'.

15. There is a further undated letter with our papers written by Mr Chappell to Benjamin Cooke of DFSG. By this letter Mr Chappell irrevocably appointed both Benjamin Cooke and Aidan James jointly and severally to be his attorneys to agree on his behalf all of the sale or purchase terms in respect of any sale and/or purchase of any LNs as envisaged under the planning proposed to be undertaken by Mr Chappell for which DFSG was engaged, including arm's length sale prices or consideration receivable. The power of attorney was stated to be governed by and construed in accordance with Jersey law.

16. Mr Chappell, by a fax message sent in July 2005 (we do not have the precise date) to Benjamin Cooke and Aidan James referred to the recently executed power

of attorney and to the fact that the LNs envisaged were to be LNs issued by either Santi Crescent Limited ("SCL") or Derryquest Limited (both companies being BVI companies). The fax, supplementing and amending the power of attorney made clear that it was not intended to give the attorneys the rôle of discretionary investment management – i.e. that the attorneys were not permitted to enter into any transaction unless the subject matter and material terms of such transaction were conveyed to Mr Chappell prior to the transaction being entered into and he had not conveyed to the attorneys his disagreement to the proposed transaction. The fax stated that in the absence of any response from Mr Chappell, the attorneys should proceed with the proposed transaction.

17. Mr Chappell sent a letter of escrow dated 14 July 2005 to Benjamin Cooke, enclosing 'a number of documents' relating to the planning that he wished to undertake, which were signed but undated, with the request that Benjamin Cooke hold these documents in escrow until 'the relevant time', which was the time when he (Benjamin Cooke) in his absolute and sole discretion believed that the documents concerned should be released from escrow. Benjamin Cooke was to date documents released from escrow in this way. Benjamin Cooke was authorised by the letter of escrow to enter, on Mr Chappell's behalf, 'the relevant nominal value as any lender agrees to lend [Mr Chappell] subject to such amount not giving rise to an amount of manufactured interest payable by [Mr Chappell] (i.e. the manufactured overseas dividend) in respect of such loan which is substantially more that the amount previously discussed between ourselves and others'. The letter included Mr Chappell's authorisation to Benjamin Cooke to delegate any of the powers given in the letter to a substitute or agent. The letter of escrow was also to be governed by and construed in accordance with Jersey law.

18. Mr Chappell applied for a bank account at SGH, again by an undated document – so far as our copy indicates. The statements for the account show that he credited it with £18,000 on 29 July 2005.

19. Also on 29 July 2005, Mr Chappell entered into a 'Global Master Securities Lending Agreement' ("GMSLA") with Barsbury. The GMSLA is governed by and is to be construed in accordance with the laws of the BVI. This document, Mr Bretten explained, would have been one of the documents in escrow until release to Barsbury. The GMSLA set up a system whereby securities and financial instruments (called generally 'Securities') could be transferred between the parties against collateral ('Collateral') which was to be a letter of credit expressed in sterling, or sterling cash, with a simultaneous agreement by the transferee (the 'Borrower') to transfer back to the transferor (the 'Lender') equivalent securities on a fixed date or on demand, against Collateral put up by the Lender to the Borrower. Such transfers were referred to as 'Loans', and the GMSLA governed the terms and conditions of such Loans.

20. The GMSLA provided (at clause 3) that the terms of each Loan would be agreed prior to its commencement. When securities were loaned pursuant to the GMSLA, all right, title and interest in the securities (and collateral) passed from

one party to the other on delivery (or redelivery) in accordance with the GMSLA. Collateral was to be delivered (and redelivered) simultaneously with the delivery of the securities borrowed (or repaid).

5 21. The GMSLA made specific provision for 'Manufactured Payments' at clause 6.1 as follows:

> '**Manufactured Payments**
>
> 10 Where Income [defined as any interest, dividends or other distributions of any kind whatsoever with respect to any Securities or Collateral (also being defined terms)] is paid in relation to any Loaned Securities or Collateral (other than Cash Collateral) on or by reference to an Income Payment Date [also a defined term] Borrower, in the case of Loaned Securities, and Lender, in the case of Collateral, shall, on the date of the payment of such Income, or on 15 such other date as the Parties may from time to time agree, (the "**Relevant Payment Date**") pay and deliver by way of a payment that is representative of a periodical payment of income a sum or money or property equivalent to the type and amount of such Income that, in the case of Loaned Securities, Lender would have been entitled to receive had such Securities not been loaned to Borrower and had been retained by Lender on the Income Payment Date, and, in the 20 case of Collateral, Borrower would have been entitled to receive had such Collateral not been provided to Lender and had been retained by Borrower on the Income Payment Date unless a different sum is agreed between the Parties.'

22. This clause made provision, in default of a different agreement between Mr 25 Chappell and Barsbury, for an equivalent payment to be made by the Borrower of Securities, when income was paid in relation to the Securities (such payment being a 'manufactured payment') and, likewise, for an equivalent payment to be made by the Lender of Securities, when income was paid in relation to Collateral (such payment also being a 'manufactured payment').

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23. Following the execution of the GMSLA, Mr Chappell wrote to Barsbury, by a letter also dated 29 July 2005 (which, again, presumably was in escrow pending release to Barsbury, and was governed by BVI law) requiring Barsbury, for an 'up-front fee' of £196 in respect of setting up and entering into the loan of the 35 LNs, to transfer for same-day settlement SCL Redeemable 2005-02 LNs to a nominal value of £6,377,280 to SGH as custodian for Mr Chappell against Collateral to be transferred by or on behalf of Mr Chappell to Barsbury of a letter of credit for £6,680,403. Repayment of the loan of the LNs was to be on (or before at Mr Chappell's choice) 9 August 2005. Pursuant to clause 7 of the 40 GMSLA, Mr Chappell agreed to pay to Barsbury on the date of repayment of the loan of the LNs, an annualised rate of 0.1% of the daily Market Value (being a defined term) of the LNs.

24. A letter of credit agreement, also dated 29 July 2005 (and likewise presumably 45 held in escrow pending release) was entered into between Mr Chappell and Heathvale (a BVI company) to procure that Heathvale provided a standby letter of credit to Barsbury in return for a fee (the details of which, at clause 6, were left blank in our copy of the agreement) and provided that Mr Chappell granted to Heathvale security over his interest in the custodian agreement between SGH and 50 himself. The agreement stated that the letter of credit was intended to be used by

Mr Chappell to provide Collateral in relation to the GMSLA, and the letter of credit would be provided to Barsbury for a maximum principal amount which was left blank in our copy of the agreement, but which we were told was the figure of £6,680,403 mentioned in the letter from Mr Chappell to Barsbury referred to in the immediately preceding paragraph of this Decision.

25. The form of letter of credit attached to the letter of credit agreement was an Irrevocable Standby Letter of Credit addressed to Barsbury by Heathvale to serve as collateral for the Securities loaned by Barsbury to Mr Chappell.

26. Also with our papers was a security interest agreement dealing with custodian rights, entered into between Mr Chappell and Heathvale and also dated 29 July 2005. This agreement was entered into in order to create security in favour of Heathvale (the issuer of the letter of credit) over the interests of Mr Chappell in the custodian agreement entered into between SGH, Mr Chappell and Heathvale (see below, paragraph 28), being the custodian agreement pursuant to which the SCL LNs were held by SGH as custodian for Mr Chappell. Thus Mr Chappell's obligations to Heathvale under the letter of credit were secured by title to the LNs.

27. There was also a form of notice, dated 29 July 2005 and executed by Mr Chappell (again, we assume, a document in escrow, pending release to SGH) by which Mr Chappell and Heathvale notified SGH of the security interest agreement.

28. The custodian agreement (whose governing law is the law of Jersey), also dated 29 July 2005, was entered into between SGH as custodian, Mr Chappell and Heathvale. Pursuant to this agreement, SGH established a custody account in Mr Chappell's name for the receipt, safekeeping and maintenance of the Securities (in practice, the LNs) and any monies held by SGH as custodian for Mr Chappell. In the custodian agreement it is acknowledged, for the avoidance of doubt, that Mr Chappell remained the beneficial owner of assets held in the custody account by SGH as custodian.

29. The next document in chronological sequence is the SCL LN Sale Agreement ("SCLLNSA") dated 1 August 2005 between Mr Chappell and Berry Lane Limited ("BLL"). BLL is an Isle of Man company. The governing law of the SCLLNSA is BVI law. The SCLLNSA provided for the sale by Mr Chappell of the LNs (i.e. £6,377,280 Redeemable 2005-02 Loan Notes issued by SCL, which were held by SGH as custodian for and on behalf of Mr Chappell) to BLL for a consideration of £6,373,804 in cash payable on completion. This document was executed on behalf of Mr Chappell by Aidan James as his attorney.

30. The next document in chronological sequence is the Qintar Limited LN Sale Agreement ("QLLNSA") dated 5 August 2005. By this agreement, entered into between Qintar Limited ("QL"), a BVI company, and Mr Chappell, signed on behalf of Mr Chappell, by his attorney, Benjamin Cooke, Mr Chappell purchased

from QL £6,377,280 SCL Redeemable 2005-02 LNs for a consideration of £6,073,588 in cash, payable at completion.

The transactions explained

31. On 29 July 2005, Mr Chappell borrowed from Barsbury £6,377,280 nominal value SCL Redeemable 2005-02 LNs (being part of a much larger parcels of such LNs – of £264,019,380 nominal value), which had been created and issued by SCL to Barsbury on that date. See: paragraph 23 above.

32. SCL Redeemable 2005-02 LNs to the nominal value of £264,019,380 were constituted by an instrument dated 29 July 2005. The £6,377,280 nominal value LNs borrowed by Mr Chappell from Barsbury were issued (subject to BVI law) on that date, and the terms of the issue provided that such LNs were to be for a term of 2 years, the final redemption date being 28 July 2007 (or if that date was not a Business Day (as defined) then the next Business Day after that date). Interest was to accrue on the principal outstanding amount of LNs at a fixed rate of 4.766230 per annum and was to be payable on the dates and for the periods and to the persons indicated as follows.

33. On 2 August 2005 (the First Interest Date), interest was payable in arrears for the period from the issue date (29 July 2005) to the First Interest Date to noteholders of subsisting LNs in the register at 7 am on the First Interest date.

34. On 4 August 2005 (the Second Interest Date) interest was payable in arrears and in advance, for the period commencing on the day immediately after the First Interest Date and continuing to the day prior to the Third Interest Date, to noteholders of subsisting LNs in the register at 7 am on the Second Interest Date.

35. On the Third Interest Date (28 July 2006 or if that date was not a Business Day, then the next Business Day after that date), interest was payable for the period consisting of the Third Interest date only (i.e. one day) to noteholders of subsisting LNs in the register at 7 am on the Third Interest Date.

36. On the Last Interest Date (27 July 2007) interest was payable for the period from the Third Interest date to the day immediately prior to the final redemption date (see: paragraph 32 above) to noteholders of subsisting LNs in the register on the Last interest Date.

37. Thus there was a very irregular pattern of interest payable on the LNs, being 4 days' interest payable on 2 August 2005, 359 days' interest payable on 4 August 2005, 1 day's interest payable on 28 July 2006 and 1 year's interest payable on 27 July 2007.

38. The £6,377,280 nominal value SCL Redeemable 2005-02 LNs, thus borrowed by Mr Chappell from Barsbury were transferred at Mr Chappell's direction to SGH as custodian for him (see: paragraph 23 above) against Collateral, consisting

of a letter of credit provided by Heathvale to Barsbury (see: paragraphs 24 and 25 above). The issue of that letter of credit was secured by Mr Chappell in favour of Heathvale by a security assignment of Mr Chappell's rights in the custodian agreement (see: paragraphs 26 to 28 above). This all took place on 29 July 2005.

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39. On 1 August 2005, Mr Chappell sold the SCL Redeemable 2005-02 LNs to BLL for a cash consideration of £6,373,804 (see: paragraph 29 above), and we see that amount recorded as a credit in the statement of Mr Chappell's call deposit account with SGH.

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40. The next day, 2 August 2005, was the First Interest Date, on which 4 days' interest was payable on the LNs. A payment of £4,164 was made on that day by Mr Chappell to Barsbury as a manufactured payment due under clause 6.1 of the GMSLA (see: paragraph 21 above). We see that amount recorded as a debit in the
15 statement of Mr Chappell's call deposit account with SGH.

41. On the same day, 2 August 2005, a sum equal to the balance of the cash consideration received by Mr Chappell on the sale of the LNs to BLL, less the manufactured payment made to Barsbury, that is £6,373,804, was transferred from
20 Mr Chappell's call deposit account with SGH to Mr Chappell's custody account with SGH.

42. Two days later, on 4 August 2005, the Second Interest Date occurred. On this date, 359 days' interest was payable on the LNs. A payment of £298,959 was
25 made on that day by Mr Chappell to Barsbury as a manufactured payment due under clause 6.1 of the GMSL (see: paragraph 21 above). Again, we see that amount recorded as a debit in the statement of Mr Chappell's call deposit account with SGH.

30 43. The next day, 5 August 2005, Mr Chappell purchased £6,377,280 nominal value SCL Redeemable 2005-02 LNs from QL for a cash consideration of £6,073,588 (see: paragraph 30 above). Again, we see that amount recorded as a debit in the statement of Mr Chappell's call deposit account with SGH. Those LNs were credited to Mr Chappell's custody account with SGH and were used by
35 him to repay to Barsbury the loan of LNs borrowed by Mr Chappell from Barsbury on 29 July 2005 (see: paragraph 31 above).

44. We did not have with our papers a copy of any executed LN certificate relating to the £6,377,280 nominal value SCL Redeemable 2005-02 LNs.
40 However Mr Goy, for HMRC, did not ask us to infer from this that no LNs were issued. Mr Bretten had submitted that the proper conclusion for us to reach was that all necessary documents were duly signed and executed and that the respective transactions were implemented. We find accordingly and proceed on that basis.

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45. No allegation of sham was made by Mr Goy, nor was he asking for a finding that no interest payments were made, although he did make the point that the state

of the evidence indicated that the parties were not acting properly at arm's length because, if that had been the case, clearer confirmation of the LNs' existence would have been needed. Mr Goy submitted that the state of the evidence was confirmation of his submission that the arrangements constituted by the transactions which we have recorded above lacked any commercial substance.

The taxation objectives sought to be achieved by Mr Chappell

46. Mr Bretten submitted that the sale by Mr Chappell to BLL of the LNs on 1 August 2005 did not attract any liability to capital gains tax ("CGT") because the LNs were qualifying corporate bonds within section 117 Taxation of Chargeable Gains Act 1992 ("TCGA") and any gain accruing on its disposal is not a chargeable gain (section 115(1) TCGA).

47. He further submitted that Mr Chappell is not liable to income tax on any interest payments made by SCL on the LNs because at the relevant Interest Payment Dates (2 August 2005 and 4 August 2005) Mr Chappell did not hold the LNs (having sold borrowed LNs on 1 August 2005 and not having acquired LNs to repay the borrowing until 5 August 2005). In technical terms, Mr Chappell neither received nor was entitled to receive any of the interest falling to be paid (by SCL) on either the LNs borrowed from Barsbury or the LNs purchased from QL during the year of assessment 2005-06. Mr Bretten referred in particular to sections 370 and 371 Income Tax (Trading and Other Income) Act 2005 ("ITTOIA").

48. Mr Bretten further submitted that Mr Chappell had incurred no 'material' liability under the accrued income scheme ("the AIS") (for which see: Chapter II of Part XVII of ICTA – sections 710 to 738) 'in respect of' the interest payments made on either the LNs borrowed from Barsbury or the LNs purchased from QL.

49. The first 'interest period' of the LNs (both borrowed and purchased) ran from 29 July 2005 to 2 August 2005 (the day after the date of issue to the First Interest Date) – see: section 711 ICTA. The second 'interest period' of the LNs ran from 3 August 2005 to 4 August 2005 (the day after the First Interest Date to the Second Interest Date) – see: section 711 ICTA.

50. During the first 'interest period' of the LNs, Mr Chappell was beneficially entitled to the LNs borrowed from Barsbury for the period from 29 July 2005 to 1 August 2005 (when he sold them to BLL). Mr Bretten accepts that he is therefore to be treated as entitled, for the purposes of taxation under the IAS, to a duly time-apportioned amount of the £4,164 interest falling due to be paid on the LNs on the First Interest Date, pursuant to section 713 ICTA. The resultant income tax liability is the liability described by Mr Bretten as not 'material'.

51. So far as the LNs acquired by Mr Chappell from QS on 5 August 2005 are concerned, Mr Bretten submitted that Mr Chappell did not hold them at any time in the first 'interest period' and accordingly no liability under the AIS in respect of them can arise for that period.

52. Crucially, so far as this part of Mr Bretten's submission is concerned, Mr Chappell did not hold any LNs (either borrowed from Barsbury or purchased from QL) during the second 'interest period' of the LNs (3 to 4 August 2005). This has the consequence, in Mr Bretten's submission, that no amount of the interest paid on these LNs on the Second Interest Date (4 August 2005 – on which 359 days' interest was payable) is to be apportioned to Mr Chappell for AIS purposes.

53. However, Mr Bretten further submitted that the payments of £4,164 and £298,959 – the manufactured interest payments referred to at paragraphs 40 and 42 above – are deductible in computing Mr Chappell's liability for income tax for 2005-06.

54. This is because the LNs borrowed by Mr Chappell from Barsbury were 'overseas securities' within paragraph 1(1), Schedule 23A, ICTA, and the loan by which the LNs were borrowed by Mr Chappell from Barsbury was a 'transfer' of those 'overseas securities' within paragraph 4(1), of that Schedule. (References in this part of this Decision to the "Schedule" are references to Schedule 23A ICTA.) It followed that the amounts of interest paid by SCL on the borrowed LNs were 'overseas dividends' within paragraph 1(1) of the Schedule and that the amounts of £4,164 and £298,959 paid by Mr Chappell to Barsbury on 2 August 2005 and 4 August 2005 respectively were MODs (manufactured overseas dividends) and that Mr Chappell was the relevant 'overseas dividend manufacturer' within paragraph 4(1) of the Schedule.

55. Mr Bretten then submitted that the relevant 'overseas securities' represented a 'loan relationship' within section 81, Finance Act 1996 and that therefore the MODs were paid by Mr Chappell in the circumstances prescribed in paragraph 2B(2) of the Income Tax (Manufactured Overseas Dividend) Regulations 1992, SI 1993/2004 (the "Regulations"). It followed that the MODs were to be treated for the purposes of 'the provisions of the Tax Acts relating to the charge to tax under Schedule D and so far as the payer is concerned, as if the amount paid was an annual payment, within section 349 [ICTA], but so that no amount [was] required to be deducted on account of income tax from the amount of the [payments], or accounted for under section 350 [ICTA]' (see: paragraph 2B(3) of the Schedule).

56. He further submitted that the amounts of the MODs were in fact payable wholly out of profits or gains of Mr Chappell brought into charge to income tax and, being required to be treated as annual payments and being in fact payable wholly out of Mr Chappell's profits or gains brought into charge to income tax for the year 2005-06, were deductible in computing Mr Chappell's total income for that year for income tax purposes. He cited in support sections 1, 3, 835 and 836 ICTA and *IRC v Plummer* [1980] AC 896, 54 TC 1.

The evidence

57. Besides the documents to which we have referred above – and to which we shall have to make further reference – we received Witness Statements, and heard

oral evidence from: Mr Chappell; Matthew Jenner (who at the relevant time was a partner in NT Advisors LLP, who worked with DFSG and SGH to develop the planning with which this appeal is concerned); Scott Clark (who at the relevant time was a self-employed consultant to the Route Group – a firm of financial advisers in the City of London – and who in that capacity introduced clients to NT Advisors LLP); John Anthony Mehigan (a chartered accountant who at the relevant time was another partner in NT Advisors LLP); Benjamin Cooke, referred to above (who at the relevant time was managing director of DFSG, based in Jersey); Stuart Gower (at the relevant time employed by SGH in the capacity of head of their offshore tax services department); and Aidan Nigel David James (who at the relevant time was a director of DFSG, also based in Jersey).

58. As stated above, we also received a Witness Statement and heard oral evidence from Anthony Stewart, an Officer of HMRC Specialist Investigations, based at Solihull.

59. We set out the relevant evidence, which we accept unless the contrary indication is given in this Decision and find facts accordingly.

60. Mr Chappell is the managing director of an investment bank called Exotix Limited, a company which trades 'exotic emerging market debt' (a quotation from his evidence). He was, in the UK tax year 2005-06, resident in the United Kingdom. He met Mr Scott Clark (for the first time) in June 2005, when Mr Clark explained to him an income tax avoidance scheme which the Route Group was suggesting to clients and which was known as 'Highlands'. He was told that leading Counsel's Opinion had been obtained as to the taxation consequences and implications of the scheme and was given a copy of the Opinion to peruse at the meeting. He understood what he called the 'basic mechanics' of the scheme, in particular that he would be required to borrow foreign loan stock to a very substantial nominal value and to pay MODs corresponding to the amount of income which he wished to shelter from UK income tax.

61. He was conscious that the scheme required him to 'go short' on the loan stock and this, as he put it in his Witness Statement was 'a matter of some initial concern to me in respect of which I sought reassurance'.

62. But having considered the matter he decided to participate in the scheme and informed Mr Clark that he wished to shelter £300,000 of income.

63. There was a second meeting between Mr Chappell and Mr Clark on 14 July 2005 at which Mr Chappell – as he states in his Witness Statement – 'signed (so far as appropriate) and handed over to' Mr Clark: the Letter of Engagement (see: above, paragraph 11); the power of attorney in favour of Benjamin Cooke and Aidan James (see: above, paragraph 15); the letter of escrow (see: above, paragraph 17); the letter to SGH (see: above, paragraph 13); and a set of transaction documents, which he understood would require to be completed in due course under power of attorney and then released pursuant to the letter of escrow.

64. He familiarised himself briefly with the contents of the several documents before signing them and he said that he was satisfied that he understood their purposes and effects.

65. At the meeting on 14 July 2005 he completed the forms necessary to open an account at SGH and on 21 July 2005 he transferred £18,000 to that account (see: above, paragraph 18 above).

66. In his self-assessment Tax Return for the tax year 2005-06, which he submitted on 17 January 2007, he claimed relief in respect of the MODs paid by him under the 'Highlands' transactions.

67. Apart from what is stated above, Mr Chappell accepted that he had personally no further involvement during the time during which the transactions were entered into (i.e. before 6 August 2005).

68. Mr Chappell could not explain the blank in the letter of credit agreement to which we refer at paragraph 24 above. He was not aware when he signed the documentation of what loan stock (the amount or the issuing company) would be borrowed by him in pursuance of his participation in the scheme (although he knew that it would be a large amount). He had no recollection of seeing the tender document (signed by Benjamin Cooke as his attorney) by which the £6,377, 280 nominal amount Redeemable 2005-02 SCL LNs were offered for sale.

69. That document states *inter alia* (at clause 2.4) of the Vendor (Mr Chappell) that 'as far as [he] is aware, [SCL] has no distributable reserves which are available for distribution to its members'. Further (at clause 2.5) it states *inter alia* that the Vendor (Mr Chappell) 'understands that money raised by [SCL] through the issue of [LNs] on 29 July 2005 has been placed on deposit with Brecknock Limited [a BVI company] ("Brecknock") which is interest earning at a rate sufficient to enable [SCL] to make interest payments under the [LNs]'. Mr Chappell said in evidence that he had in fact 'no idea' of this as 'all [was] being done for me'. He accepted that he had signed up to the scheme and left the details to be implemented by others.

70. This included finding the third parties necessary to implement the planning (BLL and QL), selecting the LNs to be borrowed, and fixing the prices at which Mr Chappell would buy and sell the LNs. He had never met Benjamin Cooke or Aidan James before appointing them as his attorneys for the purposes of implementing the scheme. He did have some (we infer, mild) anxiety about the exposure to risk (liability to repay £6,377,280 nominal value LNs) which participation in the scheme involved, but, as he said in evidence, he took comfort from his relationship with DFSG. He believed and trusted what he was told by Scott Clark (a person known to 'a number of people' working for Exotix Ltd. He thought the people involved (presumably DFSG and SGH) were 'blue chip people

and companies'. He took comfort from reading leading Counsel's opinion. He was in 2005 (at the age of 36) according to his own estimation 'a risk taker'. He thought, in view of the hoped-for tax advantage, that the risk was worth taking. He was 'very relieved' when the transaction was finished (i.e. the loan of the LNs was repaid).

71. Mr Chappell knew (at any rate in rough terms) the amount of the MODs he would be required to make, because it was equal (or roughly equal) to the amount of the income he wanted to shelter from income tax – which was £300,000. He also understood that the £300,000 required to make the MODs would come from 'within the scheme'. He expected only to be liable for the contracted-for fees (the fixed fee of £18,000 plus a contingent fee if the scheme 'worked').

72. Mr Chappell understood at the time of giving evidence to the Tribunal (though not, we infer, at the time of the transactions) that the MODs of approximately £300,000 were funded by the difference between the consideration received on the sale of LNs to BLL and the consideration required to be paid for the purchase of equivalent LNs from QL.

73. Mr Jenner's evidence was that he and his partner at NT Advisors LLP, Anthony Mehigan, had worked with DFSG and SGH in Jersey to develop the scheme, which was given the name of 'Highlands'. Two rounds of 'Highlands' transactions were implemented, the first, involving 2005-01 LNs, in early July 2005, and the second, involving 2005-02 LNs (in which Mr Chappell and 52 others participated) in late July 2005.

74. The documents which Mr Chappell had signed at his meeting with Mr Clark on 14 July 2005 were taken by Mr Clark from the meeting and delivered to Mr Jenner who extracted and retained some documents in London and couriered to DFSG in Jersey the remaining documents (together with others requiring subsequent signature).

75. Mr Jenner confirmed in evidence that the creation and issue of the LNs had been solely for the purposes of the scheme. SCL was a BVI company with share capital of £1 and redeemable loan notes of £1.5 billion. He explained that the assets of SCL were put on deposit with Brecknock, a company set up as part of the arrangements. The stated interest rate on the LNs (4.766230%) had been determined on professional advice, and Mr Jenner's recollection was that it was meant to equate to a market rate. Mr Jenner's evidence is that there was a signed LN certificate 'somewhere', although it could not be found to be produced at the hearing. His basis for saying this was that 'SGH [as custodian] would not have allowed a LN certificate *not* to exist'. He was also sure that there existed a register of SCL LNs.

76. Mr Jenner had no direct knowledge of whether any interest was paid under the SCL LNs, but he said he would have been 'shocked' if it had not been paid. He also 'believed' that Barsbury had paid face value on its subscription for the SCL

LNs. Mr Goy suggested to Mr Jenner that given that the LNs were unsecured obligations of SCL, a company with a £1 share capital, Barsbury would not realistically have plaid full value on subscribing for the LNs. Mr Jenner resisted that suggestion on the basis that the funds subscribed for the LNs were 'secure' as they were placed on deposit (with Brecknock).

77. Mr Jenner confirmed that the schedule to Mr Chappell's letter to Barsbury requesting the stock loan (which set out the description and nominal value of the LNs to be borrowed (£6,377,280)) was completed after Mr Chappell had signed the letter on 14 July 2005. He said that those details would have been determined on 29 July 2005 and the value of the letter of credit to be used as collateral would have been decided at the same time. The starting point for the calculations was the fact that Mr Chappell had requested arrangements to give tax shelter to £300,000 of taxable income.

78. Mr Jenner did not know how BLL had been in funds to make £264 million purchases of SCL LNs from Mr Chappell and other participators in the 'Highlands' arrangements (and £278 million purchases of Derryquest LNs), but assumed it had been put in funds 'by people in Jersey' as part of the arrangements. BLL had bought at 0.999455% of face value. Mr Jenner did not know why BLL had paid so much, but assumed the purchase was commercially motivated. When it was put to him that the prices paid were determined to enable the scheme to be carried out, he commented that BLL 'wanted a small turn'.

79. Mr Jenner said there were 12 potential purchasers who might have acquired Mr Chappell's LNs from him and the Invitation to Tender document went out to all of them. He said that 'hopefully' if BLL had not purchased the LNs, someone similar would have done so and that all potential purchasers had the necessary facilities to do so. BLL was chosen because it was the highest bidder.

80. Mr Jenner confirmed that QL had been created or used to participate in the scheme. He also accepted that BLL was not risking anything by participating in the scheme because it knew what would happen, and that if the parties had been at genuine risk in participating in the scheme they would have taken a different view of the risk involved. The difference between the price BLL paid and the price QL received in their respective transactions in LNs was the amount of the MODs paid by Mr Chappell. Mr Jenner accepted that this indicated that BLL and QL had taken the same view of the value of the securities and that 'parties at arm's length' would have taken a different view of the value of the securities. He stressed that BLL was 'independent' but accepted that 'they would not have participated [in the scheme] if they had not offered a decent price'.

81. Mr Jenner was asked why the LNs were kept in existence after they had been repaid to Barsbury. He did not know but did offer the explanation that if the LNs had not been kept in existence 'you [i.e. HMRC] could argue that it wasn't a loan note'.

82. Mr Clark's evidence was that at his meeting with Mr Chappell on 14 June 2005 he had explained the scheme to him as follows. It required the participant to acquire (by way of stock loan) overseas securities to a large nominal amount carrying a right to an amount of interest (up-front) corresponding with the amount of income which the participant wished to shelter from tax. The participant would go short on the stock before the *ex* dividend date, and would be required under the stock loan to pay to the lender a 'manufactured dividend' equal to the interest paid on the securities, The participant would then need to acquire similar securities to return to the stock lender at the end of the loan.

83. His evidence was that Mr Chappell was initially concerned that he would be exposed on going short of the stock, and he (Mr Clark) gave him the necessary assurance on that point based on his previous discussions with Mr Jenner.

84. When asked to expand on this he said that from memory he thought that he would have explained to Mr Chappell that the loan was real but that at all times the scheme was that the outstanding loans would be covered by assets. In this way any exposure was mitigated.

85. Mr Clark said that he felt he understood the scheme well enough (from the presentation which Mr Jenner had earlier given) to be able to explain it to Mr Chappell and he thought that Mr Chappell had understood it also.

86. Mr Mehigan was not involved directly in Mr Chappell's participation in the schema. However he gave evidence that he had had the 'core idea' for the income tax avoidance strategy which subsequently became known as 'Highlands'. He worked on that strategy with his partner, Mr Jenner, DFSG and SGH.

87. He commented that SGH's participation was particularly required to fund the strategy, but that 'the actual funding was in banking terms straight-forward'. The moneys received by a participant into his bank account on the sale of the LNs funded both his payment of the MODs and his purchase of similar notes (*ex-div*) for return to the stock lender.

88. He did not know why no executed LN certificate had been disclosed in the appeal. He assumed one could not be found. He said that he had seen a bank statement showing that interest on the LNs had been paid by SCL, but agreed that there was no evidence in front of the Tribunal confirming payment of interest by SCL.

89. Mr Benjamin Cooke confirmed that DFSG had been involved with NT Advisors LLP (who shared an office in London with DFSG) and SGH to develop the 'Highlands' strategy. DFSG's rôle was to act as the engaging party with client participants and to secure the proper implementation and completion of the transactions comprised in the scheme. Authority to that effect had been conferred on him and Aidan James (also of DFSG) by a power of attorney and letter of escrow signed by Mr Chappell.

90. He refuted the suggestion that BLL was always going to buy the LNs from Mr Chappell, saying that there were a number of possible purchasers who made tenders and that it was a possibility that no-one would be found to buy the LNs. BLL was an independent party. BLL's offer had been accepted, rather than a higher offer from QL after 'detailed discussions [within DFSG] as to the most appropriate party'. He accepted that if no purchaser had been found DFSG would not have earned a fee on the transaction (its share of the fee paid by Mr Chappell was £14,160). He also accepted that it was the 'expected result' that once a client was signed up, the scheme would be put into effect (i.e. all the transactions would be completed). When asked how the prices for the sale of LNs to BLL and the purchase of LNs from QL were determined, it being put to him that the difference between those prices (the amount of the MODs) was crucial to the scheme, he responded (somewhat evasively) that he 'didn't think any party would enter for no financial gain'.

91. He said that he though BLL and QL had independently taken a view on the market value of the LNs and that they were 'easy to price'. He had not considered whether a purchaser of the LNs was ever at risk, but demurred from the view that the prices were 'contrived'.

92. Mr James explained the tendering process leading up to the sale of LNs on 1 August 2005. It took place over a week-end. Invitations went out to tender and responses came back in the form of acceptances. The acceptances were recorded in spreadsheet form. Mr James's rôle as attorney was to go through the list of offers to see which were acceptable.. Two offers were made in relation to Mr Chappell's sale of LNs, from BLL and QL respectively. It appears that QL offered a slightly higher price than BLL, but BLL's offer was accepted (by Mr James). Mr James explained that QL might not have had the funds to buy all the LNs in the round in question. But Mr Chappell did not suffer from accepting the lower offer from BLL because, Mr James explained, DFSG bore the loss.

93. Mr James confirmed that the LNs bought by BLL were later sold by it to participants in the scheme who had earlier sold LNs to QL and *vice versa*. He accepted that where 2 companies were involved (as in Mr Chappell's case) it was predictable that if LNs had been sold to one company (BLL), they would be purchased *ex div* from the other (QL).

94. Mr James was not able to comment from experience on the purchase from QL because that had been handled by Mr Cooke.

95. Mr Gower's evidence was that SGH organised the 'very substantial' funding required for the operation of the scheme as well as setting up and operating a number of non-UK companies. He and others in his department were authorised signatories of CDS International Limited ("CDS"), an associated company of SGH which provided corporate director services to client entities.

96. CDS in due course became the sole director of SCL, Barsbury, Heathvale and Brecknock, all of which companies were owned by a charitable trust.

97. Mr Gower explained the funding of the SCL LNs as follows. Brecknock, SCL and Barsbury opened accounts with Société Générale Bank and Trust ("SGBT") in Luxembourg. SGBT advanced to Brecknock the funds required by Barsbury for investment in the loan stock of SCL. Brecknock advanced those funds to Barsbury. Barsbury subscribed for SCL LNs. SCL deposited the subscription moneys with Brecknock. Brecknock repaid the funds advanced to it by SGBT.

98. Mr Gower's evidence was that SGBT and SGH provided banking facilities for both BLL and QL. SGH also acted as custodian in respect of securities for Barsbury, BLL, QL and Mr Chappell. Mr Gower confirmed that the transactions relevant to Mr Chappell's implementation of the scheme had taken place.

99. Mr Gower confirmed that the money flowed in a circle on the same day by way of entries in the books of SGBT. Approval for the banking transactions had been obtained, probably in June 2005, from SGBT. He agreed that SCL was bound to use the funds subscribed for its LNs in accordance with the scheme. He confirmed that interest was paid by Brecknock to SCL to enable it to pay interest on the LNs. He said that SGH would have loaned funds to Brecknock to enable it to on-lend to SCL, who paid interest to SGH as custodian. SGH paid the interest to the beneficial owners of the LNs on record – BLL and QL – who used the funds to repay SGH the loan taken out by them to acquire the LNs. He agreed that Mr Chappell was never in a position to enjoy the proceeds of sale of the LNs to BLL.

100. Mr Gower confirmed that both BLL and QL were subject to funding limits imposed by SGBT. He confirmed that LNs bought by BLL from participants were sold to other participants (from whom LNs had been bought by QL) and *vice versa*.

101. Once the LNs had been repaid to Barsbury they were, according to Mr Gower's evidence, redeemed after one year (not immediately, as Mr Cooke had suggested).

102. In the course of Mr Gower's evidence, and with the Tribunal's permission, a copy of the SCL Loan Note Register was admitted in evidence. It showed that a nominal value of £264,019,380 of 2005-02 Redeemable LNs had been issued on 29 July 2005 to Barsbury and had been transferred on that date to SGH.

103. Mr Gower's evidence was that there was no reason to believe the LN certificates did not exist. But he did not think the money flows would have been affected if the LN certificates had not existed – the transactions would have gone ahead. When asked how SGH would have had its security in that case, Mr Gower responded that SGH's security was over the rights under the custody agreement.

104. Mr Stewart gave evidence of the extent of the use of the scheme. His evidence was that the scheme had been disclosed to HMRC by NT Advisors LLP as scheme promoter pursuant to section 306 Finance Act 2004. HMRC had given the scheme the title of the "IMOD Scheme", meaning the 'individual manufactured overseas dividend scheme' for the purpose of coordinating enquiries into the then unknown number of taxpayers who had implemented the scheme, it being a marketed tax avoidance scheme.

105. As indicated above, Mr Stewart's evidence was that 305 taxpayers were ultimately identified as having implemented the IMOD scheme (Mr Chappell and 304 others). Those taxpayers have as a result sought to claim tax relief totalling £391,867,802.

106. All taxpayers who implemented the IMOD scheme borrowed LNs from Barsbury. The LNs borrowed were either SCL LNs or Derryquest LNs. The borrowing was (in each case, we understand) supported by a letter of credit provided by Heathvale. SCL had issued £1,505,131,680 of Redeemable LNs as of 29 July 2005. Derryquest had issued £3,956,799,790 of Redeemable LNs as of the same date.

107. From public record information, Mr Stewart was able to say that Barsbury was incorporated on 11 May 2005 with authorised capital of $50,000 on 11 April 2005 and was struck off or dissolved without submitting accounts. SCL was incorporated on 8 July 2004 with authorised capital of $50,000 and was also struck off or dissolved without submitting accounts. Heathvale was incorporated on 11 May 2005 with authorised share capital of $50,000 and was also struck off or dissolved without submitting accounts. BLL was incorporated on 8 July 2005. Its first annual return for the period to 8 July 2006 indicated that it had called up share capital of £1 and that it had not kept accounting records since the date of its incorporation which were sufficient to show and explain its transactions. BLL received a letter dated 20 October 2008 from the IOM Companies Register advising that it had been deemed not to be in operation as a result of a failure to file annual returns. BLL was dissolved on 23 February 2009. QL was incorporated on 29 April 2005 and struck off the BVI companies register on 1 November 2008.

108. Mr Stewart confirmed that he, as HMRC's project manager responsible for coordinating enquiries into tax returns for 2005/06 submitted by taxpayers who had implemented the IMOD scheme, had made no reference to the accrued income scheme in the closure notice in Mr Chappell's case (dated 1 November 2010). This was on the basis that the IMOD scheme was regarded as artificial and therefore Mr Chappell ought not to be assessed under the accrued income scheme. All Mr Stewart, on behalf of HMRC, was purporting to do by the closure notice was to withdraw the relief in relation to the MOD of £303,123 claimed by Mr Chappell in his self-assessment. He said that if HMRC were successful in the current appeal a further adjustment would be made to Mr Chappell's self-assessment to remove the income which he had self-assessed under the accrued

income scheme – this was an amount of income of £3,123 declared in boxes 10.12 and 10.14 of his return as 'other income from UK savings and investments (except dividends)'. This apparently relates to the duly time-apportioned amount of the £4,164 interest falling due to be paid on the LNs on the First Interest Date (2 August 2005) pursuant to section 713 ICTA (see: paragraph 50 above). He commented that as the interest paid on the LNs was foreign income, on the basis that it was declarable income, it ought to have been returned in box 6.1 of the return. Mr Bretten chose not to cross-examine Mr Stewart.

The *Ramsay* attack – the parties' submissions

109. Mr Bretten asked that the Tribunal make findings of fact on two issues: (1) Was there a transfer of LNs by Barsbury to Mr Chappell? and (2) Did Mr Chappell make payments to Barsbury on 2 August 2005 and 4 August 2005? He proposed that if both of those questions were answered in the affirmative, that there followed a legal question for our decision, namely: Do the payments made by Mr Chappell to Barsbury entitle him to relief? On the basis of Ribeiro PJ's well-known dictum, commenting on the application of the *Ramsay* principle, in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKFCA 46 at [35], cited with approval by Lord Nicholls in *Barclays Mercantile Business Finance Ltd v Mawson* [2005] STC 1 at [36], Mr Bretten submitted that the Tribunal needed to view the transactions realistically and construe the relevant statutory provisions purposively, in order to determine whether Mr Chappell is entitled to the relief which he claims. (This, said Mr Bretten, was common ground.)

110. He accepted that the scheme had been implemented solely for tax avoidance and had no underlying commercial purpose whatever. The transactions were pre-ordained in the sense of being pre-planned. When Mr Chappell signed the documents on 14 July 2005, he did so in the expectation that the transactions as explained to him would be carried out. Some details remained to be determined after 14 July 2005 and that was the purpose of the letter of escrow. These details included the identity of Mr Chappell's counter-parties – BLL and QL and the prices at which the transactions were entered into.

111. Mr Bretten submitted that the transactions entered into were not to be 'struck down' simply because they were pre-planned and entered into solely for tax avoidance purposes. He cited *HMRC v Mayes* [2011] EWCA Civ 407, [2011] STC 1269, at [74] and [78].

112. *Mayes* concerned a pre-planned tax avoidance scheme including self-cancelling steps designed to produce *inter alia* allowable deductions from total income in the form of corresponding deficiency relief resulting on the disposals of second-hand life assurance policies. The Court of Appeal (Mummery, Thomas and Toulson LJJ) unanimously held that the steps of the pre-planned transactions in issue did, having regard to the *Ramsay* principle, fall within the provisions of ICTA relied on for the creation of corresponding deficiency relief.

113. At [74] of *Mayes*, Mummery LJ said:

> 'First, *Ramsay* did not lay down a special doctrine of revenue law striking down tax avoidance schemes on the ground that they are artificial composite transactions and that parts of them can be disregarded for fiscal purposes because they are self-cancelling and were inserted solely for tax avoidance purposes and for no commercial purpose. The *Ramsay* principle is the general principle of purposive and contextual construction of all legislation. ICTA is no exception and is not immune from it. That principle has displaced the more literal, blinkered and formalistic approach to revenue statutes often applied before *Ramsay*.'

114. At [78] of *Mayes*, Mummery LJ said:

> 'Fourthly, it would be an error, which the judge did not fall into, to disregard the payment of a premium at step 3 and the partial surrender at step 4 simply because they were self-cancelling steps inserted for tax advantage purposes. It was right to look at the overall effect of the composite step 3 and step 4 in the seven step transaction in the terms of ICTA to determine whether it answered to the legislative description of the transaction or fitted the requirements of the legislation for corresponding deficiency relief. So viewed, step 3 and step 4 answer the description of premium and partial surrender. On the true construction of the ICTA provisions, which do not readily lend themselves to a purposive commercial construction, step 3 was in its legal nature a premium paid to secure benefits under the bonds and step 4 was in its nature a withdrawal of funds in the form of a partial surrender within the meaning of those provisions. They were genuine legal events with real legal effects. The court cannot, as a matter of construction, deprive those events of their fiscal effects under ICTA because they were self-cancelling events that were commercially unreal and were inserted for a tax avoidance purpose in the preordained programme that constitutes SHIPS 2 [the scheme in issue]. It follows that a corresponding deficiency relief is available to Mr Mayes.'

115. Mr Bretten also cited *Berry v HMRC* [2011] UKUT 81 (TCC), [2011] STC 1057, a decision of Lewison J in a tax avoidance appeal in which losses were claimed as a result of a gilt strip planning transaction and in which the taxpayer's appeal was dismissed. He drew our attention to Lewison J's conclusion expressed *ibid.* at [31] (ix), as follows:

> 'A provision granting relief from tax is generally (though not universally) to be taken to refer to transactions undertaken for a commercial purpose and not solely for the purpose of complying with the statutory requirements of tax relief: see *Arrowtown* at [149]. However, even if a transaction is carried out in order to avoid tax it may still be one that answers the statutory description: *Barclays Mercantile* at [27]. In other words, tax avoidance schemes sometimes work.'

116. He also stressed the general point that statutory provisions bear a single meaning regardless of the circumstances to which they are sought to be applied and not a spectrum of meaning. Thus the relevant provisions which we must construe in this appeal must bear the same meanings as they would if we were seeking to apply them to wholly commercial transactions.

117. Going through his analysis of the taxation consequence of the transactions entered into by Mr Chappell (see above, paragraphs 46 to 56, and especially paragraphs 48 to 52), Mr Bretten submitted that one might have expected HMRC to mount an argument that Mr Chappell was liable to tax under the accrued income scheme on a 'material' amount of the payments of interest made by SCL on the LNs (totalling £303,123). In his submission, the true nature of the avoidance exhibited by the scheme was the 'eccentricity or idiosyncrasy of the structuring of the interest payment dates' which saved Mr Chappell from

becoming liable to tax on the interest accrued on the LNs which he sold (to BLL on 1 August 2005) *cum div*.

118. Mr Bretten submitted that the economic reality of the situation would have been reflected in a taxation analysis which treated Mr Chappell as liable to the interest paid on the LNs but allowed him relief for the MOD which he was contractually obliged to make. That is, in broad terms the arrangements provided for Mr Chappell to become entitled to a large amount of interest and likewise to pay away a MOD representing that interest. The economic reality of the situation Mr Bretten acknowledged) was that Mr Chappell was neither better nor worse off as a result of the transactions (apart from his liability to pay fees for participation in the scheme).

119. He referred us to a passage from Henderson J's judgment in *R&C Comrs. v D'Arcy* [2008] STC 1329 at 1349 (at [19] and [20]), where the learned judge said:

> ' ... since 1985 legislation has been in place, generally known as 'the accrued income scheme', which was enacted to counter 'bond washing' transactions whereby the owner of a security carrying interest could avoid tax on the interest by selling the security just before the interest payment date cum dividend, with the consequence that the proceeds of sale would be all capital, including the part attributable to the interest, and would escape taxation ...
>
> The essence of the accrued income scheme is to treat the interest as accruing from day to day between interest payment dates and to apportion it between the transferor and the transferee according to the length of their respective periods of ownership.'

120. He said – and this was not challenged by HMRC in these proceedings – that (for the reasons summarised at paragraphs 48 to 52 above) there was, however, technically no material liability on Mr Chappell under the accrued income scheme.

121. Mr Bretten submitted that that does not prejudice Mr Chappell's entitlement to tax relief for the MOD. The legislation creating relief for a MOD is not in terms written so as to make the relief dependent on the interest represented by the MOD being chargeable to tax on the person claiming the relief.

122. He argued that tax relief for the payment of a MOD was – as HMRC submitted – a relief given for a reason, which (according to Mr Goy's Skeleton Argument) may be inferred to be an intention to compensate the payer of the MOD for the tax payable by him in respect of income, the entitlement to which gave rise to the obligation to make the manufactured dividend. This, he submitted, should inform the purposive interpretation of the relevant legislation concerning the relief, and, in the absence of any applicable anti-avoidance provision, should lead to the conclusion that Mr Chappell was entitled to the relief claimed.

123. Mr Bretten addressed HMRC's *Ramsay* attack by submitting that (contrary to HMRC's case) there was indeed a relevant transfer of LNs, there was

indeed a payment of MODs, and the statute does indeed afford relief in the circumstances of this case.

124. The legislation relevant to these points is chiefly found in paragraphs 1(1), 4(1) and 8(1) of Schedule 23A, ICTA and in regulations 2B(2) and (3) of the Regulations. We set out those provisions:

Paragraph 1(1) Schedule 23A ICTA

> 'In this Schedule
>
> ...
>
> "dividend manufacturing regulations" means regulations made by the Treasury under this Schedule;
>
> ...
>
> "overseas dividend" means any interest, dividend or other annual payment payable in respect of any overseas securities;
>
> "overseas dividend manufacturer" has the meaning given in paragraph 4(1) below;
>
> "overseas securities" means –
>
> (a) shares, stock or other securities issued by a government or public or local authority of a territory outside the United Kingdom or by any body of persons not resident in the United Kingdom;
> (b) ...
>
> ...
>
> "securities" means any loan stock or similar security;
>
> "transfer" includes any sale or other disposal

Paragraph 4(1) Schedule 23A ICTA

> 'This paragraph applies in any case where, under a contract or other arrangements for the transfer of overseas securities, one of the parties (the "overseas dividend manufacturer") is required to pay to the other ("the recipient") an amount representative of an overseas dividend on the overseas securities; and in this Schedule the "manufactured overseas dividend" means any payment which the overseas dividend manufacturer makes in discharge of that requirement.'

Paragraph 8(1) Schedule 23A ICTA

> 'Dividend manufacturing regulations may make provision for-
>
> (a) such manufactured dividends, manufactured interest or manufactured overseas dividend as may be prescribed.
> (aa) such persons who receive, or become entitled to receive, manufactured dividends, manufactured interest or manufactured overseas dividends as may be prescribed, or

(b) such dividend manufacturers, interest manufacturers or overseas dividend manufacturers as may be prescribed,

to be treated in prescribed circumstances otherwise than as mentioned in paragraphs 2 to 4 above for the purposes of such provisions of the Tax Acts as may be prescribed.

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Regulation 2B(2) and (3) of the Income Tax (Manufactured Overseas Dividends) Regulations 1993 SI 1993/2004 ("the Regulations")

'(2) The circumstances prescribed are where the manufactured overseas dividend is representative of an overseas dividend on an overseas security that represents a loan relationship.

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(3) Where the payer of a manufactured overseas dividend to which paragraph (2) applies is neither a company nor carrying on a trade in circumstances where the manufactured overseas dividend is taken into account in computing the profits of that trade, the manufactured overseas dividend shall be treated, for the purposes of the Tax Acts relating to the charge to tax under Schedule D and so far as the payer is concerned, as if the amount was an annual payment, within section 349(1) of the Taxes Act, but so that no amount is required to be deducted on account of income tax from the amount of the payment, or accounted for under section 350 of that Act.'

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125. For completeness we add that regulation 2B(4) of the Regulations (see paragraph 216 below) makes matching provision to that provided by regulation 2B(3) in relation to the recipient of a MOD – the recipient is to be treated as having received income chargeable to tax under Schedule D of an amount equal to the amount of the MOD 'but not so as to entitle the recipient to claim relief under Part XVIII of the Taxes Act in respect of any tax attributable to the [MOD] received'.

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126. We also add that regulation 2B(5) of the Regulations makes clear that an overseas security shall be taken to represent a loan relationship for the purposes of regulation 2B(2) 'if a company holding that security would have a loan relationship within the meaning of section 81 of the Finance Act 1996'. Mr Chappell asserts, and we do not understand HMRC to challenge, that Barsbury's holding of the relevant LNs amounted to Barsbury having a loan relationship within the meaning of that section.

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127. Specifically, Mr Bretten contends that the SCL LNs which were borrowed by Mr Chappell from Barsbury were 'overseas securities' within paragraph 1(1) of Schedule 23A ICTA. (We refer in this part of this Decision to Schedule 23A ICTA as 'the Schedule'.)

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128. He also contends that the loan of the borrowed LNs from Barsbury to Mr Chappell was a 'transfer' of those LN's within the definition in paragraph 1(1) of the Schedule, being a disposal other than a sale. He submits that this is so notwithstanding (a) that the loan was only short term; (b) that the loan was solely for a tax avoidance purposes; (c) that the LNs were not held by Mr Chappell personally, but were credited to his custody account with SGH; and (d) the LNs were intended to be, and were, disposed of by Mr Chappell by way of sale.

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129. He submits that the definition of 'transfer' in paragraph 1(1) is of wide and unqualified ambit and in particular is wide enough to cover a handing over by way of loan. He further submits that there was a further 'transfer' of the LNs when they were transferred out of Mr Chappell's custody account with SGH on Mr Chappell's sale of the LNs to BLL, and if one looks at the transactions in the wider context of the scheme as a whole, there nevertheless was a 'transfer' of the LNs within paragraph 4(1) of the Schedule.

130. Mr Bretten contends that the commercial context in the light of which the Schedule must be taken to have been enacted would include stock loan or repo transactions where manufactured dividends will ordinarily be paid. He submits that a construction of the concept of 'transfer' appropriate to that context would also include the loan of LNs to Mr Chappell in the circumstances of this case.

131. He submits that the amounts of interest falling due to be paid on the borrowed LNs on 2 August 2005 and 4 August 2005 were 'overseas dividends' within paragraph 1(1) of the Schedule. Again, we do not understand this specific point to be contested by HMRC, other than pursuant to their general case that all the transactions have no substance, and therefore no tax consequences.

132. Mr Bretten goes on to contend that the amounts of £4,164 and £298,959 which were debited from Mr Chappell's account with SGH on 2 August 2005 and 4 August 2005 respectively, pursuant to clause 6.1 of the GMSLA (see: paragraph 21 above) were 'manufactured overseas dividends' within paragraph 4(1) of the Schedule and Mr Chappell was the 'overseas dividend manufacturer' within paragraph 1(1) of the Schedule.

133. In response to HMRC's contention that no payment of any amount within paragraph 4(1) of the Schedule (definition of MOD) should be regarded as being made for the purposes of the legislation, because a single series of pre-determined transactions both created and satisfied the apparent obligation to make the 'manufactured payments', Mr Bretten contends that the facts disclose discharges of unequivocal contractual obligations, which are payments, and therefore MODs. He submits that in many commercial cases interest may be received by a borrower of loan stock, who may expect to receive a coupon, or to pay an equivalent amount out of the proceeds of sale of the loan stock, because it was sold *cum div*. In such a case the payment of the equivalent amount is likely to be generated by the actual transaction in question.

134. Mr Bretten contends that the concept of 'payment' relative to the definition of MOD in paragraph 4(1) of the Schedule has no special definition and that the statement of Mr Chappell's bank account with SGH shows the payments made on 2 August 2005 and 4 August 2005. We have also in evidence Mr Chappell's faxed instructions to Mr Gower at SGH to 'immediately pay the Interest Amount to the account of [Barsbury] held at [SGBT] from my custody account'.

135. He referred us to *MacNiven v Westmoreland Investments Ltd.* [2001] STC 237 for a case where money was borrowed in order to pay interest to the lender and it was held by the House of Lords that the interest had been paid, notwithstanding that the money movements were circular. In that case, as in this, he submitted that the obligation to pay had been discharged, and that was enough to constitute payment . At *ibid.* [14] Lord Nicholls said:

> 'Prima facie, payment of interest in section 338 [ICTA] has its normal legal meaning, and connotes simply satisfaction of the obligation to pay. In the present case WIL's obligation to pay the accrued interest to the trustees was discharged by satisfaction. Thus, if the Revenue are to succeed, 'payment' in s.338 must bear some other meaning. Ultimately, applying in full the purposive *Ramsay* approach to interpretation, I can find no justification for giving payment in s.338 some other meaning. Moreover, I am unable to see what that other meaning could be.'

136. Mr Bretten submitted that an application of the *Ramsay* approach would not deprive the transactions of the fiscal effects for which he contended simply because they were not commercial, were circular and contrived and were entered into for tax avoidance purposes. He contended that the opposite view would be contrary to the law as laid down in *Barclays Mercantile* at [35] *et seq.*, in which Lord Nicholls, giving the opinion of the Appellate Committee of the House of Lords, to which all its members had contributed, said:

> 'In each case [*IRC v Burmah Oil Co Ltd.* [1982] STC 30, *Furniss v Dawson* [1984] STC 153 and *Carreras Group Ltd v Stamp Commr.* [2004] STC 1377] the court looked at the overall effect of the composite transactions by which the taxpayer company in *Burmah* suffered no loss, the shares in *Furniss* passed into the hands of the outside purchaser and the vendors in *Carreras* received cash. On the true construction of the relevant provisions of the statute, the elements inserted into the transactions without any commercial purpose were treated as having no significance.
>
> [36] Cases such as these gave rise to a view that, in the application of *any* taxing statute, transactions or elements of transactions which had no commercial purpose were to be disregarded. But that is going too far. It elides the two steps which are necessary in the application of any statutory provision: first, to decide, on a purposive construction, exactly what transaction will answer to the statutory description and secondly, to decide whether the transaction in question does so. As Ribeiro PJ said in [*Arrowtown*]:
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> "[T]he driving principle of the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."'

137. Mr Bretten said that he did not doubt that the legislation – *viz.* Schedule 23A ICTA – was enacted with commercial transactions in view and must be construed purposively, but he said that in the absence of any applicable anti-avoidance provision there was no basis in law for disregarding the LNs or disqualifying the transfer of them or the payments of MODs, simply because they were not brought about for commercial purposes. Words and phrases used in the statutory provisions carry the same single meaning whether applied in a commercial or in a tax avoidance context. If the Tribunal is satisfied that the SCL LNs were overseas securities, that they were created and issued, that they moved

from Barsbury's custody account to Mr Chappell's custody account and that there were movements of funds in discharge of the obligation to pay the MODs, then it should find as a fact that there was a transfer of the LNs and that there were payments of the MODs.

138. He accepted that the 'end result' of all the transactions viewed together was that Mr Chappell had paid away £18,000 in fees. But he submitted that to look at the 'end result' was not to look at what was done between 29 July 2005 and 5 August 2005. Looking realistically at what was done in that period showed a transfer of LNs and payments of MODs. Looking at the 'end result' may be appropriate to answer a question of whether a gain was achieved or a loss suffered, but it was not appropriate to discern whether there was a transfer or a payment.

139. Mr Goy, for HMRC, submitted that this was tax avoidance scheme representing a pre-ordained series of transactions that in reality amounted to nothing, and in particular did not involve any 'transfer' of 'overseas securities' within paragraph 4(1) of the Schedule nor any 'payment' of 'a MOD' for the purposes of paragraph 4(1) of the Schedule or paragraph 2B(3) of the Regulations.

140. The scheme amounted to nothing because the arrangements were self-cancelling and the legislation should be applied to the facts on this basis. He asserted (as did Mr Bretten) that the correct approach was that outlined in *Arrowtown* and approved in *Barclays Mercantile*.

141. He pointed out that the scheme was self-cancelling at different levels – first, the obligations under the stock loan agreement were cancelled out by the sale, purchase and ultimate repayment of the stock loan, involving entities created specifically for the purposes of the scheme; and, secondly, the obligation to make manufactured payments created by the stock loan agreement was satisfied by the funds apparently generated by the sale and purchase of loan stock.

142. He accepted that these features may exist when stock loans are entered into for commercial purposes where there is no pre-arrangement as to what should happen. However, he submitted that, on the evidence, there was in this case no commercial purpose; the transactions entered into and the parties involved were organised in advance; they involved the creation of loan stock purely so that it could be used in the scheme; the funding of the obligation of the borrower of the stock to make manufactured payments was pre-determined; and the arrangements precluded Mr Chappell running any real risk as a result of entering into the transactions. These features (and others) had the effect that the legislation should be applied to the transactions realistically viewed as a whole with the result that the statutory requirements in paragraph 4(1) of the Schedule were not met.

143. Mr Goy recognised that under the *Ramsay* principle of construction, circular or self-cancelling transactions do not automatically fall to be disregarded for fiscal purposes (see: *Barclays Mercantile*). In the present case, he submitted,

the question that is raised is whether the legislation can realistically have been intended to apply to the transactions carried out. The features demonstrating that the transactions had no commercial purpose – see the preceding paragraph – were features which took the transactions far away from that which Parliament could ever be taken to have contemplated when it provided for the tax treatment relied on by Mr Chappell.

144. Mr Goy referred us to *Moodie v CIR* 65 TC 610. This was an appeal in which a tax avoidance scheme was considered whereby, in consideration of a capital sum paid by a charity to the taxpayer, the taxpayer covenanted to pay an annuity to the charity. The financial arrangements enabling the payments to be made were circular and self-cancelling and the tax consequences intended were that the charity would recover from the Revenue the tax deducted by the taxpayer from the annuity payments and the taxpayer would deduct the grossed-up amounts of the annuities from his total income chargeable to surtax and higher rate tax.

145. The facts in the earlier case of *Plummer* (on which Mr Bretten relies in this appeal when dealing with the technical annual payment contention – see: paragraphs 224 and 225 below) were almost exactly the same and could not be distinguished from the facts in *Moodie* (see: *ibid.* p.659B), but, whereas the House of Lords had held in *Plummer* (which was decided before *Ramsay*) that the taxpayer had paid an annuity, in *Moodie*, applying the *Ramsay* principle, the House of Lords held that the taxpayer had not paid an annuity. This was on the basis that the book entries by which the scheme was implemented were circular, pre-ordained and made pursuant to a single composite contract – see: *ibid.* 661G. Lord Templeman, with whom the others of their Lordships agreed, said (*ibid.* p.658F/G):

> ‘With the benefit of hindsight afforded by the speeches of this House in [*Ramsay*] it is now plain that Mr Moody did not pay an annuity within the meaning of the taxing statute because the steps taken under the plan were self-cancelling. The payments and receipts were recorded as book entries but it would have made no difference if payments had been made by cash or cheque. The plan provided that all ten steps should be taken and that no one should be financially better off or worse off. The ... plan was a tax avoidance scheme which had no object or effect save the manufacture for Mr Moodie of claims that he had reduced his income by sums which amounted in the aggregate to £99,460. He had not reduced his actual income and had not been put to any capital expense save the cost of the scheme which amounted to £3,693.’

146. Mr Goy’s submission was that, as in *Moodie*, so here, Mr Chappell did not make manufactured payments as required by statute in the light of the evidence.

147. Mr Goy also referred us to *Berry* (already cited by Mr Bretten, see paragraph 115 above). That case concerned the construction of paragraph 14A, Schedule 13, Finance Act 1996, which provided, so far as relevant (see: *ibid.* [23]), as follows:

> ‘(1) A person who sustains a loss in any year of assessment from the discount on a strip shall be entitled to relief from income tax on an amount of his income for that year equal to the amount of the loss ...
>
> (3) For the purposes of this paragraph a person sustains a loss from the discount on a strip where-
>
> (a) he transfers the strip or becomes entitled, as the person holding it, to any payment on its redemption; and
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> (b) the amount paid for the strip exceeds the amount payable on the transfer or redemption (no account being taken of any costs incurred in connection with the transfer or redemption of the strip or its acquisition).
>
> The loss shall be taken to be equal to the amount of the excess, and to be sustained in the year of assessment in which the transfer or redemption takes place.’

148. Lewison J, sitting in the Upper Tribunal, commented of this provision (especially paragraph 14A(1)) that:

> ‘[t]his is not a case in which Parliament has used algebra (amount A and B) to create a notional profit or loss. It has used words which have a recognised commercial meaning; and it is to be expected that Parliament intended to tax (or relieve) real commercial outcomes. The FTT were right not to adopt a slavishly literal ‘tick-box’ interpretation of the legislation. This is precisely how the *Ramsay* principle is meant to operate.’

149. Thus Mr Goy submitted that in *Berry*, the FTT and Lewison J had concluded that there was no loss for the purposes of paragraph 14A, Schedule 13, Finance Act 1996 having regard to the fact that the scheme was self-cancelling leaving the taxpayer’s economic position the same both before and after the arrangements were entered into, and that the taxpayer incurred no element of risk in entering into the arrangements.

150. Mr Goy made the following more particular points:

151. First, the reference to a ‘transfer of overseas securities’ in paragraph 4(1) of the Schedule should be construed as a reference to securities which have a commercial reality and such a construction would exclude securities issued for no purpose other than to enable a manufactured payment to be made. In addition, Mr Goy submitted that it is reasonable to believe that Parliament envisaged that the securities transferred would not be brought into existence as a result of mere book entries, where no real money passed between the subscriber for the stock and the stock issuer, under arrangements that had the effect that the issuing company never had the use of the money allegedly paid. In the result, the Tribunal should conclude that no ‘overseas securities’ existed in this case for the purposes of paragraph 4(1) of the Schedule.

152. Further on the same point, Mr Goy submitted that the loan stock in the present case should be ignored on the authority of *Carreras*, where a debenture was ignored on the basis that its issue involved a purely formal step having no apparent commercial purpose or significance. Similarly, in *Arrowtown*, share capital was held not to be share capital for the purposes of the relevant stamp duty

group relief legislation because it had a shadowy existence, had no commercial purpose and was issued purely in order to satisfy the targeted statutory provisions for group relief (*ibid.* [152], [157] per Lord Millett NPJ).

5 153. Secondly, no MODs should be regarded as being made in this case for the purposes of paragraph 4(1) of the Schedule having regard to the fact that a series of pre-determined transactions both created and satisfied the apparent obligation to make them. In *MacNiven*, the House of Lords had held that there had been a payment of interest entitling a debtor to tax relief, but the facts of that 10 case were, Mr Goy submitted, materially different from those in this appeal, because the payment in *MacNiven* gave rise to a liability to tax in the hands of the recipient, and the obligation to pay interest in *MacNiven* arose as a result of a transaction quite separate from that under which the interest was paid.

15 154. Thirdly, the reference to a 'transfer' of overseas securities in paragraph 4(1) of the Schedule should be construed as applying to a transfer that conferred all rights and risks of ownership on the transferee. It was reasonable to conclude that Parliament had intended such a construction. In this case, however, the loan stock was kept at all times under the control of SGH as custodian, all payments to 20 Mr Chappell were similarly kept under the control of SGH as custodian, the arrangements secured that Mr Chappell could never enjoy any benefit from the securities, whether income or capital, and envisaged that the loan stock would be sold very shortly after acquisition in circumstances over which Mr Chappell had no control. There was therefore in this case, in Mr Goy's submission, no 25 'transfer' of overseas securities within paragraph 4(1) of the Schedule that gave rise to any liability to make payments of the sort referred to in the legislation. Further, a 'transfer' within paragraph 4(1) of the Schedule should be construed as one effected for a commercial purpose, which the borrowing of the LNs by Mr Chappell from Barsbury was not.

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155. Fourthly, the evident purpose behind the relief claimed by Mr Chappell (treatment of the MODs as annual payments pursuant to regulation 2B(3) of the Regulations and paragraph 4(1) of the Schedule) was to compensate the payer of an MOD for the tax payable by him in respect of income (in this case interest on 35 the LNs) the entitlement to which gave rise to the obligation to make the MODs. In this case, by a careful timing of the sale of the LNs and what Mr Bretten described as the 'eccentricity or idiosyncrasy of the structuring of the interest payment dates', it was intended that neither Mr Chappell nor anyone else would receive taxable income from the LNs. It was evident, therefore, that the scheme 40 was an abuse of the purpose for which the relief claimed had been enacted and Mr Goy submitted that there was no reason why Mr Chappell should obtain any tax relief for the payments alleged to have been made.

156. As to the facts, Mr Goy submitted that the prices at which the LNs 45 were sold and bought were fixed to facilitate the scheme, were contrived and bore no relation to the underlying value of the loan stock. There was no real market in the LNs. If there had been they would have been bought and sold at a heavy

discount because of the insubstantial nature of SCL. As to the quantum of LNs borrowed, sold and bought, this was a matter Mr Chappell knew nothing about – it was dictated by the amount of income sought to be sheltered from tax. Mr Chappell was never in a position to use the LNs borrowed by him otherwise than for the purposes of the scheme. Although it was not entirely clear whether the LNs were going to be sold to BLL (or another purchaser), because there was a tendering process, it was clear that the scheme relied on a purchaser being found who would buy at the 'right' price. This was necessary so that the arrangers and providers of the scheme would get their fees. There was no real doubt that a suitable purchaser would be found. Mr Goy submitted that the Tribunal should ignore any uncertainty arising out of the tendering process. It was not clear from the evidence that there had been a tendering process preceding the purchase of the LNs from QL.

157. Although HMRC accepted that the movements on Mr Chappell's bank account with SGH were genuine, Mr Goy submitted that they did not represent payments for the purposes of the Regulations. He requested the Tribunal to make findings as follows:

(1) The arrangements represent a pre-planned series of transactions which took place over 8 days;
(2) They involved little more that signing pieces of paper and entries being made in accounts;
(3) They had no commercial purpose and their only objective was to obtain a tax advantage;
(4) The loan stock and the obligations under the GMSLA were created solely for the purposes of the scheme – there was no other reason for their existence;
(5) The quantum of loan stock issued was dictated by the tax relief desired;
(6) The LNs never came into Mr Chappell's hands in any meaningful sense – they went to the custodian over a week-end;
(7) The sale to BLL and the purchase from QL were both at wholly contrived prices, sufficient to ensure that the arrangements fulfilled their purpose;
(8) Realistically, Mr Chappell ran no risk apart from paying the fee for participation in the scheme;
(9) The movement of moneys involved, if real, would have been 'quite staggering', but in reality the money went round in a circle from start to finish;
(10) The entities involved in the scheme were simply there to participate in the scheme.

158. Mr Goy submitted that it was not his case that the tax avoidance motive behind the arrangements automatically meant that the provisions relied on by Mr Bretten did not apply, but he also submitted that it would be wholly unrealistic to believe that Parliament intended to legislate to provide tax relief on these facts.

159. He contended that the series of transactions involved was a composite transaction which must be looked at as a whole. And when so looked at, the facts did not meet the statutory requirements.

160. Mr Goy submitted that Mr Chappell did not make any payments within paragraph 4(1) of the Schedule. That paragraph contemplates payments which have a commercial purpose, not self-cancelling movements on an account. He referred us to *IRC v Scottish Provident Institution* [2005] STC 15 at [18] and [19].

161. In that case, the House of Lords was considering whether an option was a 'qualifying contract' within the meaning of section 147(1) Finance Act 1994. Lord Nicholls (giving the option of the Appellant Committee to which all its members had contributed) said (*ibid.* at [18]) that 'the short question is whether the Citibank option gave it an entitlement to gilts'. He went on (*ibid.* at [19]):

> 'That depends upon what the statute means by 'entitlement'. If one confines one's attention to the Citibank option, it certainly gave Citibank an entitlement, by the exercise of the option, to the delivery of gilts. On the other hand, if the option formed part of a larger scheme by which Citibank's rights to the gilts was bound to be cancelled by SPI's right to the same gilts, then it would be said that in a practical sense Citibank had no entitlement to gilts. Since the decision of this House in *Ramsay* it has been accepted that the language of a taxing statute will often have to be given a wide practical meaning of this sort which allows (and indeed requires) the court to have regard to a whole series of transactions which were intended to have a commercial unity. Indeed it is conceded by SPI that the court is not confined to looking at the Citibank option in isolation. If the scheme amounted in practice to a single transaction, the court should look at the scheme as a whole. Mr Aaronson QC, who appeared for SPI, accepted before the Special Commissioners that if there was 'no genuine commercial possibility' of the two options not being exercised together, then the scheme must fail.'

162. The House of Lords went on to hold that the composite effect of transactions should be considered as they were intended to operate and without regard to the intention and expectation of the parties that the transactions might not work out as planned (*ibid.* [23]) and on that basis the possibility that the options might not be exercised together did not, without more, prevent the scheme from being regarded as a single composite transaction. So viewed, the Citibank option created no entitlement to gilts and the scheme failed (*ibid.* [24]).

163. Mr Bretten's reply on *Scottish Provident* was that in that case the taxpayer's argument was that he was entitled to gilts, when there was a linked option pursuant to which SPI would become entitled to the same gilt (the cancelling option). In those circumstances, Mr Bretten submitted, the taxpayer never realistically obtained the gilts. In contrast, in this case, Mr Chappell did actually sell LNs to BLL.

164. Mr Goy submitted that 'in a practical sense' Mr Chappell made no 'payments' when the MODs were paid. The cash used to pay the MODs did not come from Mr Chappell's pocket, it came instead, as he said in evidence, from 'the arrangements and structure of the scheme'.

165. Mr Goy accepted that in a case where a stock loan was entered into for commercial purposes, the obligation to make a manufactured payment may be funded from income from the securities borrowed without adverse tax consequences, but he contrasted that situation with the position in this case where the interest obligation on the LNs was created merely to create an obligation to pay the MOD. He submitted that in *MacNiven* circular payments had been accepted as valid for tax purposes, but the original debt had been created for commercial reasons – that was the distinguishing factor. Whereas in a commercial stock lending arrangement there were normally commercial risks attendant, here there were none.

166. On the authority of *Moodie* (see: above), Mr Goy submitted that the payments 'apparently made by Mr Chappell do not have the required character to rank as MODs for the purposes of the legislation'. He pointed out that in *Moodie*, as here, the taxpayer signed a multiplicity of documents at the completion meeting.

167. Mr Goy also referred us to the Upper Tribunal's decision in *Schofield v R&C Commrs.* [2011] STC 1920. Since the hearing of this appeal that decision has been upheld by the Court of Appeal - see: [2012] EWCA Civ 927, judgment being handed down on 11 July 2012. The debate in that case was whether the transactions entered into ought to be regarded as a single composite transaction or not. The case concerned the tax effect of certain option contracts entered into. The Upper Tribunal held (*ibid.* at [82]) that 'on the facts of the present case … the options code is to be ignored in deciding whether there was a loss within the meaning of section 2 TCGA when option 1 was closed out on 4 April 2003'. As we have said, that conclusion was upheld by the Court of Appeal (see: *ibid.* at [36]).

168. Mr Goy accepted that if one is looking at legislation concerned with 'gains' and 'losses', it is easier to look at the 'end result' and that in this appeal the Tribunal is concerned to consider whether a 'payment' was made, and that makes the application of the *Ramsay* principle more difficult. He contended that a proper construction of paragraph 4(1) of the Schedule requires the recognition that it was enacted so as to apply to 'real world transactions', that is, transactions having economic consequences to the persons concerned. In this case the payments of MODs relied on were contrived out of the scheme itself, which created the obligation to pay MODs and satisfied it as well, and the Tribunal should recognise that the payments were not of the sort contemplated by the legislation and the legislation ought not to be applied to them.

169. He commented on *MacNiven*, and submitted that the basis for the House of Lords' decision was that the payment of interest in question was 'a genuine discharge of a genuine debt' (see: *ibid.* per Lord Nicholls at [15]). He drew our attention to Lord Millett NPJ's comment in *Arrowtown* that it was 'unlikely that the same conclusion would have followed if the scheme [in

MacNiven] had included the creation of the company's liability to pay the interest in the first place' (*ibid.* at [141]).

170. Mr Goy also referred us to *DTE Financial Services Ltd v Wilson* (2001) 74 TC 14, where, in a PAYE context, the concept of payment was held by the Court of Appeal to be a 'practical commercial concept', which included the provision of a contingent reversionary interest under a settlement which was shortly after its provision turned into cash, as both the employer and the employee had throughout intended.

171. He distinguished *Mayes* (in which the Court of Appeal refused to disregard two pre-ordained and self-cancelling steps) on the basis that *Mayes* was concerned with legislation (sections 539 to 554 of ICTA) which itself created an artificial world where deemed gains and deemed losses arise – see, e.g., *ibid.* [103] per Toulson LJ. By contrast, he submitted that paragraph 4(1) of the Schedule was never contemplated as creating a disconnection with commercial reality.

172. Reverting to his submission that there was in this case no transfer of overseas securities which would be relevant for the purposes of paragraph 1(1) of the Schedule, he made the point that the LNs had no commercial substance and were only created to access the tax relief in issue, the interest payments arrangements being structured as they were for that reason. The subscription moneys raised by SCL (some £1.5 billion) were instantaneously deposited with Brecknock on terms that the interest payable to SCL by Brecknock precisely matched the interest liability of SCL to the holders of the LNs.

173. In *Carreras* the issue of a debenture for which shares were exchanged and which was redeemed after 'as short a time as was thought to be decent in the circumstances' (*ibid.* [16]) was held to have had no tax consequences. The Privy Council agreed with the majority of the Court of Appeal of Jamaica (*ibid.* [13]) that:

> 'the relevant transaction for the purposes of [the relevant] legislation comprised both the issue and the redemption of the debenture and that such transaction, taken as a whole, could not be appropriately characterised as an exchange of shares for a debenture.'

174. Mr Bretten's reply on *Carreras* was that the debenture in that case was not disregarded. The Privy Council was concerned to identify what was the consideration for the exchanged shares, viewing the matter realistically. It concluded that the consideration was not the debenture.

175. In *Arrowtown*, 'B' non-voting shares which existed not for any commercial purpose, but to satisfy the statutory test for relief from stamp duty on the sale of a company (*ibid.* [56]), were not 'issued share capital' for the purposes of that statutory test and fell to be disregarded (*ibid.* [157]).

176. Mr Bretten's reply to Mr Goy's point that there had, realistically, been no 'transfer' of overseas securities to Mr Chappell, when he borrowed the SCL LNs from Barsbury, was that the facts in this case were qualitatively no different from any case where a borrower goes short on the borrowed stock. The MOD provisions are intended to apply in such a case, the relevant 'transfer' being the transaction pursuant to which the stock is borrowed, and the only oddity about the facts in this case are that the interest provisions on the SCL loan stock were so manipulated that Mr Chappell had no more than an immaterial liability under the accrued income scheme. If there had been no such manipulation, he would have had a liability under the accrued income scheme which would have put him, for fiscal purposes, into the same position as a borrower (or transferee) of loan stock who actually becomes entitled to the interest paid on it. HMRC were wrong, therefore, in their submission that it was implicit in the provisions that a 'transfer' within paragraph 4(1) of Schedule 23A ICTA must be to a person entitled to the interest on the security transferred.

The *Ramsay* attack – discussion and conclusion

177. Our task, as both parties agree, is to view the transactions realistically and construe the relevant statutory provisions purposively (*Barclays Mercantile Business Finance)*. Specifically, in the light of the evidence and of the arguments presented to us, we must decide, as a matter of fact, whether there was a '*transfer*' of '*overseas securities*' (LNs) by Barsbury to Mr Chappell and whether Mr Chappell made '*payments*' (MODs) to Barsbury. This fact-finding exercise must be made in the context of a purposive construction of paragraphs 1(1) and 4(1) of Schedule 23A ICTA, specifically the condition precedent for the application of regulation 2B(3) of the Regulations in a case where, under a contract or other arrangements for the transfer of overseas securities, one of the parties is required to pay to the other a MOD, which is representative of an overseas dividend on a overseas security that represents a loan relationship.

178. A purposive construction of those paragraphs of Schedule 23A must have regard to the intended effect of regulation 2B(3) of the Regulations, which is relied on by Mr Chappell for his assertion that he is entitled to tax relief on the basis that the amounts of the MODs in this case are to be treated, as far as he (the *payer*) is concerned, as if they were annual payments within section 349(1) ICTA.

179. Without, at this stage, investigating the import, as a matter of income tax law, of the treatment of an MOD as if the amount of it was an annual payment within section 349(1) ICTA – the subject of the technical annual payment contention – we discern an intention on the part of the draftsman to regulate the tax consequences of a payment, made by a borrower of securities to the lender, which is representative of an income receipt derived from the securities, in a case where the lending has been made on terms that such a representative payment must be made. Of course there is no express statutory requirement (see: Mr Bretten's submission recorded at paragraph 121 above) that the borrower must have received (or become entitled to) the income receipt, before the tax consequences laid down for the representative payment can ensue, but we consider that the draftsman had that situation in mind and did not have in mind the situation – as in

this case – that the borrower makes such a representative payment without receiving (or becoming entitled to) the income receipt which it represents. In other words, we consider that paragraph 4 of Schedule 23A ICTA and regulation 2B of the Regulations are intended to apply to MODs which are compensatory payments for income receipts which the borrower receives or to which the borrower becomes entitled, and, importantly, on which the borrower may expect to be taxed.

180. This statutory purpose is indicated, in our judgment, particularly by paragraph 4(1A) of Schedule 23A ICTA which clearly and in terms provides for a MOD paid as set out in paragraph 4(1) to be treated as a trading expense where it is paid by a company carrying on a trade to which the MOD relates and as an expense of management where it is paid by company having an investment business to which the MOD relates. The same point can be made in relation to a MOD paid by a company carrying on a life assurance business (paragraph 4(1A)(c), Schedule 23A ICTA). Likewise, we consider that the same statutory purpose is carried through to regulation 2B of the Regulations which, by regulation 2B(4), provides for the recipient of a MOD which is representative of an overseas dividend on an overseas security which represents a loan relationship – being neither a company nor a trader for whom the MOD is taken into account in computing trading profits – to be charged to tax on the MOD as if it were an overseas dividend of an amount equal to the amount of the MOD. At a high level of abstraction, we see the purpose of these provisions as being to provide for cumulatively one effective charge to tax in respect an overseas dividend in circumstances where the relevant overseas security has been lent and borrowed and representative (compensatory) payments are required to be made under the terms of the lending and borrowing.

181. In agreement with Mr Bretten, we consider that the nub of the tax avoidance in this case is the structuring of the interest payment dates on the SCL LNs which, by their ‘eccentricity or idiosyncrasy’, prevented Mr Chappell from becoming liable to tax on the interest accrued on the LNs which he sold to BLL on 1 August 2005 *cum div*. The fact that the interest payment dates on the SCL LNs were structured in this way demonstrates how the devisers of the ‘Highlands’ scheme (see the evidence of Mr Jenner and Mr Mehigan), and, by extension, Mr Chappell attempted to frustrate the legislative purpose of paragraph 4(1), Schedule 23A ICTA and regulation 2B(3) of the Regulations.

182. Mr Goy invited us to make the 10 findings of fact listed in paragraph 157 above. Viewing the transactions realistically we can, on the evidence, immediately find the facts at numbers (1) to (5) and (7) to (10) inclusive on that list. Indeed we did not understand Mr Bretten to argue against our making any of the findings on Mr Goy’s list, except number (6) – that the LNs never came into Mr Chappell’s hands in any meaningful sense. If we find that fact then effectively we find that there was no ‘transfer’ of the LNs to Mr Chappell.

183. Recapitulating Mr Goy’s list, our findings of fact are as follows:

184. (1) The arrangements involving Mr Chappell's participation in the 'Highlands' scheme represented a pre-planned series of 'transactions' which took place over 8 days. Those 8 days began on 29 July 2005 (when Mr Chappell entered into the GMSLA with Barsbury pursuant to which SCL Redeemable 2005-02 LNs to a nominal value of £6,377,280 were 'transferred' for same-day settlement to SGH as custodian for Mr Chappell against Collateral to be 'transferred' on behalf of Mr Chappell to Barsbury of a letter of credit for £6,680,403). They ended on 5 August 2005 (when QL 'sold' to Mr Chappell SCL Redeemable 2005-02 LNs to a nominal value of £6,377,280 for a consideration of £6,037,588 in cash, payable at completion, enabling the 'loan' of LNs from Barsbury to be 'repaid'.

185. That those arrangements were pre-planned is clear from the evidence. Mr Chappell signed all the documents that needed his signature, in particular the Letter of Engagement with DFSG, the power of attorney in favour of Mr Cooke and Mr James and the letter of escrow to Mr Cooke at the meeting he had with Mr Clark on 14 July 2005. He paid the 'non-contingent' fee of £18,000 to DFSG (6% of the 'Sheltered Amount' as defined in the Letter of Engagement, which he had fixed at £300,000) on 21 July 2005.

186. The arrangements involved certain matters that were uncertain when Mr Chappell signed the documents – the entities to which Mr Chappell would 'sell' the LNs *cum div* and from which he would 'purchase' the LNs *ex div* (BLL and QL respectively) and the prices at which those 'transactions' would take place. We infer from Mr Jenner's evidence (see paragraphs 79 to 81 above), Mr Cooke's evidence (see paragraph 90 above) and Mr James's evidence (see paragraphs 92 to 93 above) that these uncertainties (and the continuation of the LNs in existence after they had been 'repaid' to Barsbury) were incorporated into the arrangements specifically as 'anti-*Ramsay* devices' (see: *Scottish Provident* at [23]). We regard these as commercially irrelevant uncertainties and conclude that there was no realistic possibility that the scheme would not work as planned and that the identities of the entities 'purchasing' from and 'selling' to Mr Chappell were immaterial and the prices were contrived and did not reflect the market value of the 'securities', having regard to the fact that SCL was a BVI company with share capital of £1 and redeemable loan notes of £1.5 billion and the lack of security for the LNs.

187. (2) The arrangements involved little more than signing pieces of paper and entries being made in accounts. The evidence for this is principally Mr Gower's explanation of the circular funding arrangements with SGBT for Barsbury's 'subscription' for the SCL LNs via Brecknock and the circular funding arrangements with SGH for the 'payment' of the interest on the LNs (see paragraphs 97 to 99 above), together, of course, with the circular funding arrangements with SGH for the provision of the 'sale' price for the LNs by BLL to Mr Chappell, his 'payment' of the MODs to Barsbury, and the consideration for his 'purchase' of LNs from QL (see Mr Mehigan's evidence at paragraph 87 above).

188. (3) The arrangements had no commercial purpose and their only objective was to obtain a tax advantage. This was accepted by Mr Bretten (see paragraph 110 above). The evidence for it is overwhelming (see, in particular, the Letter of Engagement (paragraph 12 above) and Mr Jenner's evidence generally).

189. (4) The loan stock and the obligations under the GMSLA were created solely for the purposes of the scheme – there was no other reason for their existence. This fact is really covered by the previous finding (3). However Mr Jenner specifically confirmed that the creation and issue of the LNs had been solely for the purposes of the scheme (see paragraph 75 above).

190. (5) The quantum of the loan stock issued was dictated by the tax relief desired. This again is really covered by the previous finding (3). But, again, Mr Jenner's evidence was specific that the starting point for the calculation was Mr Chappell's request for shelter of £300,000 of taxable income (see paragraph 77 above).

191. Moving over (6), we find, as requested (7) that the 'sale' to BLL and the 'purchase' from QL were both at wholly contrived prices, sufficient to ensure that the arrangements fulfilled their purpose. Although this was denied by Mr Cooke (see paragraph 91 above) we find that the difference between the price at which the LNs were 'sold' by Mr Chappell to BLL and the price at which the LNs were 'bought' by Mr Chappell from QL was crucial to the scheme and was determined by the quantum of the MOD 'paid', which in turn was dictated by the amount of income sought to be sheltered. Further, the prices took no account of any commercial risk attached to the LNs which (if the 'transactions' had not been pre-arranged would have been substantial). It is clear to us from the evidence that the 'sale' and 'purchase' prices were contrived.

192. (8) Realistically, Mr Chappell ran no risk apart from paying the fee for participation in the scheme. Mr Chappell's evidence was that the fact that the scheme required him to 'go short' on the loan stock was 'a matter of some initial concern in respect of which [he] sought reassurance' (see paragraph **61** above). But Mr Clark was able to give him the necessary reassurance based on his previous discussions with Mr Jenner. In particular, he was able to explain to Mr Chappell that at all times the outstanding loans would be covered by assets – this was a reflection of the circular funding arrangements underpinning the 'transactions' (see paragraphs 83 to 84 above). The scheme was self-cancelling and pre-ordained in nature and therefore carried no commercial risk. Mr Chappell had the comfort of leading Counsel's Opinion. Mr Clark, the independent financial adviser who introduced Mr Chappell to the scheme, was someone, who, although not known to him personally beforehand, had been known to a number of his colleagues at Exotix Ltd, and he trusted him and took comfort from his view that the people involved (presumably DFSG and SGH) were 'blue chip people and companies' (see above, paragraph 70). In these circumstances were find that Mr Chappell realistically ran no risk apart from his exposure to fees.

193. (9) The movements of moneys involved, if real, would have been ‘quite staggering’, but in reality the money went round in a circle from start to finish. We have made the relevant finding on the circularity of cash movements at (2) above – see paragraph 187 – and we are content to agree that the amounts involved would have been staggering in the context of commercial transactions. The relevance of this, of course, is that it underlines the lack of commerciality of the ‘transactions’.

194. (10) The entities involved in the scheme were simply there to participate in the scheme. This was accepted (in relation to QL) by Mr Jenner (see paragraph 80 above) and he also confirmed that the creation and issue of the LNs had been solely for the purposes of the scheme (see paragraph 75 above). We find that the sole purpose of all the entities was to participate in the scheme.

195. We take all the above facts as found into account in assessing what were, on a realistic view, the transactions carried out in this case. We add as a relevant fact to be taken into account the structuring of the interest payment dates on the SCL LNs which, as stated above, by their ‘eccentricity or idiosyncrasy’, prevented Mr Chappell from becoming liable to tax on the interest accrued on the LNs which he sold to BLL on 1 August 2005 *cum div*.

196. We ask ourselves again with regard to this factual matrix whether there was realistically a ‘*transfer*’ of ‘*overseas securities*’ (LNs) by Barsbury to Mr Chappell and whether Mr Chappell made ‘*payments*’ (MODs) to Barsbury in the context of paragraphs 1(1) and 4(1) of Schedule 23A ICTA and regulation 2B(3) of the Regulations, purposively construed.

197. In this part of our Decision dealing with our findings of fact, so far, we have put the terms ‘transaction’, ‘purchase’, ‘sale’, ‘transfer’, ‘overseas securities’, ‘subscription’, ‘payments’, and so on, in inverted commas, to indicate that our acceptance that the legal arrangements so described were not shams, and that the interest ‘payments’ were made – as submitted by Mr Bretten and the contrary not being alleged by Mr Goy – does not colour or pre-determine our crucial fact-finding exercise as described in the previous paragraph.

198. We find in addition that the LNs were never at Mr Chappell’s disposal for any purpose other than that of the scheme, being held for him ‘over a week-end’ by SGH as custodian (cf. item (6) in Mr Goy’s list of facts which he invited us to find – paragraph 157 above).

199. We accept Mr Bretten’s submission that words and phrases used in statutory provisions carry the same single meaning whether applied in a commercial or in a tax avoidance context. That meaning is, of course, as Mr Bretten accepted, to be arrived at by way of a purposive construction.

200. But we do not accept Mr Bretten’s submission that because the legal arrangements described as ‘overseas securities’ (in relation to the SCL LNs) were not shams, and that such ‘overseas securities’ moved from Barsbury’s custody

account to Mr Chappell's custody account, and that there were movements of funds in discharge of Mr Chappell's obligation under the GMSLA to pay MODs, that it follows that for relevant purposes there was any transfer of overseas securities or any payment of MODs.

5 201. We also accept, in agreement with Mr Bretten, that simply looking at the 'end result' of all the 'transactions' viewed together – which he acknowledged was that Mr Chappell had paid away £18,000 in fees (see paragraph 138 above) – does not of itself provide the answer to the relevant questions, which are whether there was realistically a transfer of overseas securities or payments of MODs.

10 202. That answer, we consider, lies in the qualitative nature of the legal arrangements concerned. We agree with Mr Bretten that the paradigm transfer and payment which, as a matter of fact, would answer to the statutory language, would be a commercial stock loan or repo transaction where a manufactured dividend would ordinarily be paid (cf paragraph 130 above). The question for us is whether 15 the commercial nature of a transfer or a payment is a necessary qualitative ingredient in a transaction whose legal effect is a transfer or payment, to enable such a transaction to be recognised, as a matter of fact, as one which answers to the statutory description.

203. Mr Bretten relied on *MacNiven*, where the House of Lords held that an 20 amount (of interest) 'paid' by a company to trustees of a pension fund in circumstances where the payment was made possible by a circular movement of funds starting and finishing with the pension fund, which was pre-ordained, and whose purpose was to create a tax benefit to the company without any loss to the pension fund, was indeed 'paid' for the purposes of section 338 ICTA as it stood 25 at the relevant time. In that case the relevant concept of payment was held to be the normal legal concept of payment connoting simply the satisfaction of an obligation to pay. Mr Bretten's point was that, similarly, a movement of funds answering to that normal legal concept would meet the requirement 'to pay', and be a 'payment' in the definition of MOD, where they both appear in paragraph 30 4(1), Schedule 23A ICTA. The movements of funds in this case, which were not sham movements, and which met the obligations on Mr Chappell imposed by the GMSLA, must, he submitted, similarly be recognised, as a matter of fact, as constituting payments of the MODs for relevant purposes.

204. We consider that *MacNiven* is the authority which was strongest in Mr 35 Chappell's favour of all those to which we were referred. However we have concluded that the circumstances of the movements of funds relied on in this case are so materially different to those of the movement of funds in *MacNiven* that *MacNiven* is to be distinguished.

205. We refer in particular to the fact in *MacNiven* that the payment of interest 40 (although funded by way of a circular money movement) discharged a commercial obligation to pay interest. That obligation was a 'substantial accrued interest liability' (per Lord Nicholls at [10]), it was a movement of funds within 'the commercial concept of payment of a debt' (per Lord Hoffmann at [67] – with

whom Lord Hobhouse agreed), it was a movement of funds within a series of transactions containing 'no step that falls to be ignored because it was artificial' and of which [i]t cannot be said that there was no business or commercial reason for the interest to be paid' (per Lord Hope at [79], and it was the discharge of an 'economic burden [the incurring of] which Parliament intended should give rise to the allowances given by section 338' (per Lord Hutton at [95]). Moreover there was 'no contrary context' or 'any apparent policy' (cf per Lord Hoffmann at [68] and [67] respectively) causing the movement of funds to be disregarded or treated otherwise than as constituting a payment for relevant purposes.

206. In this case, the movements of funds which Mr Chappell claims to be 'payments' of MODs for the purposes of paragraph 4(1), Schedule 23A ICTA did not discharge what we regard as a commercial obligation to pay the MODs. We accept that such an obligation derived from the GMSLA, but we reject the proposition that the obligation was commercial. It was part and parcel of the self-cancelling scheme designed (as if by magic) to create a tax deduction and no corresponding tax charge. As Mr Goy submitted (see paragraph 153), the series of pre-determined transactions in this case both created and satisfied the apparent obligation to pay the MODs.

207. Further, we discern (see paragraphs 179 and 180 above) a context which is contrary to the submission that we should regard the relevant movements of funds as payment of MODs and an apparent policy that we should not do so. As we have already said, we consider that paragraph 4 of Schedule 23A ICTA and regulation 2B of the Regulations are intended to apply to MODs which are compensatory payments in respect of income receipts which the borrower receives or to which the borrower becomes entitled, and, importantly, on which the borrower may expect to be taxed.

208. We regard the citations from *Scottish Provident* to which Mr Goy referred us (see paragraphs 160 to 162 above) as providing further authority for our approach, which is to regard all the transactions entered into by Mr Chappell, and the structuring of the interest payment dates on the SCL LNs as being artificial steps which should be ignored (see per Lord Hope in *MacNiven*, *ibid.* at [77]) and having the composite effect that there was no '*transfer*' of '*overseas securities*' (LNs) by Barsbury to Mr Chappell or '*payment*' (MOD) made by Mr Chappell to Barsbury for the purposes of paragraph 4(1), Schedule 23A ICTA or regulation 2B(3) of the Regulations. This approach is also consistent with the analysis in *Barclays Mercantile* of *Burmah*, *Furniss* and *Carreras*, where Lord Nicholls observed that 'the elements inserted into the transactions without any commercial purpose were treated as having no significance' (*ibid.* [35]) – see: above at paragraph 136. The transactions entered into in this case achieved nothing as a matter of fact for the purposes of paragraph 4(1), Schedule 23A ICTA or regulation 2B(3) of the Regulations.

209. Turning to the necessary purposive construction of those provisions, we have already indicated that we construe them as having been enacted for the purpose of applying to MODs which are compensatory payments in respect of income

receipts which the borrower of overseas securities receives, or to which he becomes entitled and on which he may expect to be taxed.

210. Mr Bretten would have had us construe them literally, and as applying to individual steps in a series of transactions on the authority of *Mayes*. However, as Mummery LJ said in *Mayes*, the statutory provisions under consideration in that case '[did] not readily lend themselves to a purposive commercial construction' (*ibid.* at [78]). We have concluded that the provisions relevant in this case do readily lend themselves to such a construction. As in the legislation in issue in *Berry*, so here, '[Parliament] has used words which have a recognised commercial meaning; and it is to be expected that Parliament intended to tax (or relieve) real commercial outcomes' (per Lewison J – see: above, paragraph 148),

211. Finally, on this aspect of the case, we refer to *Moodie* which provides direct and clear House of Lords authority for a conclusion that there need not be a payment within the meaning of a taxing provision requiring one when steps are taken (including the relevant movement of funds) which are self-cancelling. The more recent case of *Schofield* also provides authority for an approach of ignoring the taxation effect of an individual transaction carried out as part of a larger preordained series of transactions (or single composite transaction).

212. For these reasons we conclude that HMRC's *Ramsay* attack succeeds and that for that reason Mr Chappell's appeal must be dismissed. Nevertheless, in case we are wrong in this conclusion, and because the other issues were fully argued, we proceed to consider them.

The technical annual payment contention – the parties' submissions

213. Our consideration of this contention proceeds on the basis that Mr Chappell did pay MODs to Barsbury for the purposes of paragraph 4(1) of Schedule 23A ICTA.

214. Mr Bretten, for Mr Chappell, asserts that the MODs come within regulation 2B(2) and (3) of the Regulations, so that the MODs are to be treated for tax purposes, so far as Mr Chappell (the payer) is concerned, as if the amounts paid were annual payments within section 349(1) ICTA, albeit with no requirement to withhold or account for a deduction on account of income tax. He submits that because those amounts were in fact payable wholly out of Mr Chappell's profits or gains brought into charge to income tax, they may be deducted in computing Mr Chappell's total income for the year 2005/06 for income tax purposes.

215. Mr Goy, for HMRC, disputes this, arguing that a right of deduction exists only where an annual payment can be, or is required to be, made under deduction of tax.

216. Mr Bretten's argument on the purpose and effect of regulation 2B(3) of the Regulations was that regulation 2B(3) and (4) respectively provide a code for laying down the tax consequences of the payment of a MOD by three classes of

payer (*viz:* a company, a trader and anyone else) and of the receipt of a MOD by the same three classes of recipient. We have set out regulation 2B(3) above, at paragraph 124. We set out here regulation 2B(4):

5 ***Regulation 2B(4) of the Regulations***

> 'Where the recipient of a manufactured overseas dividend to which paragraph (2) applies [i.e. where it is representative of an overseas dividend on an overseas security that represents a loan relationship] is neither a company nor carrying on a trade in circumstances where the
> 10 manufactured overseas dividend is taken into account in computing the profits of that trade, the manufactured overseas dividend shall be treated, for the purposes of the provisions of the Tax Acts relating to the charge under Schedule D and so far as the recipient is concerned, as an overseas dividend of an amount equal to the amount of the manufactured overseas dividend received by him, but not so as to entitle the recipient to claim relief under Part XVIII of the
> 15 Taxes Act [Double Taxation Relief] in respect of any tax attributable to the manufactured overseas dividend received.'

217. He submitted that the legislation provides a positive tax treatment for each of the three classes of recipient. A company recipient of an MOD
20 representative of an overseas dividend on an overseas security which represents a loan relationship – references in this part of this Decision to an MOD are references to that category of MOD, which is relevant in this case – must recognise the MOD by a credit under the loan relationship rules. A trader recipient of an MOD (whether a company or not) must recognise the MOD as a credit in its
25 computation of the profits of the trade for tax purposes. Any other recipient of an MOD must treat it for tax purposes as an overseas dividend (but without any entitlement to double taxation relief).

218. Mr Bretten submitted that in this way the fiscal position corresponded
30 with the economic position. Double taxation relief may be available in respect of underlying foreign tax to the person who receives the *actual* overseas dividend, so that to give such relief to the recipient of the relative MOD would be to multiplicate the relief.

35 219. He submitted therefore that when looking at the position of the payer of an MOD, as provided for by regulation 2B(3) of the Regulations, one sees 'in some respects a mirror image of regulation 2B(4)'. Thus, relief is given to a company payer by allowing a debt in respect of the MOD under the loan relationships rules, relief is given to a trader by allowing an expense in the
40 computation of trading profits and one would expect therefore that the reference in regulation 2B(3) to treatment of the amount of the MOD as 'an annual payment within section 349(1) of the Taxes Act' would likewise give relief to any other payer of a MOD.

45 220. He explained the exclusion of the requirement to deduct tax under section 349 ICTA and account for it under section 350 as following from the fact that the legislation proceeds on the basis that what is being paid and received is actually an overseas dividend and not an annual payment. The logic behind the provisions is that a borrower of overseas securities receives interest on them (on

which he is normally taxable) and has a concomitant obligation to pay over the gross amount to the holder of the securities and so ought to be entitled to a deduction in respect of the amount paid over.

5 221. Therefore Mr Bretten submitted that the clear purpose of regulation 2B(3) of the Regulations was to provide for the deductibility of the payment of the MOD for other payers, in a similar way to the provision for the deductibility in the case of payers who are companies or traders. He contended that there was no other sensible identifiable purpose for the legislation.

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222. HMRC in their Skeleton Argument had entertained the possibility that that regulation 2B(3) might simply have 'missed its mark' if it was indeed the legislative intention to provide for a deduction. Mr Bretten criticised this as a remarkable proposition in relation to so particularly drafted legislation. He urged 15 the Tribunal to recognise the symmetry behind the legislative scheme. A deduction is being afforded to compensate for the payment of an MOD which will (in the normal way, if not in this case because Barsbury has 'sidestepped' its liability under the accrued income scheme) give rise to a tax charge on the recipient.

20

223. Mr Bretten accepted that the mere fact that a payment is classed as an annual payment is not enough to make it deductible for tax purposes. To make an annual payment deductible, it must also be made out of profits or gains brought into charge to income tax, and the deduction must not be prevented by any 25 relevant anti-avoidance law.

224. The deduction for an annual payment made out of profits or gains brought into charge to income tax followed in his submission inferentially from the requirement in section 836 ICTA that they must be returned. But the legal 30 position for which Mr Bretten contended had, he submitted, been accepted by each of their Lordships in *Plummer* where the questions which arose for decision were not whether annual payments were deductible (which was accepted without argument) but whether the payments in question were annual payments at all – or the tax advantage was defeated by specific anti-avoidance legislation. (It was on 35 the basis that, applying the *Ramsay* principle, the payments were not truly annual payments, the House of Lords in *Moodie* reached the contrary conclusion with regard to the same arrangements which had been litigated in *Plummer*.)

225. This was demonstrated by the enactment of legislation, designed to 40 reverse the decision in *Plummer*, which on consolidation appeared in section 125 ICTA and which provided that an annual payment, charged with tax under Case III of Schedule D and made for non-taxable consideration, was to be made without deduction of income tax and would not be allowed as a deduction in computing the income or total income of the person by whom it was made.

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226. Mr Bretten also submitted that section 347A ICTA demonstrates the same legislative scheme. That section provides that an annual payment made by

an individual which would otherwise be within the charge to tax under Case III of Schedule D (with certain irrelevant exceptions) is not to be a charge on income of the person making it and accordingly that person's income is to be computed without any deduction being made on account of the payment.

227. He contended that neither section 125 nor section 347A applied to the MODs in issue because, having a foreign (BVI) source, they were not within Case III of Scheduler D.

228. He submitted that the reason why regulation 2B(3) of the Regulations provided that, so far as the payer is concerned, an MOD representing interest on an overseas security was to be treated as if its amount was an annual payment within section 349(1) ICTA but without the requirement to deduct o account for income tax, was that in the payee's hands the MOD represented not pure income profit but an overseas dividend and accordingly the scheme of deduction at source (being only appropriate where the payment is pure income profit) would not be suitable.

229. Mr Goy agreed that it was obscure precisely what statutory authority permitted the deduction of an annual payment from the payer's total income for tax purposes. His case was that such a deduction is only permitted where the payment was one from which tax can be deducted at source and accounted for accordingly.

230. He referred to *Earl Howe v CIR* (1919) 7 TC 289. In that case the Master of the Rolls explained the deductibility of 'certain payments' as derived from the concept that the payments concerned were part of the taxable income of the recipient, and not of the person who makes them (*ibid.* p.300). This was demonstrated by the entitlement to deduct tax from the payment 'with the result that the tax is ultimately borne and paid' by the recipient.

231. Scrutton LJ said:

> 'The result of [the relevant sections] seems to be that the "annuities, interest and other annual payments" which can be deducted to obtain exemption are those from which the claimant can deduct tax on behalf of the recipient; being in effect the profits of the recipient who bears the tax, they are not also to be the profits of the person paying them. If no tax can be deducted on behalf of the recipient, they cannot be treated as profits of the recipient, and must be treated as paid out of profits of the person paying, who is therefore to be taxed on them.'
>
> 'These premiums ... do not seem to me to be annual payments *ejusdem generis* with annual interest or annuities, and as Income Tax on them cannot be deducted against the recipient, I see no reason why the person paying should deduct them from his taxable income. To allow this would be to establish a kind of profits which would escape taxation, in the hands of the person paying because he could deduct it as an annual payment, in the hands of the recipient because it did not represent his profits. From this point of view it is immaterial whether the payment is charged or not; it is not an "annual payment" within [the relevant sections].'

232. Mr Goy also referred us to *Bingham v CIR* (1955) 36 TC 254. In that case, Harman J commented on the decision in *Earl Howe* as follows:

> 'It will be seen, therefore, that the Court of Appeal was quite categoric that it would have been enough to say that the payments were not income payments at all in any true sense; that is to say, it was not income in the hands of the recipient, and therefore the deduction could not be made. But I think the Court went further than that and did say that unless you can make the deduction on behalf of the recipient you cannot deduct it when it comes to dealing with Surtax.'

233. Mr Goy submitted that in *Earl Howe* and in *Bingham*, the question being considered was not whether the payments in issue were being made out of taxed income, but whether a deduction could be made by the payer in respect of the payment. The necessary condition for a deduction was that there must be the ability to deduct tax from the payment.

234. Mr Goy also referred us to *CIR v Frere* (1964) 42 TC 125. In the Chancery Division, Wilberforce J stated that the provision requiring the return of the amount of interest, annuities or other annual payments to be made out of the property or profits or gains assessed on the person in question was 'pure machinery' and that it was 'impossible to regard it as a substantive provision that all interest, yearly or otherwise could be deducted' (*ibid.* p.130). Wilberforce J said that 'the true principle ... is that no payment may be deducted in the computation of total income unless the payer can deduct tax from it' (*ibid.* p.131).

235. Viscount Radcliffe's speech in the House of Lords was to similar effect. He said, commenting on the decision in *Earl Howe*:

> 'It was also the basis of the Court's decision in that case that, in arriving at the figure of total income, only those annual payments could be allowed as deductions which wee themselves payable under deduction and retention of tax as between payer and payee. The decision itself is very well known and I must say that until this case I had never heard it questioned that the principle the Court had proceeded upon was the correct one. It is, after all, "yearly interest of money, annuity or other annual payment" that the income tax code identified as forming the taxable income of the recipient and not of the payer, and it seems to me correct therefore to assume that it is only payments so identified that are to be taken as reducing the payer's "total income" under the code. The same principle was resorted to and applied by Harman J in *Bingham* ... In my opinion, the principle so applied is the correct one.' (*ibid* pp.149, 150)

236. And later, Viscount Radcliffe said (*ibid.* p.150)

> 'If *Earl Howe* ... is followed out, the Respondent's claim must fail, since it is not suggested that a payer of short interest is entitled to deduct and retain tax against the payee, even if his payment can be treated as made out of profits or gains brought into charge.'

237. Mr Goy submitted that in *Plummer* it was not an issue whether the payments were required to be made under deduction of tax or not. They were made under deduction of tax (*ibid.* p.39G) – and the charity sought to recover the tax which had been deducted – and the issue in this case did not arise in that case.

238. Mr Goy submits that the Tribunal should not assume that there is a statutory purpose behind regulation 2B(3) of the Regulations to provide a tax deduction for an individual payer of an MOD who is not a trader, particularly

where, as he submits, to achieve that result words would have to be read in to the provision.

239. He submits that the purpose of regulation 2B of the Regulations can be seen when they are viewed in their legislative context as a rider to paragraph 4 of Schedule 23A ICTA. Paragraph 4(2) and (3) of that Schedule provide for a system where the payment of a MODs which does not represent interest on overseas securities does require to be paid under deduction of tax. Thus, by paragraph 4(2) of the Schedule, 'the gross amount of the [MOD] shall be treated, except in determining whether it is deductible, for all purposes of the Tax Acts as an annual payment within section 349 [ICTA]' and there is provision for deduction of tax from that gross amount.

240. Paragraph 4(2) and (3) of the Schedule do not apply where the MOD represents an overseas dividend on an overseas security that represents a loan relationship – see: regulation 2B(1) of the Regulations. Further, the reference to the treatment of an MOD as an annual payment within section 349 ICTAS 'except in determining whether it is deductible' is, Mr Goy submitted, there to forestall any suggestion that an MOD paid by a trader would not be deductible as a trading expense because it was characterised as being treated as an annual payment.

241. Mr Goy contended that the purpose of regulation 2B(3) of the Regulations was simply to negate any withholding tax obligation in the case of an MOD which represented an overseas dividend on a security which represents a loan relationship. But even if, which HMRC denies, the regulation could have no meaning or operation but to provide for the deductibility of the MOD, then the Tribunal should conclude that the legislative language has missed its mark and it is not for the Tribunal to make up for the failings of Parliament.

242. Mr Bretten's response was that the decision of the Court of Appeal in *Earl Howe* was that the insurance premiums in issue in that case were not annual payments because they were not pure income payments, but were instead consideration for services. They were not, for that reason, comparable to payments of an annuity. Thus, the Master of the Rolls said (*ibid.* at p.300):

> 'They are clearly not annual payments within section 102 of the Act of 1842 or section 40 of the Act of 1853. They are in truth instalments of purchase money for a capital sum payable on death.'

243. He submitted that the principle was that a payment is not deductible in computing total income unless it is an annual payment within the relevant statutory provisions (section 348 or section 349 ICTA in this case). The ability or obligation to deduct tax from an annual payment is not, he submitted, a condition which must be satisfied in order for a payment to rank as a charge on income. It is instead a statutory consequence of its being within the relevant statutory provision. In the case of an MOD within regulation 2B(3) of the Regulations, that consequence is negated by the express wording of the legislation. But that does not affect the deductibility of the MOD because that arises from its

characterisation as an annual payment which is, as a matter of fact, payable out of profits or gains chargeable to income tax.

244. He submitted that Scrutton LJ in *Earl Howe* had conflated the applicable principles, which led him, wrongly, to state the rule as one under which deductibility of an annual payment was conditional on the possibility of there being deduction of income tax thereout at source. In so far as Viscount Radcliffe in *Frere* was to be taken as approving Scrutton LJ's judgment, he was misled. Likewise, in *Bingham*, the payment was not an annual payment because it was not a charge on income within either of the sections (now sections 348 and 349 ICTA).

245. This case, Mr Bretten submitted, was possibly unique in that there is a payment within section 349 ICTA but without an obligation on the payer to withhold tax out of the payment and account for it to HMRC. He urged the Tribunal to take the view that it was bound by the decision in *Earl Howe*, rather than any particular strand of reasoning. Mr Bretten submitted that the draftsman of regulation 2B of the Regulations understood the real significance of characterisation as an annual payment and that this proposition was supported by his (Mr Bretten's) purposive construction of the provision.

The technical annual payment contention – discussion and conclusion

246. The rationale for the deductibility of an annual payment seems to us to be that it must be 'pure income profit' which is effectively alienated by the payer in favour of the payee (see: *Earl Howe* and *Bingham*), thus becoming, for tax purposes, the income of the payee and not of the payer.

247. The issue between the parties is whether the entitlement (or possibly the obligation) of the payer to deduct tax from the annual payment and account for it to HMRC is a condition of the annual payment being deductible to the payer.

248. The authorities relied on by Mr Goy (*Earl Howe*, *Bingham* and *Frere*) do lay down in terms that only annual payments payable under deduction of tax are deductible. Mr Bretten objects that Scrutton LJ in *Earl Howe* had mistakenly conflated the correct principle (that an annual payment is deductible if it is within what is now section 348 or section 349 ICTA and is in fact paid out of profits or gains charged to tax) with the consequence laid down (in the normal case, of which this was not one) that tax may or must be deducted at source and accounted for to HMRC. He submitted that Scrutton LJ's error had been followed by Viscount Radcliffe in *Frere*.

249. Mr Bretten's case on the purpose of regulation 2B(3) of the Regulations, that it was there to give a deduction for a payment of an MOD representing interest on a loan relationship, where it was made by a person other than a company or a relevant trader is, in our view, an attractive proposition, having the advantage of suggesting the symmetry in the provisions which he pointed out (see paragraphs 217 to 219 above). Moreover it is consistent with the

purpose which we have discerned behind paragraphs 4(1) Schedule 23A ICTA and regulation 2B(3) of the Regulations – see paragraphs 179, 180 and 209 above – of providing for cumulatively one effective charge to tax in respect of an overseas dividend in circumstances where the relevant overseas security has been lent and borrowed and representative (compensatory) payments are required to be made under the terms of the lending and borrowing.

250. We are not attracted by Mr Goy's submission on the purpose of regulation 2B(3) of the regulations, that it is there merely to negate any withholding tax obligation in the case of an MOD which represents an overseas dividend on a security which represents a loan relationship (see paragraph 241 above). We consider that the wording used would be an unnecessarily obscure way of achieving that objective, and the rationale for such a statutory purpose is unclear to us.

251. We have however concluded that we must follow the explicit statements of the law in *Earl Howe*, *Bingham* and *Frere*, which we have set out at paragraphs 231, 232, 234 and 235 above and hold that only annual payments which are payable under deduction and retention of tax as between the payer and the payee can be allowed as deductions from the income of the payer for income tax purposes.

252. Contrary to Mr Bretten's submission, we consider that it would be wrong to assume that the draftsman of regulation 2B of the Regulations intended to shape that provision otherwise than wholly consistently with the law on the deductibility of annual payments clearly laid down in *Earl Howe*, *Bingham* and *Frere*. But we consider that the legislative language inferentially denies a right of deduction in respect of an MOD to which regulation 2B(3) of the Regulations applies – in contrast, for example to the express denial in the language used in section 125(1) (the anti-*Plummer* provision). In our view, regulation 2B(3) has effectively missed its mark in this respect, but we accept Mr Goy's submission that it is not for this Tribunal to make up for the failings of Parliament.

253. We therefore decide the technical annual payment contention in HMRC's favour. This is another reason for dismissing the appeal. We go on to consider the section 3 ICTA argument on the basis that we are wrong in our conclusions so far.

The section 3 ICTA argument – the parties' submissions

254. Mr Goy raised this argument at a relatively late stage and it does not feature in his written Skeleton Argument. HMRC's submission is that section 3 ICTA provides for a charge to income tax at the basic rate in respect of an annual payment paid out of profits or gains which may be deducted in computing total income. The consequence is that Mr Chappell, if he is entitled to any tax relief in respect of the payments of MODs, is entitled only to tax relief at the higher rate, because there is a liability under section 3 ICTA to tax at the basic rate.

255. Section 3 ICTA relevantly provides as follows:

‘Where a person is required to be assessed and charged with income tax in respect of any property, profits or gains out of which he makes any payment in respect of-

(a) any annuity or other annual payment (not being interest); ...

he shall, in respect of so much of the property, profits or gains as is equal to the payment and may be deducted in computing his total income, be charged at the basic rate.’

256. Mr Bretten’s case is that section 3 ICTA is relevant to a payment within section 348 ICTA but not to a payment within section 349 ICTA – the MODs in this case are of course to be treated as payments within section 349 ICTA by virtue of regulation 2B(3) of the Regulations.

257. Mr Goy, on the other hand, submits that section 3 applies equally to a payment within section 348 and a payment within section 349.

258. Section 348 ICTA deals with the deduction of tax from payments made out of profits or gains brought into charge to tax. It provides relevantly as follows:

‘(1) Subject to any provision to the contrary in the Income Tax Acts, where any annuity or other annual payment to which this subsection applies is payable wholly out of profits or gains brought into charge to income tax-

(a) The whole of the profits or gains shall be assessed and charged with income tax on the person liable to the annuity or other annual payment without distinguishing the annuity or other annual payment; and
(b) The person liable to make the payment, whether out of the profits or gains charged with income tax or out of any annual payment liable to deduction, or from which a deduction has been made, shall be entitled on making the payment to deduct and retain out of it a sum representing the amount of income tax thereon; and
(c) The person to whom the payment is made shall allow the deduction on receipt of the residue of the payment, and the person making the deduction shall be acquitted and discharged of so much money as is represented by the deduction, as if that sum had been actually paid; and
(d) The deduction shall be treated as income tax paid by the person to whom the payment is made.

(1A) Subsection (1) applies to any annuity or other annual payment, not being interest-

(a) which is charged with tax under Case III of Schedule D,

(aa) which-

(i) is charged with tax under Chapter 7 of Part 4 of ITTOIA 2005 (purchased life annuity payments), Chapter 10 of that Part (distributions from unauthorised unit trusts), section 579 of that Act (royalties etc. from intellectual property), Chapter 4 of Part 5 of that Act (certain telecommunication rights: non-trading income) or Chapter 7 of Part 5 of that Act (annual payments not otherwise charged), and
(ii) is not relevant foreign income,

(b) which is charged with tax under Part 9 of ITEPA 20034 (pension income) because section 605 of that Act applies to it (retirement annuity contracts: annuities), or

(c) which arises from a source in the United Kingdom and is charged with tax under Part 9 of ITEPA 2003 because section 609, 610 or 611 of that Act applies to it (certain employment-related annuities).

...'

259. Section 349 ICTA deals with the deduction of tax from payments not made out of profits or gains brought into charge to tax. It provides relevantly as follows:

'(1) Where-

(a) Any annuity or other annual payment to which this paragraph applies; or
(b) ...
(c) ...

is not payable or not wholly payable out of profits or gains brought into charge to income tax, the person by or through whom any payment thereof is made shall, on making the payment, deduct out of it a sum representing the income tax thereon.

(1A) Paragraph (a) of subsection (1) applies to any annuity or other annual payment, not being interest

(a) which is charged with tax under Case III of Schedule D,

(aa) which-

(i) is charged with tax under Chapter 7 of Part 4 of ITTOIA 2005 (purchased life annuity payments), Chapter 10 of that Part (distributions from unauthorised unit trusts), section 579 of that Act (royalties etc. from intellectual property), Chapter 4 of Part 5 of that Act (certain telecommunication rights: non-trading income) or Chapter 7 of Part 5 of that Act (annual payments not otherwise charged), and
(ii) is not relevant foreign income,

(b) which is charged with tax under Part 9 of ITEPA 20034 (pension income) because section 605 of that Act applies to it (retirement annuity contracts: annuities), or

(c) which arises from a source in the United Kingdom and is charged with tax under Part 9 of ITEPA 2003 because section 609, 610 or 611 of that Act applies to it.

260. It will be seen that section 348(1A)(a), (aa), (b) and (c) and section 349(1A)(a), (aa), (b) and (c) are in similar terms. The types of payment to which section 348(1) and section 349(1) applies are the same. They are annual payments with a UK (not a foreign) source.

261. Section 350(1) ICTA provides as follows:

'Where any payment within section 349 is made by or through any person, that person shall forthwith deliver to the inspector an account of the payment, and shall be assessable and

> chargeable with income tax at the applicable rate [see: section 350(1A) and section 4 ICTA – in these circumstances, the basic rate] on the payment, or on so much thereof as is not made out of profits or gains brought into charge to income tax.'

262. Mr Bretten's point is that the provision for assessment and charge of an annual payment within section 348, which is provided by section 348(1)(a), is not repeated in section 349. The function of section 348(1)(a), in Mr Bretten's submission is to bring section 3 into operation to offset the financial benefit to the payer derived from his entitlement to deduct and retain income tax at the basic rate on the payment – see: section 348(1)(b) and (c).

263. This shows, Mr Bretten contends, that section 3 is applicable to annual payments within section 348, but not to annual payments within section 349.

264. Mr Goy responds by saying that the sort of payment of which the MODs in this case are examples are dealt with by section 350(1) ICTA

The section 3 ICTA argument – discussion and conclusion

265. To deal with this last point first, the application of section 350 ICTA is excluded in terms by regulation 2B(3) of the Regulations – this is one of the consequences of the anomalous treatment of MODs within regulation 2B(2) which are not made by a company or a relevant trader, namely that they are to be treated, so far as the payer is concerned, as if they were annual payments within section 349 ICTA, but without the normally concomitant obligation to deduct and account for income tax. Such treatment applies even if, as in this case, the MODs are paid out of profits or gains charged to income tax.

266. Section 3 ICTA applies in terms to a person who makes an annual payment out of profits or gains chargeable with income tax. This suggests that annual payments within section 348, rather than section 349, are being referred to. The requirement that the payer be assessed and charged with income tax is directly provided for in section 348(1)(a). If section 3 were also to be applicable to section 349 payments which are, anomalously, paid out of profits or gains chargeable to income tax, that would, we consider, be merely as a result of the wording of section 3, which is intended to apply to annual payments within section 348 and not section 349, fortuitously covering such a payment. In the context of this tightly drawn series of statutory provisions we regard that as an unlikely and forced construction not in accordance with the purpose of the provisions as we discern it, which we describe in the following paragraphs 267 to 271.

267. Where an annual payment within section 348 ICTA is made, the scheme of the section is to treat the payment as the income of the payee and not of the payer, but nonetheless to retain the chargeability of the payer to income tax on the whole of the profits or gains out of which the annual payment has been made. We note that there is no obligation on a payer to deduct tax, merely an entitlement to do so.

268. The position regarding the usual sort of payment which is within section 349 ICTA (which excludes the MODs in this case) is different, in that there are no profits or gains out of which the payment is made which could attract a charge to income tax on the payer. There is in that case an obligation on the payer to deduct tax on making the payment.

269. The scheme of the legislation accommodates this difference by not (in the case of the usual sort of payment within section 349) imposing a charge to tax on the payer by reference to the profits or gains out of which the payment is made (cf. section 348(1)(a)) but by imposing a charge under section 350 ICTA. It is noteworthy that the charge under section 350 is not on the payer as such, but on the person by or through whom the payment is made. The significance of this is that it is not profits or gains of the payer (for *ex hypothesi* the payer does not make the payment out of his profits or gains) which are being charged, but the payment itself.

270. Because of these differences in the treatment of annual payments payable wholly out of profits or gains charge to income tax (section 348) and annual payments not so payable (section 349), we conclude, against Mr Goy, that section 3 ICTA does not apply to a payment within section 349, but only applies to a payment within section 348 which may be deducted in computing the payer's total income. The fact that Mr Chappell paid the MODs in issue out of profits or gains charged to income tax makes no difference.

271. In the normal case, the non-applicability of section 3 ICTA to payments within section 349 would make no practical difference, because a charge analogous to that made by section 3 is made by section 350 ICTA. However, as we have said above, the application of section 350 is specifically excluded in the case of MODs of the type with which this case is concerned.

272. In the result, we decide this issue (the section 3 ICTA argument) in favour of Mr Chappell.

Conclusion and disposition of the appeal

273. We have upheld HMRC *Ramsay* attack and decided the technical annual payment contention against Mr Chappell and so the appeal is dismissed. We have, however, decided the section 3 ICTA argument in Mr Chappell's favour. In conclusion we observe that, had the scheme succeeded, its effect (in the absence of legislation countering it) would have been to make the payment of income tax voluntary.

Right to apply for permission to appeal

274. This document contains full findings of fact and reasons for our decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Rules. 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.

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JOHN WALTERS QC

TRIBUNAL JUDGE

RELEASE DATE: 21 December 2012

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