TC04067

Appeal number: TC/2013/06344

INCOME TAX – charge on conversion of employment-related convertible securities – Chapter 3, Part 7, ITEPA 2003 – whether the redesignation of deferred shares as ordinary shares amounted to a conversion – held that it did – whether the Tribunal had jurisdiction to consider HMRC's refusal to apply a concessionary practice published in its Manuals – held it did not have such jurisdiction – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MICHAEL BRUCE-MITFORD **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN WALTERS QC
MR JOHN COLES

Sitting in public at Cardiff on 24 July 2014

Leslie Beckett, Taxation and Investigation Specialists, for the Appellant

S Foxwell, HM Revenue and Customs, for the Respondents

DECISION

Introduction and Facts

1. Michael Bruce-Mitford, the Appellant, started his travel business in 1970. It was incorporated later and in 2002 he was approached by a client, a Mr Peter Thomson, with a business proposal.

2. This proposal was acted on and, on 17 September 2002, 90% of the shares in Mr Bruce-Mitford's company, VFB Holidays Ltd, was acquired by a newly incorporated holding company, VFB Group plc, in a share for share exchange. The remaining 10% of the shares in VFB Holidays Ltd were acquired in another share for share exchange, by VFB Group plc on 21 January 2003.

3. On 31 January 2003, Mr Bruce-Mitford acquired 270,000 Deferred Shares in VFB Group plc, and held them in addition to his other shareholdings in the company. Mr Thomson also acquired Deferred Shares in the company.

4. New Articles of Association had been adopted by VFB Group plc in December 2002. From those Articles it appears that the capital of the company was £509,000 divided into 25 million Ordinary Shares of 2p each and 450,000 Deferred Shares of 2p each.

5. The consideration given by Mr Bruce-Mitford on the issue to him of the 270,000 Deferred Shares was £5,400 – that is, 270,000 x 2p.

6. Article 5.2 sets out the 'special rights, privileges, restrictions and limitations attached to the Deferred Shares'. A procedure is laid down whereby Deferred Shares can be automatically re-designated as Ordinary Shares on the company completing an acquisition of shares in another company or the business and assets of a going concern within 2 years of the date of issue of the first Deferred Share. That procedure is involved and prolix but in essence it provided for a holder of Deferred Shares to instruct the company's auditors to certify that an acquisition by the company was a Qualifying Acquisition or Major Acquisition (as defined by reference to stock exchange rules) and on the auditors so certifying (at the company's expense) automatic redesignation of Deferred Shares as an equal number of Ordinary Shares would take place.

7. In April or May 2005, the name of the company was changed from VFB Group plc to Travelzest plc. ("Travelzest").

8. The Chairman's Statement in Travelzest's Reports and Financial Statements for the year ended 31 October 2005, which appears above Mr Bruce-Mitford's name contains the following narrative:

> 'On 3 October [2005], the company's [Travelzest's] shares commenced trading on AIM following the move from OFEX and the company announced the acquisition of Holiday Express Limited, a major online holiday retailer. This move was made to facilitate the company's strategy to become a rapid consolidator of niche businesses within the travel industry. £5.15

> million (before expenses) was raised through a placing of 4,087,477 Ordinary Shares at a price of 126p per share, to fund acquisitions. In addition to the placing, the company issued 624,217 ordinary shares arising as part of the consideration for Holiday Express, 450,000 ordinary shares arising as a result of the conversion of deferred shares on a one for one basis (there are no more deferred shares in issue) and further warrants to warrant holders as a result of the conversion of the deferred shares, the issue of the initial consideration shares and the issue of the placing shares.'

9. It is the event (which some of the correspondence in our papers states occurred on 30 September, not 3 October 2005) by which the 270,000 Deferred Shares in Travelzest held by Mr Bruce-Mitford became Ordinary Shares in the company on a one for one basis, which gives rise to the issue in dispute in this appeal.

10. In the tax year 2006-2007 Mr Bruce-Mitford disposed of 310,000 Ordinary Shares in Travelzest for a consideration of £444,266. Capital gains tax was paid by reference to those disposals.

11. Mr Bruce-Mitford gave evidence – he had also provided a Witness Statement – and was cross-examined by Mr Foxwell. We also had, as already indicated, a bundle of documents. From this evidence, we find the facts stated above and as follows.

12. Mr Bruce-Mitford obtained legal advice to the effect that no income tax charge arose on the conversion or re-designation of his Deferred Shares as Ordinary Shares because the Deferred Shares were not convertible securities for the purposes of the relevant income tax legislation at the time of their issue.

13. The background to this is that the legal advice obtained by Mr Bruce-Mitford proceeded on the basis that the conversion or re-designation of his Deferred Shares was 'automatic', and automatic conversions of securities were not covered by the relevant definition of 'convertible securities' in force on 31 January 2003 (the date of Mr Brice-Mitford's acquisition of his Deferred Shares) – which was contained in section 435 Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"), itself part of Chapter 3 of Part 7 of ITEPA.

14. However, following the Finance Act 2003, the text of Chapter 3 of Part 7 of ITEPA was comprehensively amended and the definition of 'convertible securities' was replaced with effect on and after 1 September 2003 by the following definition (contained in section 436 ITEPA):

> 'For the purposes of this Chapter [viz: Chapter 3 of Part 7, ITEPA, headed "Convertible securities"] securities are convertible securities if-
>
> (a) they confer on the holder an entitlement (whether immediate or deferred and whether conditional or unconditional) to convert them into securities of a different description,
>
> (b) a contract, agreement, arrangement or condition authorises or requires the grant of such an entitlement to the holder if certain circumstances arise, or do not arise, or
>
> (c) a contract, agreement, arrangement or condition makes provision for the conversion of the securities (otherwise than by the holder) into securities of a different description.'

15. The legal advice obtained by Mr Bruce-Mitford was that the 'new' definition which took effect on 1 September 2003 did cover securities amenable to 'automatic'

conversions, but that the practice outlined in the published Manual of the Respondents ("HMRC") ERSM 40040 (convertible securities acquired before 1 September 2003) covered the Deferred Shares in this case, and that the income tax charge under Chapter 3 of Part 7 ITEPA would not be enforced in cases concerning the Travelzest Deferred Shares.

16. Mr Foxwell, while maintaining that the practice in ERSM 40040 did not apply in Mr Bruce-Mitford's case, and also that the Tribunal had no jurisdiction to determine whether it did or it did not, assured the Tribunal that HMRC would not seek to impose a penalty on Mr Bruce-Mitford in relation to his not including a charge under Chapter 3 of Part 7, ITEPA in his self-assessment for the tax year 2005-2006.

17. Eventually, on 9 July 2009, HMRC issued a closure notice to Mr Bruce-Mitford, charging £334,800 income to income tax for the year 2005-2006. This gave rise to a tax liability of £133,920 and an appeal was entered on behalf of Mr Bruce-Mitford.

18. There is no dispute as to quantum, which has been calculated on the basis that the Ordinary Shares obtained by Mr Bruce-Mitford on the re-designation or conversion of his Deferred Shares had a value of £1.26 each. 270,000 shares therefore had a value on the re-designation or conversion of £340,200, against which was set Mr Bruce-Mitford's acquisition cost on the issue of the Deferred Shares to him, of £5,400.

The parties' submissions

19. Mr Beckett, for Mr Bruce-Mitford, submitted that no charge to income tax arises under Chapter 3 of Part 7, ITEPA because the Deferred Shares were not 'convertible securities' within the 'new' definition in section 436(2) ITEPA (set out above), because although the Deferred Shares could be (and were) re-designated as Ordinary Shares, this did not amount to conversion of securities into securities of a different description.

20. Alternatively, he submitted that HMRC should apply the concessional practice outlined in ERSM 40040 and not charge the gain to income tax.

21. There was a suggestion in the papers that he also wished to take a point that the amendment to section 436 ITEPA following the Finance Act 2003 was retrospective legislation not permitted under the European Convention on Human Rights (the "ECHR"). However, at the hearing Mr Beckett made it plain that he was no longer pursuing this argument. We consider that he was correct in taking this course.

22. Mr Foxwell, for HMRC, submitted that a charge arose under Chapter 3 of Part 7 ITEPA because a conversion of securities took place (within the 'new' definition in section 436(2) ITEPA) after 1 September 2003 (when that 'new' definition took effect), on the re-designation of Mr Bruce-Mitford's Deferred Shares in Travelzest as Ordinary Shares on 30 September (or 3 October) 2003.

23. On that re-designation, which HMRC contend amounted to a conversion for relevant purposes, the value of the shares went from 2p each to £1.26 each.

24. Mr Foxwell told us that HMRC had considered whether to apply the concessionary practice set out in their Manuals at ERSM 40040 but had decided not to do so as they had taken the view that the facts of this case make such application 'inappropriate'. However Mr Foxwell's main submission on this point is that the Tribunal has no power to decide whether the concessionary practice ought or ought not to be applied in this case. He referred us to the decision of Judge Bishopp in *Michael Prince and Others v Commissioners for HM Revenue and Customs* TC08152 in which this Tribunal decided that it had no jurisdiction to consider the application of a discretionary concession and struck out appeals brought on the basis that it had. Mr Foxwell submitted that any challenge to HMRC's decision not to apply the practice set out in their Manuals at ERSM 440040 needed to be made by way of a claim for judicial review.

25. Mr Foxwell made the same submission in relation to any case made that the retrospective application of the 'new' definition in section 436(2) ITEPA was not compatible with the ECHR.

Discussion and Decision

26. The procedure for redesignation of Deferred Shares in Travelzest as Ordinary Shares in the Articles of Travelzest did not provide in terms for the holder of Deferred Shares to have an entitlement to such redesignation. It did however provide for the holder of Deferred Shares to instruct Travelzest's auditors (at Travelzest's expense) to certify that an acquisition by Travelzest or a subsidiary of shares in another company or of a business was a Major Acquisition or a Qualifying Acquisition, as those terms were defined, and, on the auditors making such a certificate, for the Deferred Shares concerned to be automatically re-designated as Ordinary Shares in Travelzest on a one for one basis.

27. We have no doubt that the Deferred Shares in Travelzest were 'convertible securities' within the 'new' definition of that terms in section 436(2) ITEPA as it had effect on and after 1 September 2003. This is because the Articles of Travelzest (and in particular Article 5.2) made provision for the conversion of the Deferred Shares into Ordinary Shares within the meaning of section 436(2)(c) ITEPA.

28. There is no doubt that the re-designation provided for by the Articles was a conversion for the purposes of the legislation. The re-designation effectively made what had been Deferred Shares into Ordinary Shares with different and much more valuable rights. This was a conversion of Deferred Shares into Ordinary Shares on any ordinary meaning of the word 'conversion'. Mr Bruce-Mitford recognised as much, by using the word 'conversion', in the narrative from Travelzest's Reports and Financial Statements for the year ended 31 October 2005 cited above.

29. It follows that the elements necessary for the charge to income tax on the occurrence of the conversion of the Deferred Shares (being employment-related convertible securities within the meaning of Chapter 3 of Part 7, ITEPA) provided by section 438, 439(2)(a) and 440 ITEPA are made out. As there is no dispute on the figures, we uphold the amendment made by the closure notice appealed against. Mr

Foxwell made it clear that credit will be given to Mr Brice-Mitford for capital gains tax paid by him by reference to the disposal of the converted shares

30. With regard to HMRC's practice set out in their Manuals at ERSM40040, we agree with Mr Foxwell that this Tribunal does not have jurisdiction to determine the question of whether that practice should be applied in Mr Bruce-Mitford's case or not. We agree that Judge Bishopp's decision in *Prince and Others* makes this very clear – in particular at [23] and [24] as follows:

> '23. …The tribunal is not being asked, as in *Oxfam*, to determine how much tax is due – that has already been agreed – but whether HMRC should be required to exercise their discretion not to collect the tax. That is not a tax dispute at all, but a matter governed by public or administrative law, and precisely the kind of issue which must be determined by judicial review. Nothing in the legislation could be construed as conferring any jurisdiction to determine such an issue on this tribunal, nor do I see any basis on which an argument of legitimate expectation that a statutory duty (such as HMRC's obligation to collect tax which is due) will, or should, be waived could properly be regarded as the province of a tribunal whose task is to determine the amount of tax which is due: …
>
> 24. I conclude, therefore, that this tribunal has no jurisdiction to consider whether or not HMRC have exercised their discretion correctly, or reasonably, and it would correspondingly be purposeless for it to hear evidence and make findings about whether or not any individual appellant comes within the ESC as a matter of fact, since it would be unable to give effect to any such determination. In addition, as I have concluded that there is no jurisdiction in the tribunal in relation to an ESC, I see little purpose in my speculating what the jurisdiction might have been had I come to the opposite conclusion.'

31. The decision of the Upper Tribunal in *Revenue and Customs Commissioners v Noor* [2013] UKUT 71 (TCC); [2013] STC 998 – that the First-tier Tribunal does not have jurisdiction to consider legitimate expectation in the context of a VAT dispute – is plainly consistent with the approach taken in *Prince and Others.*

32. The claim advanced on behalf of Mr Bruce-Mitford that HMRC should adopt, in his favour, the practice published in ERSM 40040 does not therefore constitute a basis on which we could decide this appeal in Mr Bruce-Mitford's favour. We do not say anything further about this aspect of the matter.

33. Finally, we note that Mr Beckett, correctly in our view, does not advance a submission in reliance on the ECHR. We would only add on this point that if there had been an issue of human rights law engaged in this appeal then, unlike the position with extra-statutory concessions, it would be correct for this Tribunal to consider the issue – such an issue is not one of those which can only be litigated in a judicial review.

34. For the reasons given above, we dismiss Mr Bruce-Mitford's appeal.

35. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JOHN WALTERS QC
TRIBUNAL JUDGE

RELEASE DATE: 14 October 2014