



[2019] UKFTT 204 (TC)

INCOME TAX - company buyback of shares – whether a company distribution – whether a disposal of trading stock

FIRST-TIER TRIBUNAL

TC07052

TAX CHAMBER

Appeal Number: TC/2017/8203

BETWEEN

Mr BOSTAN KHAN

Appellant

-and-

**THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS**

Respondents

**TRIBUNAL: JUDGE PETER KEMPSTER
Mr JOHN ROBINSON**

Sitting in public at Taylor House, London on 23 November 2018

Mr Laurent Sykes QC (instructed by Gabelle LLP) for the Appellant

Mr Ashley Wilkinson (HMRC Solicitor's Office and Legal Services) for the Respondents

DECISION

Introduction

1. The Appellant (“**Mr Khan**”) appeals against a closure notice (“**the Disputed Closure Notice**”) issued by the Respondents (“**HMRC**”) on 5 July 2017 in respect of an enquiry into Mr Khan’s self-assessment income tax return for the tax year 2013-14. In June 2013 Mr Khan disposed of shares in Computer Aided Designers Limited (“**the Company**”) by means of a share buyback by the Company. He contends that the disposal was one of trading stock, while HMRC contend the proceeds represent a distribution of company assets.

Evidence

2. We had a document bundle and took oral evidence from Mr Khan. Mr Khan confirmed and adopted formal witness statements dated 3 August 2018 and (with a minor amendment) 21 November 2018.

3. The Company’s business was as an employment bureau for consultants.

4. Mr Khan was an accountant in practice in Brighton and acted from the mid-1990s for the Company, preparing the management accounts. The Company rented space at Mr Khan’s offices.

5. There was a number of disputes between the shareholders of the Company over the years, and by around 2009 they had decided they no longer wished to work together (also, one of them was ill), and would look for a buyer for the business. An offer was received around July 2012 but the potential buyer required the shareholders to continue to work for the Company, because of their personal contacts with contractors, which was not acceptable to the individuals; there was also a disagreement between the shareholders as to an acceptable price. The deal fell through. The shareholders decided to wind up the business, as they believed there was no real prospect of finding another buyer. The employees of the Company were not interested in a management buyout. In June 2013 the shareholders approached Mr Khan to see if he would be interested in buying the Company with a view to winding it up, as they did not want the burden and responsibilities of closing down the Company.

6. Both the shareholders (“**the Vendors**”) and Mr Khan had separate legal representation, and the deal was fully documented. Originally it was planned (emails dated 14 June 2013 in evidence) that the Company would buy back 96 (out of 99) shares from the Vendors for £1.8 million, and Mr Khan would then purchase the remaining three shares for £200,000-£300,000 (later reduced to around £35,000 - £50,000). Draft documentation was prepared by the lawyers on that basis. On 20 June 2013 the Vendors’ solicitor flagged that accountancy advice had been received that queried whether the Vendors might lose their CGT entrepreneurs’ relief under the proposed deal structure. On 25 June the Vendors’ solicitor proposed a tax indemnity to be given by Mr Khan; in an email he wrote to Mr Khan’s solicitor:

“With reference to our recent telephone conversation, the clause which I am proposing to add to the [share purchase agreement] is as follows:-

"The Buyer agrees to fully indemnify and keep indemnified the Sellers on demand against all and any loss of tax-relief suffered or incurred by the Sellers whether on account of any chargeable gains or otherwise arising as a result of the sale or disposal of the Sale Shares or the Buy Back Shares."

I am currently taking instructions from my clients on the matter and will revert to you later on today.”

That proposal was unacceptable to Mr Khan and was rejected. On 27 June Mr Khan’s solicitor wrote to Mr Khan stating that the revised structure of the deal was now, in effect, to reverse the order of the share purchase and the buyback – Mr Khan would buy all the Vendors’ shares and then sell all bar one of the shares to the Company. That email also gave advice on the company law consequences of the share buyback; it is not clear what, if any, taxation advice Mr Khan sought or obtained. Mr Khan’s solicitor pointed out that there was a potential breach of the Companies Acts, which he described as “relatively minor and technical”, but suggested that as Mr Khan would be the sole owner of the Company after the transactions, this could be rectified by shareholder consent. He stated, “As accountant for the company you are satisfied that there are sufficient distributable reserves available for the buy back to take place.” That was in accordance with earlier advice; in an email dated 19 June he wrote, “Just to reiterate and to make perfectly clear my previous advice ... the buy back is being made out of distributable reserves i.e. cash that is available to the company that ordinarily could be distributed to the shareholders.”

7. The structure of the deal as transacted was that Mr Khan bought the entire issued share capital (99 shares) of the Company for cash consideration of £1.95 million plus net asset value (ignoring the reserves representing £1.95 million); this was documented in a share purchase agreement. The Company then immediately bought back from Mr Khan 98 of the shares for cash consideration of £1.95 million; this was separately documented in an off-market purchase agreement. Both transactions completed on 28 June 2013.

8. Most of the cash for the buyback was provided by the Company drawing down an invoice discounting facility made available by NatWest. Mr Khan indemnified the Vendors in respect of any liability under the invoice discounting facility; he also provided a personal guarantee to NatWest. The Company’s bank statement showed on 1 July 2013 a receipt of £1,216,000 from NatWest in respect of the invoice discounting facility, and a payment of £1,950,000 to Mr Khan. The parties agree that although shown as 1 July, these items actually happened on 28 June.

9. Mr Khan’s bank statement showed on 28 June 2013 a receipt of £1,950,000 (source not obvious but the statement is annotated in handwriting “Received from CAD” – ie the Company) and a payment of an identical amount (plus CHAPS charge) to Mr Khan’s lawyer.

10. Mr Khan’s evidence included the following:

- (1) he agreed to purchase the Company with a view to oversee its orderly closure;
- (2) he did not have the technical engineering knowledge required to continue trading long term but as an accountant he could effect an efficient winding-up;
- (3) the Company was housed in his premises so it was convenient;
- (4) he did not like the idea of the four employees of the Company being made redundant immediately;
- (5) the price sought by the shareholders could be funded from the Company’s own immediate resources (Mr Khan could not have afforded the transaction otherwise);

(6) Mr Khan decided that he had little to lose, and could benefit from any surplus on winding-up and the profits of a short period of continued trading;

(7) the business was not expected to continue long, as the contractors retained by the Company were beginning to retire (without being replaced), and the ending of their personal relationships with the shareholders might prompt them to move to another agency;

(8) Mr Khan would leave the day-to-day management of the Company to the employees; as employees left they were not replaced;

(9) turnover in 2012 of £22 million fell to £17 million in 2013; the only reasons the Company continued to be profitable were that the shareholders ceased to draw salaries (nor did Mr Khan), and Mr Khan did not charge rent for the premises; the Company had since made losses;

(10) he had expected to wind up the Company within two or three years of acquisition but in August 2015 HMRC opened their tax enquiry and he was advised not to do anything with the Company until the enquiry was closed.

Appellant's case

11. Mr Sykes QC submitted as follows for the Appellant.

12. The purchase and sale of the shares was a trading transaction by Mr Khan. It was the “carrying out of a scheme for profit-making”: *Californian Copper Syndicate v Harris* 5 TC 159 (at 166).

13. Mr Khan intended from the outset to make money from the shares by winding-up the Company within two years. A single transaction could amount to an adventure in the nature of a trade: *CIR v Toll Property Co Ltd (in liq'n)* 34 TC 13, *IRC v Fraser* 24 TC 498, *Johnston v Heath* 46 TC 463, *Turner v Last* 42 TC 517, *Edwards v Bairstow & anor* 36 TC 207. Intention was important: *Ensign Tankers (Leasing) Ltd v Stokes* [1991] STC 136, *Iswera v IRC* [1965] 1 WLR 663, *Johnston v Heath*. Securities could be either an investment or trading stock. Realisation by a buyback or liquidation was acceptable as a means of disposal of trading stock: *Californian Copper Syndicate*. The deal was in effect financed by the Company itself: *Iswera*. Mr Khan had drawn no salary or dividends from the Company – he had even ceased charging rent. The buy-back shares had been owned for less than one hour. Although he had not yet liquidated the Company, that was his continuing intention once the tax dispute had been resolved: *Terrace Hill (Berkeley) Ltd v RCC* [2015] UKFTT 75 (TC).

14. As the shares were trading stock, the trading profits rules take precedence over the provisions relating to savings and investment income: s 366 Income Tax (Trading and Other Income) Act 2005. The 99 shares were acquired for around £1.95 million. The disposal of the 98 shares by buyback for £1.95 million resulted in a small taxable trading profit (figures were still under discussion between the parties). Mr Khan still held one share and when the Company was liquidated as expected, there would be a further trading profit if a surplus over cost was achieved.

15. Alternatively, the whole transaction could be viewed as a single whole whose effect was to place Mr Khan as the owner of one share in the Company, with a small net cost: *PA Holdings v RCC* [2012] STC 582 (at 58-60).

Respondents' case

16. Mr Wilkinson submitted as follows for the Respondents.

17. When Mr Khan sold 98 shares to the Company in the buyback transaction, that was (save for £98 representing the nominal value of the shares) a “distribution out of assets of the company in respect of shares in the company” and constituted dividend income of Mr Khan: s 383 ITTOIA 2005, s 989 Income Tax Act 2007 and s 1000 Corporation Tax Act 2010. That had been reflected in the Disputed Closure Notice.

18. Section 1033 CTA 2010 provided relief for “purchase by unquoted trading company of its own shares” if certain conditions were met. Mr Khan did not satisfy those conditions – for example, he did not meet the minimum ownership period in s 1035.

19. Mr Khan’s activities relating to the shares do not demonstrate in any significant way that he was engaged in a commercial trade. Further, the overall impression is that the transactions were capital in nature. In *Ransom v Higgs* [1974] 50 TC 1 (at 84) Lord Morris quoted with approval Lord Clyde's approach to the question of whether something is a trade as set out in *CIR v Livingston* [1926] 11 TC (at 542):

"I think the test, which must be used to determine whether a venture such as we are now considering is, or is not, ‘in the nature of trade’, is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made."

20. The accounts of the Company for the period ended 30 June 2014 showed profits of around £380,000, and those for the period ended 31 December 2015 profits of around £374,000. The Company had generated significant returns since its acquisition by Mr Khan.

21. There was clearly a purchase of 99 shares followed immediately by a sale (the buyback by the Company) of 98 shares; it was a misinterpretation to describe there being only one transaction. Each transaction was separately documented in its own legal contract. The documentation, accounts and professional advice received by Mr Khan were all explicit that the buyback consideration was met out of the distributable profits of the Company. Mr Khan still held one share with a significant capital acquisition cost, available for offset against any future disposal proceeds.

22. If Mr Khan was seeking a rectification of the transaction documentation then HMRC contended:

(1) The two transactions were entered into with professional assistance and advice, after extended commercial negotiation, and with explicit confirmation that the sale price amounted to a distribution of profits by the Company; and

(2) That equitable remedy was in any event not within the jurisdiction of the Tribunal.

Consideration and Conclusions

Whether the transactions should be reanalysed

23. We deal first with the Appellant’s contention that the transactions should be analysed as involving the acquisition of a single share by Mr Khan. Mr Sykes emphasised that this was his

client's subsidiary argument, and he did not press it hard. We do not find the contention is supported by the passage from Moses LJ's decision in *PA Holdings* cited in argument. Taking a broad view of the acts of the parties (as advocated there) we consider that the Vendors wished to sell the Company which had accumulated sizeable distributable profits. The Vendors apparently did not like the tax consequences of extracting the reserves by declaring a pre-sale dividend, nor effecting a pre-sale buyback of shares by the Company. Instead, it was agreed that they would sell the shares to Mr Khan and he would extract the reserves in cash (by a share buyback). That view of the acts of the parties is clearly supported by the deal documentation and the professional advice received by the respective parties at the time of the deal. It is also the view taken by HMRC in the Disputed Closure Notice.

Whether the transactions were in the nature of a trade

24. There is, of course, a wealth of caselaw on the issue of trading versus investment – and we are grateful to both advocates for their references to the authorities. We consider the approach we should adopt, which we believe is uncontroversial, is:

- (1) The Tribunal is to conduct a multi-factorial evaluation of the evidence available.
- (2) The relative importance of factors will vary from case to case.
- (3) The Tribunal should not adopt a box-ticking approach to a checklist – rather, the matter should be viewed and evaluated in the round.

25. We find particularly helpful the summary given by the then Vice-Chancellor in *Marson v Morton* [1986] STC 463:

“I will deal first with the submission that the true and only reasonable conclusion in this case was that the taxpayers were entering into an adventure in the nature of trade. It is well established in dealing with appeals of this nature that there is a band of cases, sometimes referred to as 'no-man's-land', in which different minds come to different conclusions in the circumstances on the question of whether or not there was an adventure in the nature of trade. There are some cases where the position is so clear, one way or the other, that there is only one true and reasonable conclusion. If so, then if the commissioners reached something other than that conclusion, an error of law was disclosed. But if the case falls within the band where more than one conclusion is possible on the basis of the facts found, then in the absence of misdirection on the face of the decision the court has no jurisdiction or right to intervene.

Against that background one turns to consider what the position is so far as the law on this matter is concerned. Like the commissioners I have been treated to an extensive survey of the authorities. But as far as I can see there is only one point which as a matter of law is clear, namely that a single, one-off transaction can be an adventure in the nature of trade. Beyond that I found it impossible to find any single statement of law which is applicable to all cases in all circumstances. I have been taken through the cases and invited to compare the facts in some cases with the facts in the case here before me. I fear that the General Commissioners may have become as confused by that process as I did. The purpose of authority is to find principle, not to seek analogies on the facts.

It is clear that the question whether or not there has been an adventure in the nature of trade depends on all the facts and circumstances of each particular case and depends on the interaction between the various factors that are present in any given case. The most that I have been able to detect from the reading of the authorities is that there are certain features or badges which may point to one conclusion rather than another. In relation to transactions such as this, that is to say a one-off deal with a view to making a capital profit, there do seem to be certain things which the authorities show have been looked at. For convenience I will refer to them in a moment. But I would emphasise that the factors I am going to refer to are in no sense a comprehensive list of all relevant matters, nor is any one of them so far as I can see decisive in all cases. The most they can do is provide common sense guidance to the conclusion which is appropriate.

The matters which are apparently treated as a badge of trading are as follows:

(1) That the transaction in question was a one-off transaction. Although a one off transaction is in law capable of being an adventure in the nature of trade, obviously the lack of repetition is a pointer which indicates there might not here be trade but something else.

(2) Is the transaction in question in some way related to the trade which the taxpayer otherwise carries on? For example, a one-off purchase of silver cutlery by a general dealer is much more likely to be a trade transaction than such a purchase by a retired colonel.

(3) The nature of the subject matter may be a valuable pointer. Was the transaction in a commodity of a kind which is normally the subject matter of trade and which can only be turned to advantage by realisation, such as referred to in the passage that the chairman quoted from Reinhold? For example, a large bulk of whisky or toilet paper is essentially a subject matter of trade, not of enjoyment.

(4) In some cases attention has been paid to the way in which the transaction was carried through: was it carried through in a way typical of the trade in a commodity of that nature?

(5) What was the source of finance of the transaction? If the money was borrowed that is some pointer towards an intention to buy the item with a view to its resale in the short term; a fair pointer towards trade.

(6) Was the item which was purchased resold as it stood or was work done on it or relating to it for the purposes of resale? For example, the purchase of second-hand machinery which was repaired or improved before resale. If there was such work done, that is again a pointer towards the transaction being in the nature of trade.

(7) Was the item purchased resold in one lot as it was bought, or was it broken down into saleable lots? If it was broken down it is again some indication that it was a trading transaction, the purchase being with a view to resale at profit by doing something in relation to the object bought.

(8) What were the purchasers' intentions as to resale at the time of purchase? If there was an intention to hold the object indefinitely, albeit with an intention to make a capital profit at the end of the day, that is a pointer

towards a pure investment as opposed to a trading deal. On the other hand, if before the contract of purchase is made a contract for resale is already in place, that is a very strong pointer towards a trading deal rather than an investment. Similarly, an intention to resell in the short term rather than the long term is some indication against concluding that the transaction was by way of investment rather than by way of a deal. However, as far as I can see, this is in no sense decisive by itself.

(9) Did the item purchased either provide enjoyment for the purchaser (for example, a picture) or pride of possession or produce income pending resale? If it did, then that may indicate an intention to buy either for personal satisfaction or to invest for income yield, rather than do a deal purely for the purpose of making a profit on the turn. I will consider in a moment the question whether, if there is no income produced or pride of purchase pending resale, that is a strong pointer in favour of it being a trade rather than an investment.

I emphasise again that the matters I have mentioned are not a comprehensive list and no single item is in any way decisive. I believe that in order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question—and for this purpose it is no bad thing to go back to the words of the statute—was this an adventure in the nature of trade? In some cases perhaps more homely language might be appropriate by asking the question, was the taxpayer investing the money or was he doing a deal?

If that approach is right, then it seems to me that this is essentially a case which falls in the no-man's-land where different minds might reach different conclusions on the facts found. ...”

26. We conclude that the issue before us in this appeal also “falls in the no-man's-land where different minds might reach different conclusions on the facts found”. On the one hand, and pointing against a trading transaction: the transaction was a one-off; it was unrelated to Mr Khan’s profession of an accountancy practice; although Mr Khan had purchased and sold shares on other occasions, there was no suggestion that he was a regular dealer in securities; he performed no work on the shares to enhance their value (indeed, he did not replace staff as they left and he adopted a hands-off approach to management); there was no intention to sell off or otherwise realise the shares piecemeal; the acquisition was self-funded in the sense that the resources came from within the Company and Mr Khan did not borrow funds (although as the new owner of the Company he did provide personal guarantees to NatWest). On the other hand, we have Mr Khan’s evidence that his plan from the outset was to run the Company for two years and then wind it up, hoping to realise some value at the end of the day – although in fact he did not wind up the Company; he owned the buyback shares (which represented 98 of his 99 purchased shares) for only a short time; and he obtained no enjoyment from the remaining one share (he took no salary, rent or dividends from the Company during his ownership).

27. Having carefully considered all the above, we conclude that Mr Khan’s acquisition and disposal of the shares was not an adventure in the nature of a trade being carried on by him. He is not a securities trader; instead he saw an opportunity to acquire the Company, which he has owned outright since the acquisition, as an investment and fund that investment using the Company’s own reserves and borrowings. While he may not have viewed it as a long-term investment, it was, we conclude, still an investment, rather than a share trading transaction.

28. Accordingly, we conclude that the Disputed Closure Notice correctly states the tax consequences of the buyback, as being the receipt of a company distribution.

Decision

29. The appeal is DISMISSED.

30. We were asked to make a decision in principle on the matter in dispute, as there were outstanding issues on valuation and calculation, and we grant leave to the parties to revert to the Tribunal if they are not able to agree figures.

Right to apply for permission to appeal

31. 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.

**PETER KEMPSTER
TRIBUNAL JUDGE**

RELEASE DATE: 19 MARCH 2019