Neutral Citation: [2024] UKFTT 00749 (TC)

Case Numbers: TC09267

FIRST-TIER TRIBUNAL
TAX CHAMBER

Taylor House Tribunal Centre

Appeal reference: TC/2017/06730
TC/2017/06732

Closure Notices – mis-selling of interest rate hedging products (‘IRHP’) – FCA principles of sale and review – compensation – receipt of money – basic redress payments – sum labelled interest – whether basic redress payments for opportunity cost – no – whether payments income or capital – income – whether chargeable to income tax – yes – whether interest under statute – yes – whether chargeable to income tax – yes – appeal dismissed

Skeleton Arguments – Written submissions – length – Tribunal directions

Heard on: 4 and 5 June 2024
Judgment date: 15 August 2024

Before

TRIBUNAL JUDGE RUDOLF KC
MICHAEL BELL

Between

(1) SIMON HACKETT
(2) EDWARD HACKETT

Appellants

and

THE COMMISSIONERS FOR HIS MAJESTY’S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellants: Mr Andrew Bowe, of Rational Tax Limited, and Dr Rupert Macey-Dare, counsel, instructed by Rational Tax Limited

For the Respondents: Ms Laura Poots, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. The Appellants are the brothers Mr Simon Hackett (TC/2017/06730) and Mr Edward Hackett (TC2017/06732). (without any discourtesy intended, hereafter 'the Hacketts'). The Respondents are the Commissioners of His Majesty's Revenue and Customs ('HMRC'). The facts and circumstances surrounding each of the appeals are the same and the parties have agreed that the appeals should be heard together and determined accordingly.

2. These are the Hacketts' appeals against Closure Notices ('CNs') dated 5 January 2017 made by HMRC under section 28A of the Taxes Management Act 1970 ('TMA') amending each of their tax returns for the tax year 6 April 2014 to 5 April 2015 in the sum of £219,042.57. These sums relate to the chargeability to income tax said to be owed on (a) 'basic redress' made to the Hacketts by HSBC by way of compensation and (b) the interest on such sums at 8% paid by HSBC ('HSBC' or 'the Bank') and RBS (the RBS 'basic redress payments' not being the subject of appeal before this Tribunal as it was treated as taxable by the Hacketts when filing their self-assessment tax returns for the year ended 5 April 2015).

3. HMRC defend the CNs as validly raised and say the Hacketts have not proven they are excessive in amount. The CNs were raised as HMRC submit that the 'basic redress' given by way of compensation for mis-selling of an 'interest rate hedging product' ('IRHP') by HSBC after an investigation by the Financial Conduct Authority ('FCA') was chargeable to income tax. That is because it is, or is treated as being, income under section 268 of the Income Tax (Trading and Other Income) Act 2005 ('ITTOIA'). Additionally, whatever the taxable status of the 'basic redress' the interest on any such sums paid at 8%, by HSBC (and under this heading only, RBS) is chargeable to income tax under section 369 ITTOIA.

4. The Hacketts, in their restated notice of appeal dated 9 May 2024 at paragraph 2, contend:

> *... that the Respondents' argument for the tax assessment is logically invalid. Specifically, it is contended that the Respondents have conflated a metaphorical characterisation (A can be imagined as B) with literal equivalence (A is B) thereby denying their own premise (A is not B). In consequence, the logical form of the argument is a contradiction that violates the laws of thought.*

5. That was reformulated in the Hacketts' final iteration of their skeleton argument at paragraph 2:

> *The Appellants submit that the Respondents' characterisation of a compensable cost as a quantity of payments, contradicts their definition of that cost's measurable-magnitude which they define not to be a quantity of payments. The contradiction takes the form "the compensation was paid for X, but only to the extent that X is not X" and it is false for all semantical values of X. As such there is no logically consistent case to answer.*

6. As a result, we were told in oral submissions, as the receipt of funds was for the opportunity cost in losing the ability to invest in different hedging products, and not compensation, the money is not chargeable to tax at all in the Hacketts' hands. The CNs are excessive and should be reduced to £NIL.

7. There is an alternative ground of appeal at paragraph 31 of the restated notice of appeal, where it is contended:

> *In the alternative, the Appellants submit a second argument which considers what would be the case if the Respondents' characterisation of the damage (as an "excess of*

the product's payments") was consistent with the facts. However, to even consider this possibility common ground facts have to be changed.

8. That was reformulated in the skeleton argument at paragraph 341:

On the Strong-Form, the Respondents' premise that the "excess payments" were of revenue on an individual basis is not accepted. The premise is simple:

If payments are compensable to 100% of their value (i.e., the payments were made without any prospect of return), then they are not paid out of revenue, but out of capital.

9. As a result, therefore, we were told in oral submissions, the money received was capital not income and as a result the CNs are excessive and should be reduced to £NIL.

10. As to interest the written material was silent but the Hacketts submitted orally that the decision on the chargeability to tax would follow the chargeability to tax (or otherwise) of the 'basic redress payments' and that considerations such as why 8% was elected drove away from the 'interest' as being reflective of income.

BACKGROUND

Wilkinson and cases stayed behind it

11. This case (and there may be more) was stayed behind *Gadhavi v HMRC* [2018] UKFTT 600 (TC) ('Gadhavi') and *Wilkinson v RCC* [2020] UKFTT 362 (TC) ('Wilkinson'), the only other cases that have dealt with the tax treatment of similar redress payments. In both the Tribunal favoured the arguments of HMRC. Neither case has been appealed (although we accept there is nothing to be read into that). Here, both parties focussed on Wilkinson and its impact. The Hacketts submitted it was not binding, wrong and ought not to be followed (Mr Bowe having appeared for the taxpayer in that case as well). HMRC accepted it was not binding but submitted that it was correctly decided and its persuasive reasoning, which was strong, should be applied.

12. We will return to Wilkinson, but at this stage note the following from that case. At paragraph 8 Judge Beare recites:

There is no material dispute between the parties as to the relevant facts in this case …

13. At paragraph 32 having set out the law Judge Beare further records:

There is no dispute between the parties as to any of the above. This leads naturally to the question of why, if the parties are ad idem on the events which have occurred and on the relevant legal principle to apply, they disagree on the correct tax treatment of the Basic Redress Element?

Materials before this Tribunal

14. Unlike Wilkinson, and despite the optimism in HMRC's skeleton argument regarding agreement, we were informed by Mr Bowe that there was little agreement on the facts and little as to the applicable law.

15. We heard no witness evidence. No witness statements were served by either side.

16. We did receive a documents bundle running to 1,095 pages. Much of the first half of the bundle related to various prehearing applications and directions which it is fortunately not necessary to rehearse. At the end of the hearing the Hacketts produced some further documentation relating to RBS. After a short break HMRC confirmed they had no objection to its admission, and we therefore received it.

17. Further, we received an authorities and legislation bundle for which we were grateful and both sides provided documents headed skeleton argument. HMRC's ran to 16 pages and was a skeleton argument. The Hacketts' was 58 pages and (in the main bundle) attached over 100 pages of what were called "Internet and Book Authorities referred to in the Appellants' Skeleton Argument". These included numerous articles and Wikipedia entries.

Written arguments

18. We must say something about this.

19. As we have said the Hacketts tendered a 'restated' "skeleton argument" dated 9 May 2024 containing 357 paragraphs and running to 58 pages (which replicated in length the original). In truth, these were full written submissions. There was nothing skeletal about them.

20. However, in future, if full written submissions are sought to be tendered rather than a skeleton argument, the Tribunal (and the parties) would be assisted by a different direction being requested to that normally given in relation to skeleton arguments. First, it means the Tribunal has an idea of what it will receive. Secondly, it ought to reduce the estimated length of any hearing. Thirdly, if that is not done, there is a risk the Tribunal will refuse simply to receive a document headed 'skeleton argument' when that is in truth not what it is.

21. Rule 15 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ('The Rules') states (in material part):

> ***Evidence and submissions***
>
> *15.— (1) Without restriction on the general powers in rule 5(1) and (2) (case management powers), the Tribunal may give directions as to—*
>
> *...*
>
> *(e) the manner in which any evidence or submissions are to be provided, which may include a direction for them to be given—*
>
> *(i) orally at a hearing; or*
>
> *(ii) by written submissions or witness statement; and*
>
> *(f) the time at which any evidence or submissions are to be provided.*

22. Several directions have been made about skeleton arguments in this case. The first, which does not appear to have been amended in any significant way states:

> ***OUTLINE OF CASE***
>
> *10. Not later than 14 days before the hearing both parties shall send or deliver to each other an outline of the case that they will put to the Tribunal (a skeleton argument) including the details of any legislation and case law authorities to which they intend to refer to at the hearing. At the same time both parties will file with the Tribunal an electronic copy of their skeleton argument.* (emphasis added)

23. It is true that no page limit was given by the Tribunal (nor is there one in the Rules or in any practice direction). However, an 'outline' or 'skeleton argument' does not, on any view, admit of the description of a document of 58 pages. Simply putting 'skeleton argument' on the top does not alter that. In this case the Tribunal would have been quite entitled to refuse to recieve the document.

Oral Argument

24. We heard oral submissions on the issues that arise in this case. As was apparent from the pleadings, HMRC focussed on the tax treatment of the basic redress payments and interest by reference to statute and authority. The Hacketts focussed upon the economic, philosophical, mathematical, semantic, logic based linguistic position and dealt with how some of authorities cited to us should be applied and criticised HMRC's approach.

Debarring HMRC from further participation

25. Finally, before we turn to the facts, the rival submissions, the law and our analysis we must mention the application that was made after an hour or so of oral submission by Mr Bowe. Having spent some time (perfectly properly) commenting upon certain parts of HMRC's skeleton argument and seeking to draw support for his case in that way there came, without notice or warning, an application to "strike out" HMRC's case in its entirety. Rule 8 of the Rules applies to HMRC save that the reference to 'striking out' is to be read as 'barring of the respondent from taking any further part in the proceedings' (Rule 8(7)(a)).

26. Asked why this had only arisen at the hearing, Mr Bowe replied he had only recently had HMRC's skeleton argument. That argument was served, in line with the Tribunal's direction, 14 days prior to the hearing. The problem with making a written application to "strike out" HMRC's case was that it would have resulted in the automatic striking out of the Hacketts' appeal due to the directions previously issued by the Tribunal. However, on close consideration of the wording of the direction, an oral application was not prohibited.

27. Mr Bowe submitted that HMRC had made a 'false statement of fact' which formed the basis for the 'strike out' *unless HMRC can present authority permitting it*. The allegation of false statement is summarised at paragraph 29-32 of the Hacketts' "skeleton argument". It is sufficient to quote paragraph 29:

> *At the date of this skeleton argument, the Respondents' case is stated in terms of a logically impossible form: "The compensation is paid for a quantity of payments (i.e., not the Excess), but only to the extent that the quantity is not a quantity of payments (i.e., the Excess)". If this appeal were a criminal trial, then the logically equivalent case would state "The defendants are guilty of murder, but only to the extent they are not guilty of murder". The Respondents' error is in the form of their argument (the conjunction of "X and not-X") and it is inherently false.*

28. As we pointed out to Mr Bowe, his application to "strike out" was based upon the premise that his submissions were unanswerably correct and HMRC's position demonstrably and obviously wrong on their face. Rule 8 (3) of the Rules provides:

> *(3) The Tribunal may strike out the whole or a part of the proceedings if—*
>
> *(a) the appellant has failed to comply with a direction which stated that failure by the appellant to comply with the direction could lead to the striking out of the proceedings or part of them;*
>
> *(b) the appellant has failed to co-operate with the Tribunal to such an extent that the Tribunal cannot deal with the proceedings fairly and justly; or*
>
> *(c) the Tribunal considers there is no reasonable prospect of the appellant's case, or part of it, succeeding.*

29. The only conceivable applicable part of the rule is (c). Although we were not taken to the Rules at the time, the Tribunal is familiar with the test, and we did not consider there was 'no reasonable prospect' of HMRC's case succeeding. Not least, similar though not completely identical arguments had been made by Mr Bowe in Wilkinson where HMRC did succeed.

30. Further, the head on collision between HMRC's focus upon the tax treatment of the basic redress payments and interest under statute and authority and the Hacketts' approach is manifestly unsuited to an application to debar the Respondents from taking any further part in the proceedings. Full argument, based upon the evidence and authority, was required.

31. In any event, it is for the Hacketts to prove, on the balance of probabilities, the CNs are excessive in amount if HMRC can show they were validly raised (of which there was no challenge). We refused the application without calling upon HMRC.

FINDINGS OF FACT

32. These are our necessary findings of fact from the documents that were placed in front of us. On occasion the submissions made on behalf of the Hacketts came close to, or may have been, the provision of evidence. We have treated any such as submission only, save (if relevant) where something may be so well-known judicial notice can be taken of it.

33. Apart from the receipt by the Hacketts of the money from HSBC and RBS), nothing else was agreed.

34. The Hacketts are brothers who ran a property rental business.

35. On 27 January 2006 and 15 May 2006, the Hacketts jointly purchased two IRHPs from HSBC. The first IRHP ('product 1') was a Libor cap with Knock-in floor for £3m with an effective date of 27 February 2006 and a maturity date of 28 January 2013. For this an upfront premium of £27,500 was paid. The second IRHP ('product 2') was a Libor cap with Knock-in floor for £3.8m with an effective date of 15 June 2006 and a maturity date of 15 May 2013. For this an upfront premium of £125,000 was paid.

36. In August 2006, the Hacketts jointly purchased an IRHP from RBS. We do not need to dwell upon this in any detail as the only item under appeal is the interest upon the payment made to the Hacketts by RBS. In a document produced in the hearing, dated 17 January 2014, it seems that the interest figure calculated at that stage by RBS was £59,030.01. However, on 20 October 2016 HMRC wrote to the Hacketts indicating the gross interest figure was £65,173.76. The Hacketts' then agents wrote back disputing the principle of chargeability to tax but not the figure. In the absence of any further evidence or explanation we prefer the uncontradicted figure of £65,173.76,

37. These are complex products. For present purposes it is sufficient to explain that these products existed to assist customers manage fluctuations in interest rates on loans taken. They are generally separate from the loans, although in relation to product 1 it was a condition of the loan that the Hacketts took, that they purchased an IRHP. Here, HSBC told the Hacketts in the redress determination:

> *Under the terms of your HBSC loan, entry into an interest-rate hedging product was a condition of HSBC lending to you. Based upon contemporaneous information available and on HSBC's credit assessment of your business model, on acceptance of the £650,000 loan, entered into via a facility letter dated 12/01/06, a Base Rate increase in excess of 1% would have resulted in key covenants of all outstanding debt being breached. Accordingly the Bank imposed hedging as a condition of lending to you, with a requirement to protect at least 50% of outstanding debt, as a means of mitigating this risk. It was therefore necessary for you to purchase interest rate protection to comply with conditions of your loan.*

38. Product 2 was purchased for similar reasons although the impetus for that came from the Hacketts rather than the bank.

39. There were four broad categories: Swaps, caps, collars and structured collars.

40. Here the Hacketts purchase of the Libor cap with a Knock-in floor appears to be a structured collar. As the FCA put it:

> *Structured collars are in some respects similar to simple collars. They enable customers to limit interest rate fluctuations to within a range. However, while the ceiling functions in a similar way, the floor is more complex and customers can end up paying increased interest rates if the base rate falls below the floor. They require a more difficult assessment of the benefits and risks.*

41. Libor stands for London Interbank Offered Rate. There were different currency Libors. The details of their definition, setting and operation do not matter for these purposes (but see, for example, *Hayes & Polombo v Rex* [2024] EWCA Crim 304 where such matters are described).

42. The rating details of the products were as follows:

Amortisation	*Bullet*
Index	*1 Month Libor*
Cap Rate	*5.00%*
Floor Rate	*5.00%*
Knock-in Floor Rate	*3.00%*

43. The effect of those terms was that if the 1 Month Libor tenor exceeded 5% HSBC would have to make payments to the Hacketts reflecting that. If the tenor was below 5% but above 3% neither the bank nor the Hacketts were liable to make any payment. If the tenor dropped below the 3% Knock-in floor rate, then the Hacketts would be liable to the bank to make payments.

44. Until late 2008 the tenor was above 5% and in the Hacketts' favour. The bank made payments. However thereafter, until June 2012 when payments were suspended, the tenor dropped below the 3% Knock-in floor rate and substantial payments were made by the Hacketts to the bank.

45. Under product 1 the Hacketts paid £436,816.07 to the bank. Perfectly properly, for calculating the tax owed in the relevant tax year the Hacketts deducted the largest part representing IRHP payments to the bank as expenses of the property business profits. Under product 2 the Hacketts paid £641,932.84 to the bank. Again, perfectly properly, for calculating the tax owed in the relevant tax year the Hacketts deducted the largest part representing IRHP payments to the bank as expenses of the property business profits.

46. From 2010 onward it became clear that problems existed with the (mis)selling of IRHPs such as those the Hacketts had bought. As a result, the FCA reached agreement with nine banks, including HSBC and RBS, as to how a review of such products would work and provisions for providing redress if mis-selling was shown.

47. The review principles, insofar as relevant to this case, were expressed to be as follows:

> ## *IRHP: the review process*
>
> *These steps summarise how IRHP sales will be reviewed. Independent reviewers will provide oversight of every case.*
>
> ### *Start*

Sales of those products and to those customers covered by the review are divided into 3 categories: structured collars (category A); caps (category C); and all other standalone IRHPs (category B).

...

Sophistication

...

Customers assessed as 'non-sophisticated' for these purposes are included within the review. Customers assessed as 'sophisticated' are outside the scope of the review.

...

Opt-in and testimony

Category A customers who have been assessed as 'non-sophisticated' are automatically included in the review.

...

Compliance

Category A sales do not need to be assessed for compliance and can proceed straight into redress phase (however, to determine the appropriate redress, the banks will still need to review the sale and may need to meet with customers).

...

These include the relevant conduct of business rules and Principles for Businesses in force at the time of the sale. (our emphasis)

…

48. Here, as the Hacketts had structured collars, and were non-sophisticated, they were automatically entitled to be entered into the redress phase. That redress phase needed to involve a review of the sale including considering the relevant conduct of business rules and Principles for Businesses in force at the time in order to reach final conclusions on (mis)selling. This exercise was therefore conducted against the 'FCA's Sales Review Principles'.

49. The FCA set out the following as reflecting how mis-selling should be dealt with by way of redress:

IRHP: determining the level of redress

What you can expect to receive as fair and reasonable redress, including compensation for consequential losses.

Fair and reasonable redress means putting the customer back in the position they would have been in had the regulatory failings not occurred, including any consequential loss.

What is fair and reasonable redress will vary from case to case and will be determined by a review of evidence and customer testimony. All redress offers will be scrutinised and approved by an independent reviewer.

How the banks agreed to calculate redress under the review:

Basic redress	*The difference between actual payments made on the Interest Rate Hedging Product and those that the customer would have made if the breaches of relevant regulatory requirements had not occurred.*
Interest	*The opportunity cost (loss of profits or interest) of being deprived of the money awarded as basic redress.* *The banks will either pay 8% a year of simple interest, or an interest level in line with:* *1. an identifiable cost that the customer incurred as a result of having to borrow money; or* *2. an identifiable interest rate that a customer has not earned as a result of having less money in the bank.*

Taking into account the economic environment over the last five years, interest will avoid many customers from having to put together consequential loss claims.

50. There is then reference to consequential loss, which we are not concerned with here, as the money received from HSBC in relation to that was in 2017-18 and, as a result, not covered by this appeal.

51. The FCA further set out:

> ## *Basic redress*
>
> <u>*The objective of the review is to put customers back in the position that they would have been in, had it not been for the mis-sale*</u>*. Our principles of fair and reasonable redress give rise to three possible basic redress outcomes for customers:*
>
> *1. Some customers would never have purchased a hedging product and will receive a 'full tear up' of their interest rate hedging product (IRHP). These customers will receive a full refund of all payments on their IRHP.*
>
> *2. Some customers would have chosen the same product they originally purchased whilst some customers may not have suffered any loss. These customers will receive no redress.*
>
> *3. Some customers would still have sought or been required to enter into a product that provided protection against interest rate movements, but would have chosen an alternative product. These customers will receive redress based on the difference between the payments they would have made on the alternative product, compared with the payments they did make.* (<u>emphasis added</u>)

52. Additionally:

> ## *Tax on redress*
>
> *The exact tax treatment of any redress is likely to depend both on the circumstances of the case and on the customer's own wider financial and tax position. This is not something we can advise on. Ultimately, the customer will need to contact HM Revenue and Customs and confirm the position.*
>
> *Customers may find it helpful to know that HMRC has issued guidance about the tax treatment of IRHP redress [3] [[3] http://www.hmrc.gov.uk/news/redress-payments.htm].*

53. That framework in place, HSBC then proceeded to implement it when reviewing the Hacketts' IRHPs.

54. On 6 June 2014 HSBC wrote to the Hacketts with a *final redress determination*. They said:

> *... This letter sets out our Final Redress Determination of those interest rate hedging products. It explains the redress that we are offering to you under the FCA Review and what you need to do next if you decide to accept our Final Redress Determination. If you decline, then the review of your sale is now complete and you will not receive anything further from us in relation to the FCA Review.*

55. We interpose that the Hacketts accepted the final redress determination and were paid by the bank.

56. HSBC continued:

> *This redress offer is in full and final settlement of any claim to recover part or all of the payments you made under the interest rate hedging products that were considered in the review of your case. If you accept this redress, you would be agreeing that you could not then bring court proceedings against HSBC for any claim to recover part or all of the payments you made under these products. Acceptance of this offer will not affect your ability to pursue a claim for consequential loss against the bank. Once HSBC has determined your consequential loss, you will have the opportunity to either accept or discuss that determination as a separate exercise under the FCA Review.*

57. The final redress determination also makes clear in considering what the interest is. We find it is compensation for the time value of the sum of money equal to the basic redress.

58. The bank then reviewed products 1 and 2.

59. The bank then concluded its final redress determination on product 1. It determined that the Hacketts would have, but for the mis-selling of product 1, entered into an alternative product at the time 'replacement product 1' namely a base rate 'cap' IRHP of 5% for £1.5m with a maturity date of 27/01/2013.

60. As a result, the Hacketts would be paid £571,071.59 in cash, being the difference between the premium and payments actually made under product 1 and the premium and payments the Hacketts would have made under replacement product 1. There was also a waiver of £78,959.99 which was otherwise owed under product 1 from when payments were suspended, but this gives rise to no relevant tax consequences for our decision, so we say no more about it.

61. The bank also concluded its final redress determination on product 2. It again determined the Hacketts would have, but for the mis-selling of product 2, entered into an alternative product at the time 'replacement product 2' namely a base rate 'cap' IRHP of 5% for £3.8m with a maturity date of 15/05/2013.

62. As a result, the Hacketts would be paid £661,870.92 in cash, being the difference between the premium and payments actually made under product 2 and the premium and payments the Hacketts would have made under replacement product 2. Again, there was a waiver, in this case, of £155,622.81 for the same reasons as product 1 and, for the same reasons, we say no more about that.

63. A number of reasons were given by the bank for this. In relation to product 1:

(1) The IRHP was a condition of the original loan

(2) The sale of product 1 did not meet standards required by the FCA's Sales Review Principles, primarily because:

> (a) the bank agreed with the FCA to provide fair and reasonable redress for 'non sophisticated' customers who were sold certain complex products such as caps with Knock-in floors
>
> (b) the explanations of the features, benefits and risks of product 1 given at the time of sale were deficient particularly the disclosure of potential exit costs as was the explanations of the features, benefits and risks of alternative products.

64. The bank set out why replacement product 1 would have been entered into:

(1) The balance of the evidence indicated had they been given proper explanation of the features, benefits and risks of replacement product 1 in line with the FCA Sales Review principles (as opposed to the improper explanations in breach of those principles in relation to product 1) it is reasonable to conclude such a purchase would have taken place as:

> (a) Base Rate cap was the simplest most flexible product that allowed the customer to benefit if interest rates fell
>
> (b) The Hacketts had considered alternatives including base rate caps and believed at the time base rates could fall
>
> (c) The Hacketts demonstrated a willingness to pay upfront premiums and would have selected a product with such
>
> (d) To mitigate the potential impact of exit costs and to meet the lending requirement, the bank believed the Hacketts would have selected a base rate cap.
>
> (e) The £1.5m hedge represented the minimum required as a condition of lending, the seven year period was the same as product 1 when at the time the Hacketts were presented with both a five and seven year option, the 5.00% cap struck a balance between the bank's requirements and affordability of premium and the replacement product references base rate rather than Libor.

65. In relation to product 2, the Hacketts determined a requirement to hedge rather than it being a requirement of lending. However, for the same reasons as product 1 and replacement product 1, the bank determined a mis-selling of product 2 and that the Hacketts would have purchase replacement product 2.

66. On 3 July 2014 the bank sent a further letter to the Hacketts. It appears that the Hacketts had replied to the bank's letter of 6 June 2014 making some further observations. HSBC recite:

> *Generally you continue to assert that you did not consider at the time that interest rates would rise or that you would have entered into any interest rate hedging had HSBC met with sales principles identified by the FCA.*

67. The bank then records their response to suggestions of pressure and other matters remains as previously provided to the Hacketts. In response to a specific suggestion that the bank required product 2 to be entered into as a condition of lending that was considered and refuted. The determinations in the letter of 6 June 2014 were not altered.

68. Several further findings of fact must be set out:

(1) The FCA put in place a scheme we have set out above. The objective of the review was to put customers back in the position that they would have been in, had it not been for the mis-sale. Several options were given to banks.

(2) HSBC used the FCA's third option in relation to pay basic redress (see paragraph [51] above).

(3) It is not as clear as it might have been that the replacement products were, in fact, available. However, in light of the content of the letter in particular *of the simple interest rate products that were available at the time, the Base Rate Cap was the simplest, provided the most flexibility and allowed you to benefit without limitation if interest rates fell* we find that replacement products 1 and 2 were available to the Hacketts, as opposed to hypothetical, alternatives. Further, on the material before us, we find that the Hacketts would, for the reasons given by the bank, have purchased replacement products 1 and 2.

(4) The reason for the calculation of interest using a rate of 8% has not been formally explained. The difference in rates such between base rates at the time, the 3% knock-in floor, 5% cap and 8% interest on the payments made by the bank after the outcome of the FCA review was the subject of complaint by Mr Bowe. However, overall that complaint ignores contractual and commercial reality in terms of agreement between parties. Further, insofar as it matters, the explanation for the rate of 8% is that the 'basic redress' was paid in lieu of court proceedings. A consequence of acceptance of the payments was a waiver of the right to bring any court proceedings in relation to the premium and payments made (see [56] above). Any successful claim would have attracted the judgment debt rate of interest set by statute at 8%.

69. At Appendices A.1 and B.1 HSBC set out the breakdowns for products 1 and 2 respectively:

Description	***Under Original product 1***	***Under Replacement Product***	***REFUND DUE***
	£	***£***	***£***
Total net payments made by the customer	*(436,816.07)*	*(27,617.36)*	*(409,198.71)*
Interest at 8% simple (see Appendix A.4)			*(111,872.88)*
Total			***(521,071.59)***

Description	***Under Original product 2***	***Under Replacement Product***	***REFUND DUE***
	£	***£***	***£***
Total net payments made by the customer	*(641,932.84)*	*(123,265.84)*	*(518,667.00)*
Interest at 8% simple (see Appendix B.4)			*(143,203.92)*
Total			***(661,870.92)***

70. Appendices A.4 and B.4 set out the calculations for interest. Interest on the total overpayment balance was calculated at 8% on a simple basis – i.e. 8% applied to the total

overpayment balance for the length of the period in question, here the last date of payment to 19/5/2014.

71. Due the delay in the between the HSBC letter and the actual payment the final payment made to the Hacketts jointly was £1,198,601.83; comprising £927,865.71 for the 'basic redress' and £270,736.12 for interest.

72. The interest paid by RBS was £65,173.76. That was paid to the Hacketts jointly and is part of the appeal against the CNs. The £244,464 received as 'basic redress' from RBS in the tax year 2014 – 2015 is not a part of this appeal for the simple reason that the Hacketts included the receipts in their individual tax returns for that year. Whether or not an amendment was being sought to those returns to remove that sum, we do not hold against the Hacketts the inclusion of those figures, if their appeal is otherwise well founded in relation to the basic redress.

73. As set out by the FCA *the objective of the review is to put customers back in the position that they would have been in, had it not been for the mis-sale.* That included an interest element at 8% which in many cases (not the Hacketts) forestalled the need for any consequential loss claim. As we have said the Hacketts in fact pursued, and were paid, by the bank for consequential loss but this payment is outside the scope of the appeal.

74. In July 2014 HMRC published its advice for the tax treatment of IRHPs redress payments consisting of six pages in total and explaining HMRC's tax treatment of the various elements of redress payments.

75. The payments made by HSBC including interest, and the interest from RBS paid upon the basic redress payment by them were not included in the Hacketts individual tax returns for the tax year 2014-2015.

76. On 11 April 2016 HMRC notified the Hacketts of their checks into the individual tax self-assessment ('ITSA') for the year ending 5 April 2015 under section 9A TMA; specifically, because they became aware of the basic redress payment from HSBC. Exchanges of correspondence followed. After a request for further information from HMRC Mr E Hackett replied on 30 June 2016 including:

> *As discussed when we were calculating this, please can you take into consideration the fact that we have not had tax relief on the alternative product and this needs allowed [sic] for.*

77. On 16 August 2016 it was recorded, after receiving advice from Leading Counsel, that the Hacketts did not want to amend a claim they had against HSBC in case the bank required the return of the basic redress.

78. On 17 August 2016 HMRC calculated an amount of income tax due in relation to receipts from HSBC. On 2 September 2016 HMRC proposed concluding the enquiry by contractual settlement. After further correspondence on 2 December 2016 the Hacketts appointed an agent and signed form 64-8 allowing HMRC to deal with the agent directly. This disputed chargeability to tax.

79. On 5 January 2017 HMRC timeously issued the CNs amending the ITSAs so that £219,042.57 was payable by each of the Hacketts and replying to the submission that there was no chargeability to tax.

80. On 25 January 2017 the Hacketts' agent appealed the issuance of the CNs. On 9 February 2017 HMRC issued its view of the matter which concluded the CNs were properly raised in the correct sum. The Hacketts were told that they had 30 days to request an independent review or appeal to the Tribunal. On 13 April 2017 HMRC wrote to the Hacketts

and their agent telling them that as they had not had a response to the view of the matter letter the appeal was being treated as settled by agreement under section 54(1) TMA. On 28 April 2017 the agent (not Mr Bowe) replied proffering an excuse as to why no independent review was requested. It appeared that the Hacketts may not have received the letter of 9 February 2017 and HMRC extended time to request an independent review or appeal to the Tribunal to 31 May 2017. An independent review was requested on 30 May 2017 in a long letter written by the then agent running to 38 pages and 152 paragraphs, enclosing many appendices.

81. On 24 July 2017 the independent review upheld HMRC's view of the matter. Having reviewed HMRC's guidance of July 2014 and wider commentary the independent review said:

> *In this case you purchased an IRHP in respect of loan financing in relation to the purchase of rental properties. HMRC have argued that Tax relief on the payments made to the bank re IRHP has been claimed as an allowable business expense in the relevant accounts/tax returns. The redress element paid to the taxpayer represents a refund of IRHP premiums and tax relief was claimed on premiums paid to the bank. The amount of the IRHP payments refunded by the bank that was claimed as tax relief is therefore taxable and the repayment of the payments must be treated as business income. This follows the guidance published by HMRC and included in the accountancy articles above.*

82. Further:

> *Regarding the latter comment that the payment may be of a capital nature, HMRC published guidance (Additional Guidance on IRHP redress payments) contradicts the agents view as follows: - "…The sum is a trading receipt, since these payments are being made to compensate businesses for recurring costs associated with business loans. These costs were generally treated not as capital costs but as revenue costs, deductible in the businesses profit and loss account. The redress payments are made to put the business back in the position it would have been in had the product not been miss-sold and so are taxable as trading rather than capital receipts."*

83. The Hacketts remained aggrieved by this decision and appealed to the Tribunal.

THE RIVAL CASES

84. We deal with HMRC's submissions first as the Hacketts' case is premised in large part in a critique of HMRC's approach.

<u>HMRC's submissions</u>

85. Ms Poots made submissions about the chargeability to income tax of the basic redress and the interest, building upon her skeleton argument dated 21 May 2024.

1. Basic Redress

86. The basic redress paid to the Hacketts this was chargeable to income tax by operation of section 271 and 272 ITTOIA. The authorities on the chargeability to tax of compensation dealing with trade apply to property rental business in precisely the same way. It was paid as a compensation for the expenditure of the Hacketts paid after the mis-selling of the IRHP product. The original payments of the IRHP were properly deducted by way of expenditure for the purposes of calculating profit at the time, upon which tax was paid. As a matter of fact, the basic redress was part of the profits of the business.

87. In terms of the authorities, Ms Poots submitted that the principles to be followed were:

(1) First, the Tribunal must decide what the compensation was paid for (Diplock LJ's 'first problem' in London & Thames Haven Oil Wharves Ltd v Attwooll [1967] Ch 772. In doing so the source of the legal right to compensation is relevant. Further, the method of calculating the compensation does not, of itself, answer that question, rather it is a factor which may assist in identifying the answer,

(2) Secondly, the Tribunal must decide whether the money in respect of which the sum had been paid would have been taxable as an income receipt had it been received (Diplocok LJ's 'second problem' in London & Thames Haven Oil Wharves Ltd v Attwooll [1967] Ch 772).

88. In doing so it was clear that a sum of money received in respect of a failure to receive a different sum of money which, had it been received, would have been part of the taxable profits of the property rental business, was itself subject to tax as part of the profits of the property rental business. Equally, a sum of money received in respect of an expense which has been incurred as a deductible expense from the profits of the property rental business is subject to tax as a part of the profits of the property rental business (see Donald Fisher (Ealing) Limited v Spencer (Inspector of Taxes) [1989] STC 256).

89. In applying those principles it is submitted, the sum of money that would have been received would have been a taxable part of the profits of the property rental business in the hands of the Hacketts as the IRHP was entered into for the purpose of that business. As a result, the money received back having been deducted at the time as an expense for calculating the profits was chargeable to income tax.

90. At paragraph 43 of her skeleton argument, it was put in the following way:

a. *It is absolutely clear that the Basic Redress was paid in order to compensate the Appellants for the fact that, by entering into the IRHPs as a result of the mis-selling, the Appellants incurred more expenses than they would have done if that miss-selling had not occurred;*

b. *The Basic Redress was paid in order to compensate the Appellants for those expenses incurred, rather than (as the Appellants argue) to compensate the Appellants for their loss of opportunity to enter into the simple caps.*

91. In answering the first question at paragraph [87] above, the legal source of the compensation is relevant, namely the FCA's Review and the principle applied by them to put the customer back into the position they would have been in had the mis-selling not occurred. The FCA's summary of redress calculations and the HSBC Final Determination letter are both clear that the alternative product is considered in quantifying the extent to which the actual payments made were excessive, rather than refunding the full amounts. In other words, the alternative product is used to identify the true measure of loss resulting from the mis-selling. The acceptance of the compensation was in full and final settlement of any claim to recover part or all of the payments made.

92. This was not compensation for consequential losses which were dealt with separately.

93. Ms Poots submitted that none of Mr Bowe's arguments on behalf of the Hacketts that the payments were for the lost opportunity, or the opportunity cost, of not being able to enter the simple caps, were correct in law (whether they were correct as a matter of 'logic', drawing as they do extensively on mathematics, philosophy, linguistics and semantics).

94. The alternative argument that these were capital payments rather than income was also not sustainable given why the payments were made to the Hacketts as basic redress.

2. Interest

95. Interest is chargeable to income tax by operation of section 369 (1) ITTOIA As the 8% payment upon the basic redress was interest as a matter of fact, income tax was due.

96. In terms of the authorities, Ms Poots submitted that the principles to be followed were, in essence:

(1) First, to be interest within section 369 ITTOIA, it simply needs to be compensation for the time value of money. That is, compensation for the loss suffered because they did not have the relevant money on time /compensation for the profit that might have made if they had had the relevant money. Riches v Westminster Bank Ltd [1947] AC 390 ('Riches').

(2) Secondly, there needs to be a sum of money received actually due to the person who receives, it upon which the 'interest' was calculated. Re Euro Hotels (Belgravia) Limited [1975] STC 682.

(3) Thirdly, there is no requirement that it is necessary to know the amount of the sum of money in respect received upon which the 'interest' is calculated at the time it should have been due. This can be calculated at a point in time afterward. Riches and Chevron Petroleum (UK) Ltd & others v BP Petroleum Development Ltd & others [1981] STC 689.

97. At paragraph 48 of her skeleton argument Ms Poots put it:

> *The interest elements paid by HSBC and RBS were compensation for the time value of the sum of money equal to the Basic Redress. This can be seen clearly from the FCA website summary and from the Final Redress letter.*

98. As a matter of law, the interest could still be chargeable to income tax even if the basic redress was not as they were governed by different sections of ITTOIA. The Hacketts' position that interest followed the chargeability to tax of the basic redress was therefore incorrect.

The Hacketts' submissions

99. The restated grounds of appeal dated 9 May 2024 and the "skeleton argument" of the same date were supplemented by oral submissions by Mr Bowe and Dr Macey-Dare.

100. In summary it was submitted that for a variety of reasons the payments made to the Hacketts were for the opportunity cost of not being able to enter into the simple caps and, as a result were not income by way of part of the profits of the property rental business. That meant there was no chargeability to income tax under section 271 ITTOIA and the interest was separately not chargeable under section 369.

101. To make good that overall submission the Hacketts made a number of arguments set out in writing. The oral submissions concentrated on an attack upon HMRC's approach and what was said to be an inconsistency in the treatment of the payments by them.

1. Basic redress

102. We make no apology for recording, at some length, the Hacketts' arguments. That is an inevitability of the way the case was argued.

Ground 1a. Opportunity cost not income

103. The Hacketts identified the issue in the following way (numbers taken from the written submissions):

THE DEFINITION OF THE COST'S MEASURABLE MAGNITUDE

4. The Respondents argue that approximately £1 million of the compensation was paid for the ***"Excess"****, defined as:*

*The difference between, ("**A**") the net payments incurred on hedging interest rate risk, by using the IRHP, and ("**B**") the net payments that would have been incurred on hedging interest rate risk, by not using the IRHP. Or the extent to which $\mathcal{A}$ exceeds $\mathcal{B}$.*

This argument (the "Argument") is common ground and not in dispute.

THE ISSUE

5. The central issue concerns the proper and logically consistent characterisation of the Excess. While the Respondents claim the Excess is a quantity of $\mathcal{A}$, the Appellants claim this cannot be so. In terms of a question, therefore, the issue can be defined as follows:

5.1. What, in the literal sense, is the Excess a quantity of? Or

*5.2. What, in the literal sense, is the quality of the Excess quantity? [the "**Issue**"].*

104. Thereafter there was a section headed ***Outline of the Appellant's argument***. That stated:

6. The Appellants contend that the Respondents have committed a logical error by identifying the Excess in a nonliteral or imagined way, rather than in a literal or factual way, resulting in both the mischaracterisation and mis categorisation of the quantity defined by the Excess.

7. The relevant premise is straightforward:

The characterisation of the Excess is correct, if and only if, it is logically consistent with its definition.

8. To ensure consistency, it is essential not to conflate the different forms, or modes of characterisation. For instance:

*8.1. If the Excess is characterised in a metaphorical, or hypothetical way, then it can be regarded as a quantity of $\mathcal{A}$, since it can be imagined as one [the "**Nonliteral Sense**"]. Whereas,*

*8.2. If the Excess is characterised in a factual, or veridical way, then it cannot be regarded as a quantity of $\mathcal{A}$, since it is defined not to be one [the "**Literal Sense**"]*

Provided the two forms are not conflated no problem arises as the two characterisations are not drawn from the same formal system.

9. Consequently, distinguishing between these two modes without conflation is crucial:

9.1. The Nonliteral Sense means visualising, or imagining, the Excess to be something it is not, by deviating from the facts which define it, or by adopting a premise known to be false; it represents a metaphorical understanding rather than a literal truth. In contrast,

9.2. The Literal Sense means categorising the Excess as something it is, by adhering to the facts and premises which define it; it represents a deduced inference that is literally true.

The point is simple: the Issue is not concerned with what the Excess can be imagined to be (in the Nonliteral Sense), but with what it actually is (in the Literal Sense).

10. The problem arises when the Respondents fail to be consistent and conflate the two senses resulting in a category error. A category error occurs when two distinct concepts, or categories are treated as if they are the same due to some superficial resemblance. Specifically, the Respondents have conflated "payments not made" ($\mathcal{B}$ in the Literal Sense) with "payments made" ($\mathcal{B}$ in the Nonliteral Sense) in order to characterise the Excess as a quantity of payments.

11. Although it confounds intuition the logically consistent characterisation of the Excess is that:

11.1. It quantifies the difference between $\mathcal{A}$ and $\mathcal{B}$, which is an abstract opportunity cost of c£1 million in compensable value. But,

11.2. It does not quantify an extent of $\mathcal{A}$ itself, which is a concrete transaction cost of £0 compensable value. And,

No amount of recharacterisation, or mental reification, can ever change this brute fact.

12. Thus, while the Respondents define the Excess NOT to be a quantity of $\mathcal{A}$, they characterise it to be one, resulting in an impossible contradiction – the Excess is both a quantity of $\mathcal{A}$, and not a quantity of $\mathcal{A}$ at the same time. This contradictory argument should be dismissed.

105. It is the submission at paragraph 12 of the Hacketts' written submissions that was a part of the focus of Mr Bowe. He submitted that HMRC needed an authority, for treating a source of payment as both one thing and another, where a contradiction followed.

106. Mr Bowe amplified his written arguments by submitting that HMRC have misunderstood how to go about quantifying compensation in this context because they are hedging payments incurred when the interest rate falls and not when it does not. That says Mr Bowe is incorrect. He says the real cost of the hedging payment is £NIL and, as a result, the basic redress payment cannot be compensation in the way HMRC submit. The reason it is £NIL is that HMRC discount from their analysis what happens if the interest rate does not fall. If it does not then a person does not incur a payment but they incur more interest. There is no cash difference between the two positions, and they are therefore the same. The real cost of hedging is therefore £NIL.

107. Mr Bowe submits that these errors of approach have infected HMRC's arguments. First was how payment under the product worked. Secondly, he reminded us of paragraph 43 a. of Ms Poots' skeleton argument. We have set that out already but for convenience we set it out again:

It is absolutely clear that the Basic Redress was paid in order to compensate the Appellants for the fact that, by entering into the IRHPs as a result of the mis-selling, the Appellants incurred more expenses than they would have done if that miss-selling had not occurred;

108. This he submits is to concede the Hacketts' point by misunderstanding what the compensation was paid for. As it was circa £1m rather than the £NIL it would have been if it had been for hedging repayments, it can only be the product opportunity cost.

109. It is a foregone opportunity, says Mr Bowe, whatever label it is given. The 'alternative products' that the FCA require to be included in the calculation have nothing real world about them. They are hypothetical which, again, supports the argument that the payment was for the lost opportunity not compensation for excess payments on the back of mis-selling.

110. Further support for this, says Mr Bowe, is found in paragraph 43 b. of Ms Poots' skeleton argument. That says:

> *The Basic Redress was paid in order to compensate the Appellants for those expenses incurred, rather than (as the Appellants argue) to compensate the Appellants for their loss of opportunity to enter into the simple caps.*

111. This says Mr Bowe is nothing more than calling a *rose by another name of opportunity cost*. No matter what it is called, it is an opportunity cost. Mr Bowe sought to variously colour this in argument by references to unicorns and ice-creams. In other words, you can call a table a unicorn: it is still a table.

112. What you cannot do, submits Mr Bowe, is ask whether an opportunity cost is a pear because that is actually like asking what type of apple it is (as an opportunity is neither income nor capital and asking the question is a categorisation error). When assessing business costs, you cannot deduct what you would have done in the alternative or profits would disappear.

113. HMRC were criticised for not being able to express their position conceptually as opposed to linguistically based upon what they said were the facts. Mr Bowe took exception to paragraph 44 d. of Ms Poots' skeleton argument. That stated:

> *The HSBC Basic Redress was calculated on the final basis. The FCA's summary of redress calculations and the HSBC Final Determination letter are both clear that the alternative product is taken into account in quantifying the extent to which the actual payments made were excessive, rather than refunding the full amounts. In other words, the alternative product is used to identify the true measure of loss resulting from the mis-selling. The language of those documents does not support an argument that the Basic Redress was compensation for a lost opportunity to purchase a simple cap.*

114. Mr Bowe invited the Tribunal to accept this paragraph as a revelation of the inherent problem in HMRC's position: before you quantify an excessive characteristic of payment you must define what it is otherwise you do not know where to place the tape measure.

115. And conceptually, Mr Bowe submits, HMRC cannot do so. Mr Bowe goes further and submits that the result is *astonishing* because it is defined by reference to something that was not a payment all: the forgone alternative.

116. Therefore, submits Mr Bowe, HMRC should not be permitted to succeed as they are treating something as a payment and not as a payment at the same time.

117. That submissions led to Mr Bowe asking the Tribunal to find that the learning set out in cases such as London & Thames Haven Oil Wharves Ltd v Attwooll [1967] Ch 772 and Donald Fisher (Ealing) Limited v Spencer (Inspector of Taxes) [1989] STC 256 is irrelevant as they cannot apply to the current facts in such circumstances. Treating the payments as chargeable to tax by way of income must fail as a position.

118. We have set out our understanding of the principal argument presented by the Appellant at paragraphs [100 to 117] above.

119. Mr Bowe and Dr Macey-Dare outline in their written submissions what they say are the 'correct logic' and 'correct intuition' (with summaries) at paragraphs 16 – 32 at page 6. At paragraph 33 these are then indexed as being presented in 10 parts from pages 7 to 51, with the alternative argument on capital, being found at page 52. Page 7 states:

> *Part I: Identifies and formalises the logic of the Argument. Pages 7-9.*

Part II: Demonstrates what the Excess is a quantity of by formal deduction. Pages 10-13.

Part III: Sets out the sources of mischaracterisation. Pages 14-19

Part IV: Verifies the analysis in Part III by measurement. Pages 20-24.

Part V: Tests the competing views against the evidence of the FCA's Scheme. Pages 25-26

Part VI: Analyses the contradiction in the Respondents' conclusion. Pages 27-30.

Part VII: Analyses the arguments the Respondents make in support of their view. Page 31-37

Part VIII: Considers the arguments in Wilkinson to the extent not covered. Pages 38-41

Part IX: Details the Appellants' argument and its conclusions. Pages 42-47

Part X: Details the authorities relied upon. Pages 48-51.

The Appellants second ground of appeal begins on page 52.

120. Mr Bowe told us he could not do any better than refer us to paragraphs 93 to 102 of his "skeleton argument" in support of his principal argument. We set out paragraphs 100 to 102 as reflecting that:

100. *As should be clear, once the interest rate falls, the compensable value of the Excess increases from £0 to £1 million. The appropriate remedy now requires not only the setting-aside the mis-sold fixed rate, but also a cash sum of £1 million. In other words, the cash compensation plainly addresses the increased opportunity cost of using the fixed rate, a cost which the Accountant neither recognised nor deducted in the computation of the loan's allowable cost.*

101. The only counterintuitive aspect lies in the fact that the computation of the opportunity cost results in the deduction of a negative sum (i.e., the minus of a minus), which paradoxically decreases, rather than increases, the cost of the loan. It is only when the cost of the forgone opportunity increases in magnitude from (£1m) to £0, that the use of mis-sold fixed rate becomes both onerous and regretted.

102. Crucially, the same conclusion is reached even if the fixed interest rate is decomposed, or bifurcated, into separate "floating-rate" and "IRHP" components. Although the Accountant would recognise the nominal cost of the hedging-payments, they would only do so to the extent that the interest-payments being hedged had fallen, such that the real cost of the loan would remain unchanged, and the real cost of the hedging-payments would be £0.

121. Turning to further authority Mr Bowe made several submissions. He began with Glenboig Union Fireclay Co. v Inland Revenue 1922 S.C. (H.L.) 112. Mr Bowe submitted, properly understood, there was no dispute whether the loss was an opportunity cost or not because the parties were inviting the court to consider the binary question of whether the sum received was income or capital. The court rightly pointed out what it would be was irrelevant. But the owner was deprived of the opportunity to mine.

122. In Higgs (Inspector of Taxes) v Olivier [1952] Ch 311 the actor received a sum for *not* acting. In Crabb (Inspector of Taxes) v Blue Star Line Limited [1961] 2 ALL ER 424 Mr Bowe submits the logic of that case is correct which brings the argument back to Deeny and

others v Gooda Walker Ltd (in voluntary liquidation) and others (Inland Revenue Commissioners third party) and related appeals [1996] 1 STC 299. Mr Bowe says:

> *309. In Deeny the question was raised as to whether Diplock's formalisation in Attwooll was an accurate statement of law, or merely a useful tool. In answering that question, the Judges were unanimous in finding that the correct legal approach involved two questions:*
>
> *309.1. First, is a compensation receipt a receipt of the business. And*
>
> *309.2. Second, if it is such a receipt, then is it of a revenue or capital quality.*

123. Mr Bowe continued:

> *311. Regardless of whether Diplock's rule is authoritative for both questions (the Appellants agree with Lord Hoffman, but it matters not), the conclusion is unaffected. The compensation receipt is not a receipt of the Appellant's business, per the first question in Deeny, whether that fact is established by the logic of Glenboig, or the logic of Diplock, for it is the same logic.*

Ground 1b. Capital not revenue

124. Mr Bowe and Dr Macey-Dare had a second argument. We set out their written argument as it was not amplified at all in oral argument.

> *313. For completeness, the Appellants now submit a second ground of appeal based on the alternative assumption that the Respondents' characterisation of the Excess, as a quantity of the IRHP's payments, is accurate.*
>
> *314. However, to even consider this hypothetical, the Excess must first be redefined, or the contradiction will persist even in the alternative. In other words, the Respondents' argument must first be made logically consistent with the facts to even consider an alternative argument.*
>
> *315. This can be done by simply assuming that the IRHP and the Alternative refer to the same asset, to avoid confusion we shall refer to this asset as "**the IRHP**". In this scenario, the IRHP can be thought of as referring to the **IRHP** in its damaged state, whereas the Alternative can be thought of as referring to the **IRHP** in its undamaged state.*
>
> *316. The logical implications of this change upon the various payments are worth noting:*
>
> *316.1. First, the hedging-payments made under the old basis are now overpaid-payments made under the new basis, since the IRHP does not hedge interest rate reductions.*
>
> *316.2. Second, around two thirds of the hedging-receipts received under the old basis are now over-received receipts under the new basis, since the IRHP hedges less risk. And,*
>
> *316.3. Third, the premiums paid under the old basis are now underpaid premiums under the new basis, since the IRHP is around £30,000 more expensive despite hedging less risk.*
>
> *317. On this alternative basis then:*

317.1. c£1m of net payments incurred on and under the IRHP would have been pure "overpayments" arising from some unspecified malfunction of the IRHP. And,

317.2. The Excess would be:

The extent to which "A" the net payments incurred on and under the IRHP, exceeded "B" the net payments that would have been incurred on and under the IRHP, but for its malfunction.

*[the "**Alternative Basis**"]*

318. The Excess now defines a measurable and compensable quantity of payments incurred under the IRHP. Consequently, the compensation receipt can now be considered a receipt of the Appellants' business, such that the first question in Deeny is answered in the affirmative.

THE SECOND ISSUE

*319. The second question in Deeny can now be asked, viz, does the Excess possess a revenue or capital quality? [the "**Second Issue**"]. This Second Issue is now on all fours with the issue that has arisen in the authorities many times before, including in Attwooll, and Spencer.*

320. This second ground of appeal has two forms, a weak-form, and a strong-form. On the weak-form, the Appellants accept (for the sake of argument) that the individual overpayments were deductible revenue expenses. On the strong-form that premise is contested.

125. The 'strong-form' argument had the following essential features:

341. On the Strong-Form, the Respondents' premise that the "excess payments" were of revenue on an individual basis is not accepted. The premise is simple:

If payments are compensable to 100% of their value (i.e., the payments were made without any prospect of return), then they are not paid out of revenue, but out of capital.

…

343. The relevant point is simple. For the case in question, the overpaid element is not merely 95% it is 100%. The payments contain no hedging-element whatsoever. In this context, to call the payments "hedging-payments" is a clear mischaracterisation. The problem is obvious, if the overpayments are not hedging-payments, then why are they being treated as revenue?

344. In qualitative terms, the overpayments represent an outflow of wholly unproductive money, made without even the possibility of benefit or profit in return. In other words, the overpayments correspond only to the damage, or malfunctioning characteristic of the IRHP. Such payments are merely the deadweight loss of so much capital. Payments of a wholly-erroneous and unproductive character are paid out of capital, not revenue, and therefore, the compensation recovered for them is paid into capital, not revenue, for the same reason.

345. Of course, this conclusion implies that the Appellants' (unintentionally) understated their revenue profits in earlier years by (inadvertently) deducting payments of a capital nature. That mistake, however, does not concern the compensation receipt received in 2014/15, but the payments made in the

preceding 7 years. It is too late at this stage, for the Respondents to be raising new assessments into tax years where there is no new discovery.

Interest

126. Finally, turning to interest. In short Mr Bowe's argument is that the answer to whether the 8% payments is 'interest' follows the decision upon whether the basic redress is chargeable to tax. It was accepted that if there was a genuine overpayment in hedging that would create a debt.

127. But Mr Bowe says this is interest in name only. There was no debt upon which interest can accrue as required. Mr Bowe pointed out that 8% was so far above the market interest rates at the time that whatever else it was, it couldn't be 'interest' properly called.

THE LAW

128. We will begin with the issuing of CNs.

129. We will then consider the statutory framework for chargeability to income tax on profits (including deductions for expenses) followed by the relevant authorities before drawing the threads together.

130. Considering the criticisms made by Mr Bowe of Wilkinson we will do so by reference to binding authority before returning to it although it is right to point out that Mr Bowe, when the Tribunal asked him directly whether paragraph 21 of Wilkinson reflected his position before us, agreed that it did. That says:

> *21. Both parties are agreed that, if the Basic Redress Element was paid as compensation to the Appellant for expenditure which the Appellant deducted in calculating the profits of his property rental trade, then the Basic Redress Element is subject to income tax in the hands of the Appellant. In contrast, if the Basic Redress Element was paid as compensation for something other than expenditure which the Appellant deducted in calculating the profits of his property rental trade – for example, as compensation for a decline in the value of a capital asset or, specifically in this case, a failure to obtain a capital asset which the Appellant would have received if the mis-selling had not occurred – then the Basic Redress Element was capital in nature and is not subject to income tax in the hands of the Appellant.*

131. We note 'something other than expenditure' appears to be said to be principally the opportunity cost of investing in the simple caps, with the capital position the secondary argument as we have set out above at paragraphs [124 – 125].

1. Closure Notices

132. The CNs were issued under section 28A TMA. That states (in pertinent part):

> *(1) An enquiry under section 9A (1) or 12ZM of this Act is completed when an officer of the Board by notice (a "closure notice") informs the taxpayer that he has completed his enquiries and states his conclusions. In this section "the taxpayer" means the person to whom notice of enquiry was given.*
>
> *(2) A closure notice must either–*
>
> *(a) state that in the officer's opinion no amendment of the return is required, or*
>
> *(b) make the amendments of the return required to give effect to his conclusions.*
>
> *(3) A closure notice takes effect when it is issued.*

133. By section 31 TMA a taxpayer has a right of appeal to the Tribunal.

134. Here there was no challenge to the validity of the raising of the CNs. They were in time, and stated the amendment required to the ITSAs. We say no more about the process as the real challenge by the Hacketts is to the amount of the CNs, said to be excessive, and requesting the Tribunal reduce the amount in them to £NIL (by section 50 (7A) TMA). HMRC ask we dismissal the appeal. In that case the CNs 'would stand good'.

135. As we have said, once HMRC have shown the CNs were validly raised (as they have and we repeat there is no challenge in relation to their validity), it is for the Hacketts to show on the balance of probabilities that the CNs are excessive in amount.

2. The statutory framework for chargeability to income tax - The Income Tax (Trading and Other Income) Act 2005 ('ITTOIA')

136. We begin with section 268 ITTOIA. That states:

> ***268 Charge to tax on profits of a property business***
>
> *Income tax is charged on the profits of a property business.*

137. Section 271 states:

> ***271 Person liable***
>
> *The person liable for any tax charged under this Chapter is the person receiving or entitled to the profits.*

138. Section 272 states:

> ***272 Profits of a property business: application of trading income rules***
>
> *(1) The profits of a property business are calculated in the same way as the profits of a trade.*
>
> *(2) But the provisions of Part 2 (trading income) which apply as a result of subsection (1) are limited to the following–*

139. Subsection (2) includes within the table that follows: section 34.

140. Section 34 is headed: ***Expenses not wholly and exclusively for trade and unconnected losses***. That states:

> (1) *In calculating the profits of a trade, no deduction is allowed for–*
>
> *(a) expenses not incurred wholly and exclusively for the purposes of the trade, or*
>
> *(b) losses not connected with or arising out of the trade.*
>
> *(2) If an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade.*

141. Put the other way, deduction against profits (in whole or in part) is only allowed where expenses were incurred wholly and exclusively for the purposes of the trade.

142. Thus section 34 is applicable to section 268 as section 272 (1) requires the profits of a property business to be calculated in the same way as a trade and section 272 (2) lists section 34 as applying to that purpose.

143. As we set out at paragraph [130] above, Mr Bowe helpfully agreed with the proposition that *if* the basic redress was paid as compensation to the Hacketts for expenditure which the Hacketts deducted in calculating the profits of their property rental trade, then the basic redress is chargeable to income tax in their hands.

144. In relation to interest ITTOIA is clear. In the section headed ***Charge to tax on interest*** section 369 (1) states simply:

> *Income tax is charged on interest.*

145. Sections 370 and 371 respectively provide that tax is charged on the full amount of interest arising in the tax year and, in a mirror provision to section 271, that the person liable to pay tax is the person receiving or entitled to the interest.

3. The authorities

146. Before dealing with the authorities, we wish to respectfully repeat what Lord Hoffman said in Deeny and others v Gooda Walker Ltd (in voluntary liquidation) and others (Inland Revenue Commissioners third party) and related appeals [1996] 1 STC 299 at page 308J when he was considering part of what Diplock LJ had to say in London & Thames Haven Oil Wharves Ltd v Attwooll [1967] Ch 772. Lord Hoffman said:

> *I think that Diplock LJ can safely be credited with having known that the duty of the court is to apply the language of the statute and not to add its own glosses or addenda.*

147. It is not necessary to refer to all the authorities put before us. Those we do we deal with from earliest in time (dealing with the receipt of principal sums (a neutral term denoting neither income nor capital prior to evaluation) and then those cases dealing with what is termed interest)

3a. The receipt of principal sums

148. In Glenboig Union Fireclay Co. v Inland Revenue 1922 S.C. (H.L.) 112 ('Glenboig') the Judicial Committee of the House of Lords held that compensation was not profits within the meaning of the Finance (No. 2) Act, 1915, in that it was paid to the Company as the consideration for a capital asset which had been rendered unavailable for the purposes of its business where a railway company, so it could extend, insisted the fireclay company cease working for the period of the interdiction. In that case as Lord Buckmaster stated:

> *... the capital asset of the Company to that extent has been sterilised and destroyed, and it is in respect of that action that the sum of 15,316 was paid.*

149. Lord Wrenbury stated in similar terms:

> *Is a sum profit which is paid to an owner of property on the terms that he shall not use his property so as to make a profit? The answer must be in the negative. The whole point is that he is not to make a profit and is paid for abstaining from seeking to make a profit. The matter may be regarded from another point of view. The right ta work the area in which the working was to be abandoned was part of the capital asset consisting of the right to work the whole area demised. Had the abandonment extended to the whole area, all subsequent profit by working would of course have been impossible; but it would be impossible to contend that the compensation would be other than capital. It was the price paid for sterilising the asset from which otherwise profit might have been obtained.*

150. In Higgs (Inspector of Taxes) v Olivier [1952] Ch 311 ('Oliver') the Court of Appeal held, in what Lord Evershed MR concluded was *one which is related to, and related only, to the rather unusual facts of this rather unusual case* (pages 315-316) that Sir Laurence Olivier

when he accepted £15,000 *not* to act in or direct any film anywhere except for the company paying the consideration had not received income and it was not taxable as such.

151. In Crabb (Inspector of Taxes) v Blue Star Line Limited [1961] 2 ALL ER 424 ('Blue Star') Buckley J held that sums received under policies of insurance were of a capital nature and should not be considered for the purposes of computing income tax. It had been found as a fact that Blue Star frequently entered ship-building contracts under which the purchase price was to be increased in the event of delivery before the due date and reduced in the event of delay. Buckley J ruled that the policies are really associated with the price which the taxpayers felt justified in paying the ship-builders (page 429C-D).

152. In London & Thames Haven Oil Wharves Ltd v Attwooll [1967] Ch 772 (Attwooll) Willmer LJ gave his judgment in a case where damages had been recovered for a collision with the respondent's jetty. The appeal was allowed from the decision of the High Court. In it he said (at page 803F-G; 804A):

> *The final result of it all was as follows. The respondents recovered in full the physical damage to their jetty, amounting to £83,167. They recovered by way of contribution towards their consequential loss the sum of £21,404, and they also recovered the sum of £2,325 by way of interest, making a grand total of £106,897. The question is whether that sum of £21,404 recovered from the tanker-owners in part satisfaction of the claim for loss of use is taxable as a trading receipt in the hands of the taxpayer company.*
>
> *... But it does seem to me that the question which we have to decide is eminently a question of fact, which depends on the answer to the question: What did the sum of £21,404 represent? To adopt a phrase used in one of the authorities to which we have been referred, what place in the economy of the taxpayers' business does this payment take?*

153. He continued (at page 804E-F):

> *If there had been no collision, the profits which the taxpayer company would have earned by the use of the jetty would plainly have been taxable as a trading receipt. Why, it may be asked, should not the same apply to the sum of money recovered from the wrongdoer in partial replacement of those profits?*

154. Willmer LJ went further (at page 806G; 806A-B):

> *I repeat, therefore, the question which I asked before: Why should not damages recovered under this head be regarded as a trading receipt, in that they represent the trading profit which the owner would have earned if he had had the use of his ship, or of his jetty? If that is not a correct view of the law, then I would venture to say that there is something very much wrong with the law, for the consequence would be that a jetty-owner, such as the taxpayer company, would be better off by being subjected to a casualty of this sort (that is, by losing the use his jetty and recovering damages therefor) than he would be if he were able to make use of it continuously for the purpose of making profits. That it seems to me would be a very strange result indeed.*

155. Diplock LJ concurred. He said (at page 815D-816A-D):

> *I start by formulating what I believe to be the relevant rule. Where, pursuant to a legal right, a trader receives from another person compensation for the trader's failure to receive a sum of money which, if it had been received, would have been credited to the amount of profits (if any) arising in any year from the trade carried on by him at the time when the compensation is so received, the compensation is to be treated for*

income tax purposes in the same way as that sum of money would have been treated if it had been received, instead of the compensation.

The rule is applicable whatever the source of the legal right of the trader to recover the compensation. It may arise from a primary obligation under a contract, such as a contract of insurance, from a secondary obligation arising out of non- performance of a contract, such as a right to damages, either liquidated, as under the demurrage clause in a charterparty, or unliquidated, from an obligation to pay damages for tort, as in the present case, from a statutory obligation, or in any other way in which legal obligations arise.

But the source of a legal right is relevant to the first problem involved in the application of the rule to the particular case, namely, to identify what the compensation was paid for. If the solution to the first problem is that the compensation was paid for the failure of the trader to receive a sum of money, the second what I shall call for brevity an income receipt of that trade. The source of the legal right to the compensation is irrelevant to the second problem.

The method by which the compensation has been assessed in the particular case does not identify what it was paid for; it is no more than a factor which may assist in the solution of the problem of identification.

…

In the present case the source of the legal right of the respondent trader was his right to recover from the owners of the tanker damages for the loss caused to him by the negligent navigation of the tanker. Damages for negligence are compensatory. His right was to recover by way of damages a sum of money which would place him, so far as money could do so, in the same position as he would have been in if the negligent act had not taken place.

156. In Donald Fisher (Ealing) Limited v Spencer (Inspector of Taxes) [1989] STC 256 (Spencer) the Court of Appeal dismissed an appeal about the nature of the compensation agreeing with the decisions before it that it was revenue in character not capital in nature. Here due to negligence, a counter-notice had not been served meaning that Spencer incurred increased rental payments beyond what they should have been had the negligence not occurred. Kerr LJ giving the substantive judgment said (page 261J):

So if one asks oneself: what was the nature of the loss for which the compensation was paid – what was it paid for; what was its purpose? – it seems to me obviously paid for the increased rent which the taxpayer company had to pay as a result of the negligence. That was the basis of the tenant's claim against Mr Clay, and the payment was made to settle that claim. The predominant feature or characterisation of this payment and its purpose follow from these considerations.

157. In Deeny and others v Gooda Walker Ltd (in voluntary liquidation) and others (Inland Revenue Commissioners third party) and related appeals [1996] 1 STC 299 ('Deeny') Lord Hoffman gave the opinion of the House of Lords. In a passage that was agreed to by the rest of the Judicial Committee he said (at page 308E):

Although Diplock LJ refers to the trader's failure to receive a sum of money which would have been a revenue receipt, his principle must apply equally to compensation for his liability to pay a sum of money which was a revenue receipt (see Donald Fisher (Ealing) Limited v Spencer (Inspector of Taxes) [1989] STC 256).

158. In John Lewis Properties PLC v Inland Revenue Commissioners [2003] STC 117 (John Lewis) the Court of Appeal (by majority) upheld previous decisions that the monies representing future rent in the circumstances of the case were capital in nature. They emphasised that whether a payment was to be regarded as capital or income nature depended much upon the nature of the transaction in issue and the matrix in which it was set.

159. Lord Dyson MR, writing as part of the majority said (at page 143 at paragraph 80):

> *I would identify the following in a case such as the present as being relevant to the question of whether a payment is capital or income. I emphasise 'such as the present' because the guidance derived from dealing with one situation may have little application to a wholly different situation.*

160. He addressed 'compensation cases' addressing Arden LJ's dissenting judgment.

161. Arden LJ, in that dissenting judgment, said in relation to 'compensation cases' (at page 130 paragraph 40):

> *The compensation cases are all part of a piece with the other cases I have cited. The theme in all those cases is that the nature of the asset, from which the payment in issue is derived, has a strong influence on the characterisation of that payment as income or capital.*

162. Lord Dyson MR said (at page 146 at paragraph 95):

> *Arden LJ is of the opinion that the source or the nature of the asset from which payment is derived has a strong influence on the characterisation of that payment as income or capital ... Reliance is placed upon the compensation cases to illustrate this principle. The compensation cases show that were A receives a payment from B to compensate him for a loss of income, then the payment is to be treated as income ... Where A receives compensation for loss of income, the payment is a true substitute for, and therefore equivalent to, income. It fills a whole in his income.*

163. Schiemann LJ agreed with Lord Dyson MR and did not address the issue of 'compensation cases' directly.

3b. The receipt of interest

164. Turning to interest we do not wish to make this judgment any longer than it is by recitation of the facts. In Riches v Westminster Bank Ltd [1947] AC 390 ('Riches') Viscount Simon said (at pages 396-397:

> *The appellant contends that the additional sum of 10,028l., though awarded under a power to add interest to the amount of the debt, and though called interest in the judgment, is not really interest such as attracts income tax, but is damages. The short answer to this is that there is no essential incompatibility between the two conceptions. The real question, for the purpose of deciding whether the Income Tax Acts apply, is whether the added sum is capital or income, not whether the sum is damages or interest. Before the coming into force of the Act of 1934, the rule at comon (sic) law prevailed that when an action for the payment of a debt succeeded the court could not add interest on the debt down to judgment unless interest was payable as of right under a contract expressed or implied. Provisoes (b) and (c) of s. 3 show that these exceptions were not touched by the Act of 1934 and the discretion conferred on the court by the enacting words is a direction to add interest when judgment is given for a debt or damages, although there is no contractual right to interest. The added amount may be regarded as given to meet the injury suffered through not getting payment of the lump sum promptly, but that does not alter the fact*

that what is added is interest. This is the view taken by Evershed J., and by the Court of Appeal (du Parcq, and Morton L.JJ. and Cohen J.). Notwithstanding Mr. Grant's excellent argument, this view, in my opinion, is correct.

165. In Re Euro Hotels (Belgravia) Limited [1975] STC 682 ('Euro Hotels') Megarry J (pages 690F – 691E) said:

> *In Bennett v Ogsten (1930) 15 Tax Case 374 at 379 ... Rowlatt J said that 'interest' was 'payment by time for use of money'.*
>
> ...
>
> *It seems to me that running through the cases there is the concept that as a general rule two requirements must be satisfied for a payment to amount to interest, and a fortiori to amount to 'interest of money'. First, there must be a sum of money by reference to which the payment which is said to be interest is to be ascertained. A payment cannot be 'interest of money' unless there is the requisite 'money' for the payment to be said to be 'interest of'. Plainly, there are sums of 'money' in the present case. Second, those sums of money must be sums that are due to the person entitled to the alleged interest; and it is this latter requirement that is mainly in issue before me.*

166. Finally in Chevron Petroleum (UK) Ltd and others v BP Petroleum Development Ltd and others [1981] STC 689 ('Chevron') Sir Robert Megarry, V-C re-emphasised what he had recorded in Euro Hotels (page 697C):

> *I certainly do not think it is essential to the nature of 'interest' that it should be a form of punishment for wrongdoing or a failure to perform an obligation; it suffices that it is a compensation by time for the use of money ...*

167. It does not matter that the total of the principal upon which interest will fall due is not known at the time it falls due (page 696H).

168. Having set out the relevant authorities as cited to us; we turn to draw the threads together.

4. Drawing the threads together

4a. Chargeability to income tax or not?

169. We have taken account of the arguments of the parties set out above, but in the end, there did not really appear to be much in the way of a dispute as to what the principles were, as opposed to how they should be applied.

170. Drawing the threads together from ITTOIA and the authorities in our judgment the principles to be applied as follows in the context of compensation paid for mis-sold IRHPs:

(1) There is to be no gloss or addenda on the words of the statute (Deeny),

(2) Guidance given in one situation may have little application to another situation (John Lewis),

(3) In order to characterise a payment, first identify what the compensation was paid for ('the first problem') (Attwooll),

(4) In doing so, the source of the legal right to compensation is only relevant to that question (Attwooll),

(5) The method of calculating the compensation is no more than a factor which may assist answering that question (Attwooll),

(6) Having identified what the compensation was paid for, decide whether the money in respect of which the sum has been paid would have been taxable as an income receipt had it been received ('the second problem') (Attwooll),

(7) In doing so, the nature of the asset, from which the payment in issue is derived, has a strong influence on the characterisation of that payment. Where a person receives compensation for loss of income, the payment is a true substitute for, and therefore equivalent to, income (John Lewis),

(8) The same is true where a person receives compensation for an expense, which has been incurred as a deductible expense from the profits arising out of a property business, it is chargeable to income tax (Attwooll, Deeny, Spencer).

171. These are the principles we will apply to the facts we have found. In our judgment cases such as Olivier and Blue Star are prime examples of how the individual facts of a case might lead to a result. They add nothing to the principles.

4b. Interest

172. As to whether the 'interest' payments are 'interest' for the purposes of section 369 ITTOIA the principles are:

(1) First, there must be a sum of money by reference to which the payment which is said to be interest is to be ascertained (Euro Hotels),

(2) Secondly, those sums of money must be sums that are due to the person entitled to the 'interest' (Euro Hotels),

(3) Thirdly, there is no impediment to aggregating the principal sum and 'interest'. The former does not in law subsume the latter to make it any less 'interest' (Riches)

(4) Fourthly, it must be a compensation by time for use of money (Chevron).

5. Wilkinson – Redux 1

173. We have, independently of Wilkinson, set out our analysis of the law. However, having drawn the threads together above we find ourselves in general agreement with Judge Beare in Wilkinson as set out in his at paragraphs [22 to 31] and [60].

DISCUSSION AND ANALYSIS

174. As we stated there was little agreement as the facts and the law. As a result, this judgment is overall considerably longer than it needed to be.

Basic Redress

175. We have set out the rival submissions at some length. In doing so, we are able to answer the questions before us with relative brevity. We turn to the application of the eight principles set out in paragraph [170] above.

176. We remind ourselves we are not to gloss or add to the terms of ITTOIA. There is no guidance from the Upper Tribunal or beyond in this context. This is only the third time the tax treatment of payments such as these has reached us.

177. We must therefore answer Diplock LJ's 'first and second problems'.

178. Turning to the first, what was the compensation therefore paid for? We are in no doubt it was compensation for business expenditure that the Hacketts would not have otherwise incurred but for entering into the mis-sold IRHPs. It must be recalled that these IRHPs were entered into as a part of the property rental business. That this quantum of compensation included a deduction for the costs that would have been incurred on entering an alternative

product was entirely in line with the scheme that the FCA set up and enforced upon those who mis-sold in the first place.

179. The source of the legal right was derived from the FCA scheme to compensate those who had been mis-sold IRHPs something relevant to the answer to the first problem. The Hacketts and others had made significant payments for those products. The scheme of compensation predicated that the offended party would have bought an alternative product which they would have deducted the costs against tax. The method of calculation in terms of options 1 to 3 (and here FCA option 2) assists in answering the question, as the nuance of considering alternative products provided a methodology to cater for individual circumstances as found, such as the Hacketts.

180. A simple reminder of the terms of the FCA scheme makes this clear:

> *Fair and reasonable redress means putting the customer back in the position they would have been in had the regulatory failings not occurred, including any consequential loss.*
>
> *What is fair and reasonable redress will vary from case to case and will be determined by a review of evidence and customer testimony. All redress offers will be scrutinised and approved by an independent reviewer.*
>
> *How the banks agreed to calculate redress under the review:*
>
> *Basic redress* — *The difference between actual payments made on the Interest Rate Hedging Product and those that the customer would have made if the breaches of relevant regulatory requirements had not occurred.*
>
> *Interest* — *The opportunity cost (loss of profits or interest) of being deprived of the money awarded as basic redress.*
>
> *The banks will either pay 8% a year of simple interest, or an interest level in line with:*
>
> > *1. an identifiable cost that the customer incurred as a result of having to borrow money; or*
> >
> > *2. an identifiable interest rate that a customer has not earned as a result of having less money in the bank.*
>
> *Taking into account the economic environment over the last five years, interest will avoid many customers from having to put together consequential loss claims.* (emphasis added).

181. It also means that taxpayers like the Hacketts were not put in a *better* position but for the mis-selling by reference to the product they would have bought (as set out in the FCA's compensation scheme). The Hacketts, as we found above, have not displaced their burden in relation to the amount of the CNs as there is no evidence upon which the Tribunal can discount the banks findings.

182. We reject Mr Bowe's attempts to apply economic, philosophical, mathematical, semantic, logic based and linguistic theory at the expense of the law. Those tools may be valuable in certain circumstances, but not where the arguments obfuscate the facts of the case and the task of the Tribunal. Mr Bowe's submissions start off on a wrong footing and continue in that vein.

183. Contrary to what Mr Bowe said HMRC had not contradicted themselves on their position. This was predicated on Mr Bowe's case being correct that the value of the hedging loss was £NIL (see paragraph [106] above). It is not. The value of the hedging payments was just short of £1m which arose from mis-selling of the IRHPs. What *might* have occurred had

rates gone up and not down is nothing to the point. The compensation was paid for what occurred tempered by the banks assessment that the Hacketts would have entered into alternative products. The existence of three options simply allowed the banks to offer fact specific compensation at levels appropriate to the victim of the mis-selling they were dealing with.

184. The basic redress was paid to put the Hacketts back in the position they would have been in but for the mis-selling in relation to their property rental business. We reject the submission at paragraph [123] above, that the receipt was not a part of the property rental business. The fact they could have used the money for other things is nothing to the point. The issue is what the compensation was for. And the answer to that is in our judgment clear.

185. Issues such as 'category errors' and further concepts relied upon by the Hacketts do not detract from that finding. Nothing in the submissions, that we have set out at length and referred to, made by Mr Bowe counter's HMRC simple proposition, based upon the facts, and applying the law, that the compensation was paid for the reasons the FCA set out. No more and no less.

186. The compensation was paid for the reasons we have given. Not for the opportunity cost of not being able to purchase the simple caps.

187. We must then turn to Diplock LJ's second problem, which brings Mr Bowe's alternative submission as to the capital nature of the money into play.

188. Turning to the second problem we are again in no doubt as to the answer. Had the money been received it would have been income in the Hacketts' hands and chargeable to income tax. This can be tested by reference to the deductions against profits that the Hacketts properly took on their ITSAs for the sums paid pursuant to the mis-sold IRHPs.

189. Any argument to the contrary would result in the Hacketts receiving tax relief for the sums paid toward the mis-sold IRHPs but not being subject to any tax for sums received back to compensate them for the very same expenditures being made in the first place.

190. That of course can be an outcome under tax legislation. And if it is, it must be respected. However, for the reasons we have given in this case it is not.

191. Mr Bowe's argument is that (assuming for these purposes we have entered the 'alternative basis') the 'strong form' is to be preferred over the 'weak form' (which he accepts would result in payments that were income derived and therefore taxable). As we understand the argument, because the overpayments being returned are 100% of those payments rather than 95% they themselves containing no hedging payments. On that basis they were made out of capital not revenue. As a result, their return should be categorised in the same way.

192. As a matter of fact, in this case there were deductions to take account of the costs of the alternative products (and HMRC's calculations leave the proper deductibility of the value of those notional amounts intact). But the argument conflates the hedging nature of the payments as a whole with any requirement to sub divide an overpayment being returned containing a sub hedge. In our judgment no such sub-division is required.

193. Even if we were wrong about that, the argument fails because of the original deduction against tax of the sums paid toward the mis-sold IRHP.

194. The compensation was revenue in nature not capital. As a result of the provisions of ITTIOA it is chargeable to income tax.

Interest

195. Turning to interest we are not seduced by the phrase *opportunity cost* used by the FCA in their scheme (see paragraph [49] above). That part must be read as a whole. The interest of 8% was an agreed rate designed to prevent many from submitting consequential loss claims. As noted the Hacketts have both received the interest and put in a consequential loss claim as they were entitled to do.

196. We can deal with this briefly as Mr Bowe did not concentrate on this aspect accepting in large part it would follow from our findings on the basic redress if we were against him.

197. Applying the principles set out in paragraph [172] above, first, there was a sum of money by which the 'interest' is calculated – the basic redress. Secondly, they were due to the Hacketts (about which there was no dispute). Thirdly, the fact they are added together makes no difference. Fourthly, they were compensation by time for use of money. The terms of the FCA scheme applied by the bank (see paragraph [49] above) make that clear. The election of 8% is a default and base line which is capable of change if evidence is adduced. That does not change the nature of the 8% interest, which the Hacketts accepted.

198. For those reasons in our judgment the interest by section 369 ITTOIA is interest that is chargeable to income tax.

Wilkinson - Redux 2

199. We have refrained from simply applying Wilkinson. As a reading of that case and this will show the arguments were not identical. In particular Mr Bowe appears to have refined the argument on opportunity cost in the instant case and added a separate ground relating to capital. In Wilkinson they appeared to be part and parcel of the same argument (see paragraph [130] above).

200. However, for reasons which are similar to those of Judge Beare our decision is consistent with his. If fortification were required (which it is not) Judge Beare's decision provides it.

CONCLUSION

201. For the reasons given above the appeals are dismissed and the CNs in relation to the Hacketts stand good.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

202. 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.

NATHANIEL RUDOLF KC
TRIBUNAL JUDGE

Release date: 15th AUGUST 2024