[2013] UKFTT 189 (TC)

TC02604

Appeal number: TC/2011/4624

INCOME TAX – relevant discounted securities the terms of which resulted in very substantial diminution in value 15 days after issue –* Mayes, Astell, Berry, Campbell *and* Audley *considered – whether the amount paid was the value of the RDS after 14 days – yes – whether the taxpayer acquired the RDS when it was always intended to give them to a trust – no – whether the anti-avoidance provisions of paragraph 9A applied – no – appeal dismissed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

GEORGE REX BRETTEN QC	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Respondents**

TRIBUNAL: JUDGE BARBARA MOSEDALE

Sitting in public at Bedford Square, London on 14-15 January 2013

G R Bretten QC in person

P Jones QC and A Nathan, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. Mr Bretten appeals against an HMRC amendment made to his self assessment tax return for the year 2002/03. The amendment was made when HMRC closed an enquiry into his tax return for that year on 31 May 2011. The effect of the amendment was to increase Mr Bretten's charge to income tax by denying him the claimed loss of £475,000.

Facts

The evidence

2. Apart from the documentary evidence, witness evidence was given by Mr Bretten.

3. I find as follows:

The Transactions

4. On 18 February 2003 Mr Bretten established two UK-resident trusts, which were referred to in the hearing and to which I will refer to in this decision notice, as Trust 1 and Trust 2. Mr Bretten established each of them with a nominal trust fund of £10.

5. <u>Trust 1:</u> the trustees of Trust 1 were the appellant and the appellant's daughter, Mrs S Cox. Mr Bretten was the life tenant of this trust with the remainder held for the Mr Bretten's children with charities as the ultimate default beneficiary.

6. <u>Trust 2:</u> the trustees of Trust 2 were the appellant and his daughter's husband, Mr A Cox. Mrs S Cox was the life tenant of this trust, and the remainder was held for Mrs Cox' children with charities as the ultimate default beneficiary.

7. Oakcrown Consultants Limited ("OCL") was a company established in 2002 and owned by the partners of a firm of accountants. It was not connected to Mr Bretten.

8. <u>The call option:</u> It was a condition precedent to Mr Bretten's subscription for the loan notes mentioned below that OCL first granted a call option to Trust 1 which would allow Trust 1 to be substituted as debtor (or obligor) in place of OCL for an amount equal to the redemption price of the loan notes mentioned below. That option was granted by OCL to Trust 1 on 24 February 2003.

9. On the same day, OCL issued six loan notes at face value to the Bretten in return for £500,000. (Four of the loan notes were for £100,000 and two for £50,000).

10. The loan notes: the terms of the six loan notes were identical. They would mature on 30 April 2043 (a term of 40 years). They carried a maturity premium of 25% and an interest rate of 0.25% per annum payable on 31 December each year.

11. Significantly for this appeal they carried the right of early redemption:

> (a) On written notice given before the 10th day after issue they were redeemable at the noteholder's option for 100% of the issue price;
>
> (b) On written notice given *after* the 9th day of issue but *before* the 15th day of issue they could be redeemed at the noteholder's option for 99.9% of the issue price (£499,500);
>
> (c) On written notice given *after* the 14th day following issue but before the expiry of the first year after issue, they were redeemable at the noteholder's option for 5% of the issue price (in total £25,000).

12. For the first 90 days after issue the loan notes were secured by a charge over OCL's money deposits or other investments. In reality, this security was only in place until the call option was exercised (when OCL would cease to be the issuer) and it was always intended that the call option would be exercised during the first 14 days (as indeed it was).

13. The loan notes were (save for the first 7 days after issue) freely transferable. And the issuer had the power to substitute any company listed in the FTSE 250 or any person connected with the noteholder.

14. Clause 5 of the loan notes provided for automatic redemption at issue price of the loan notes if the FTSE 100 index exceeded 4000. Mr Bretten said he placed no reliance on this clause. He agreed that it was inserted to make the loan notes more robust from a tax avoidance point of view by inserting a genuine if remote uncertainty.

15. Exercise of call option: on 5th March 2003 the trustess of Trust 1 (Mr Bretten and Mrs Cox) gave notice to OCL that they were exercising the call option granted to them on 24 February 2003. On that same date OCL and the trustees of Trust 1 entered into an agreement the effect of which was to substitute the trustees as the issuer of the loan notes and discharge OCL from liability on them: and in accordance with this agreement OCL paid £499,500 to the trustees.

16. We note for the sake of completeness but it has no bearing on the case that £499,500 was thought to be the redemption value of the loan notes but the parties made a slight miscalculation. March 5th was the 9th and not 10th day after issue of the loan notes so the redemption price was actually £500,000. Technically OCL still owes Trust 1 £500 but this had not been demanded or paid.

17. Gift of loan notes: on the same day, Mr Bretten gifted the loan notes to Trust 2. The end result was that Trust 1 had £499,500 in cash but liability on the loan notes: Trust 2 became the noteholder. It did not exercise its right to redeem the loan notes, and that right has now of course expired with the passage of time.

18. As at the date of the hearing, some 10 years later, the position was unchanged: Trust 1 had retained the £499,500 and liability on the loan notes. Trust 2 remained possessed of the loan notes.

19. Valuation of loan notes: no formal valuation of the loan notes was produced in evidence but the parties were agreed that as at the date of issue the loan notes' value was approximately their face or issue value. This was because for effectively the first 14 days of issue they carried the right of redemption at issue price (or in the last 5 days, issue price less £500).

20. There was a dispute about the *market value* of the RDS at the moment of issue for the purposes of Schedule 13 (see paragraph 53 below). Mr Bretten conceded, and I find, that the market value of the RDS at the moment of issue was *less* than the face value because a willing purchaser could redeem them for no more than £500,000 and therefore, were they to purchase them, would expect to pay less than this in order to make a small profit and cover their costs.

21. The parties were also agreed that the value of the loan notes after the first 14 days of issue was no more than (in total) £25,000. This was because for the first year (after the initial 15 days) the loan notes could be redeemed at 5% of face value which was (in total) £25,000. Both parties were also agreed that thereafter (in so far as relevant to the appeal) the value of the loan notes on the open market would be even lower: they could not be redeemed until 2043 and, as they were no longer secured, it was unlikely a third party would pay very much at all for all such a distant and uncertain return.

Planned transactions and motive

22. It was not in dispute that these transactions were intended although not bound to happen.

23. These transactions were not circular. The end result was that Mr Bretten had half a million pounds less in capital than he started with: although this may well have made little practical difference to him as he was the life tenant of the trust in which that half million pounds (minus what was seen as a transaction fee of £500) ended up vested. What he had done was swopped absolute entitlement to £500,000 to entitlement only to the income from that sum of money.

24. So far as inheritance tax was concerned, Mr Bretten was satisfied that these arrangements gave rise to no liability (as he was the life tenant of trust 1) and HMRC do not suggest otherwise.

25. His reason for putting half a million of his assets into a trust was not tax avoidance. Rather it was to avoid potential creditors. Mr Bretten was a "name" at Lloyds and at the time of these transactions there was a perception that he (and many other Names) were at risk of large future liabilities. I do not need to consider whether putting assets into a trust in this manner would be successful in its creditor-avoidance objective: I find that this was the ultimate objective, whether or not it succeeded.

26. The *method* of transferring the assets to the trust (using loan notes issued by OCL) I find, as Mr Bretten stated, was planned and intended to be tax efficient. In particular, it was intended to generate a loss of £475,000 for Mr Bretten. (The intended loss was £475,000 because it was the issue price of the loan notes at £500,000 less the £25,000 which the parties agreed was their market value as at the date of their transfer by Mr Bretten to Trust 2).

27. Mr Bretten agreed that if asset protection had been his only concern he would have transferred the £500,000 direct to Trust 1 or even given it to his wife, as indeed he transferred a number of assets to his wife at this time. The loan notes transactions were undertaken solely for tax avoidance reasons.

28. He also agreed that there were features of the loan notes that were inserted solely to bolster the tax planning. In particular, it was his evidence he would have been content had there been one loan note issued for £500,000 but he went along with the suggestion of Mr Harris (a partner in the firm of accountants which owned OCL) of having 4 loan notes at £100,000 and 2 at £50,000. Mr Bretten referred to clause 5 as a "built-in anti-*Ramsay* device". The idea was to build in an element of randomness so that the courts could not say the transactions was pre-ordained. Again, this clause was Mr Harris's suggestion, and one in which Mr Bretten says he did not have confidence, but he thought it did no harm. In the event, of course, Mr Brettten does not rely on it in any way to support his case.

29. The loan notes carried interest solely because it was perceived as important to make them look commercial. A low rate of interest was selected to avoid a material income tax liability. There was no particular reason why a 40 year term was selected: other than that it was necessary for the term to be long so that the valuation at date of transfer should be negligible, the term was irrelevant to Mr Bretten.

OCL's involvement

30. It was agreed that OCL was owned and controlled by a third party. It was Mr Bretten's evidence that the firm of accountants who owned and controlled OCL understood the tax planning and indeed agreed to the participation by OCL on the understanding that they would in effect get a fee of £500 (by the option being exercised after day 9) to cover their costs plus have the right to replicate the planning for their clients.

31. Mr Bretten agreed that OCL did not require a loan of £500,000 and OCL's involvement with the loan and loan notes was and was always intended to be short lived. I find its involvement was solely to facilitate the tax planning. It had no other purpose.

32. Mr Bretten agreed he would not have loaned £500,000 to OCL were it not for the security provided by OCL and its grant of the call option to Trust 1. In other words, OCL's involvement was virtually risk free to Mr Bretten. The cash given to OCL was secured by a charge over the money and could not therefore be spent or lost

by OCL and Mr Bretten could in any event cause Trust 1 to exercise its option to call for the money and substitute itself for OCL as the debtor under the loan notes.

33. I find OCL's grant of the call option and its issue of the loan notes was done solely to facilitate Mr Bretten's tax avoidance scheme.

34. Mr Bretten agreed that he could have done the same planning scheme and cut out OCL entirely by using a trust. He did not do this because he had concerns that the grant of the loan notes needed to be issued by a corporate body and not a trust. He said (and I accept) that he did not choose OCL because he was concerned about the application of paragraph 9A of Schedule 13 (an anti-avoidance provision discussed below): he did not think paragraph 9A would apply in any event because in his view the RDS would be issued at full value.

35. However, the tenor of his evidence was, and indeed he had already accepted in a letter to HMRC, that the arrangements that were implemented would not have been chosen by him as the most convenient way of sheltering his assets. So I find that the incorporation of OCL into the scheme was solely in order to facilitate the tax avoidance.

The 14 day redemption rights

36. As outlined above, for the first 14 days that loan notes existed, Mr Bretten (or Trust 2 after the notes were donated to it on day 9) had the right to redeem the loan notes for face value or (day 10 to day 14) for face value less £500.

37. HMRC's case was that this redemption right was inserted solely for tax avoidance reasons. It was there so that market value of the securities would be virtually their issue price for the first 14 days of their existence so that it would not be possible to say that they were granted at an undervalue.

38. Mr Bretten's evidence was that there was a dual motive to the 14 day redemption rights. He accepted that he saw it as necessary to establish that the loan notes were worth what he paid for them but he said he also saw it as a cooling off period. His evidence was that he had concerns about (a) whether he as a tax barrister should enter into a tax avoidance scheme and (b) whether the scheme would be countered in the impending budget. He also said that it was vital to him that, for the time that OCL, a third party, was involved, his £500,000 was protected. He could, in effect, call for it to be repaid and that right was protected by security.

39. I find that the main purpose of the 14 day redemption clause was tax avoidance and in particular to establish that the loan notes were issued at full value. The scheme was pre-planned and the dramatic drop in value from £499,500 to £25,000 on day 15 was engineered on the face of the documents. If this had not been built-in as it was, Mr Bretten would not have been able to claim that they were issued at full value.

40. And while I find Mr Bretten was genuinely concerned about whether he ought to enter into this tax planning at all, and that it suited his concerns also to have a

cooling off period, these concerns were not the main reason for the 14 day right of redemption at full value. Because, had these concerns been the primary motivating factor behind those clauses of the document, he could have protected them more easily by simply delaying entering into the transactions. He could have waited until he was happy the time was right. Alternatively, and as he was well aware, he could have implemented the planning without an opt out as he always had the opt out of simply not claiming the relief in his tax returns. So gaining an opt out was not Mr Bretten's main purpose in including the 14 day redemption clause.

41. I accept that had the Government actually promulgated tax avoidance measures which Mr Bretten considered would catch this planning, he may have exercised this opt out. But I also find that the chance of this was quite remote. This is because while the Government were quite likely to promulgate tax avoidance legislation, the chances of it being within the 14 day "cooling off" period was less likely; and even if the Government did announce it during those 14 days, Mr Bretten may not have regarded it as impacting on his planning. Indeed, he did not (and does not) regard Schedule 9A as catching his planning scheme. And even if he had been less certain of this, he may have decided to go ahead in any event and simply not claim the tax relief (which in the event was how he did at first proceed).

42. Further, I have found that overall the only reason for OCL's incorporation into Mr Bretten's plan to divest himself of assets was to implement this plan in a tax efficient manner. The only reason for OCL's inclusion was tax avoidance; the fact that the involvement of a third party in the planning meant Mr Bretten needed to ensure the integrity of his £500,000 with the provision by OCL of security does not mean that the purpose of the 14 day redemption clause was anything other than tax planning: on the contrary, it reinforces the fact that its main purpose was tax avoidance.

43. In conclusion, the inclusion of the 14 day right of redemption had considerably more to do with Mr Bretten's desire to establish that the RDS were issued at full value than with a desire for a cooling off period. And while he did regard having a cooling off period as advantageous, Mr Bretten did not satisfy me that there was any more than a remote possibility it would be exercised.

Post-implementation

44. I find the scheme was implemented in the manner expected. Following implementation, Mr Bretten submitted his self assessment tax return for the year 02/03 *without* making a claim for the loss relief he hoped that the planning entitled him to. On 21 December 2004, however, he amended his return to claim the loss relief. This was shortly after the publication of the Tribunal decision in the case of *Campbell* (discussed below) and Mr Bretten said that he had waited for the outcome of that case before deciding whether to make the claim. The taxpayer was successful and Mr Bretten made the claim.

The legislation

45. The applicable legislation was agreed between the parties and this was the provisions (now largely repealed) on relevant discounted securities ("RDS") contained in Finance Act 1996 ("FA 96") Schedule 13 as in force at the time of the events at issue in this appeal.

Relevant discounted securities legislation

46. Paragraph 3 of that Schedule provided the definition of an RDS:

> "(1) … in this Schedule "relevant discounted security" means any security which (whenever issued) is such that, taking the security as at the time of its issue, the amount payable on redemption –
>
> (a) on maturity, or
>
> (b) in the case of a security of which there may be a redemption before maturity, on at least one of the occasions on which it may be redeemed,
>
> is or would be an amount involving a deep gain, or might be an amount which would involve a deep gain…."

47. Sub-paragraphs (3) & (4) provided the definition of a deep gain as follows:

> "(3) For the purposes of this Schedule the amount payable on redemption of a security involves a deep gain if –
>
> (a) the issue price is less than the amount so payable; and
>
> (b) the amount by which it is less represents more than the relevant percentage of the amount so payable.
>
> (4) In this paragraph "the relevant percentage", in relation to an amount payable on redemption of a security means –
>
> (a) the percentage figure equal, in a case where the period between the date of issue and the date of redemption is less than thirty years, to one half of the number of years between those dates; and
>
> (b) in any other case, 15 per cent;….."

48. The parties were agreed that the six loan notes issued in this case were relevant discounted securities ("RDS"). As can be seen from the recital of facts above, the amount payable on redemption on maturity (ie paragraph 3(1)(a)) would involve a deep gain because the amount payable was a 25% increase on its issue price which was more than the 15% increase specified by Paragraph 3(4)(b).

49. The claim to loss relief was based on paragraph 2, taken with paragraphs 4 & 8 of Schedule 13 FA 96. Paragraph 2 provided as follows:

> "**Paragraph 2**
>
> (1) Subject to the following provisions of this Schedule, where -
>
> (a) a person sustains a loss in any year of assessment from the discount on a relevant discounted security, and

(b) makes a claim for the purposes of this paragraph before the end of twelve months from the 31st January next following that year of assessment,

that person shall be entitled to relief from income tax on an amount of the claimant's income for the year equal to the amount of the loss.

(2) For the purposes of this Schedule a person sustains a loss from the discount on a relevant discounted security where -

(a) he transfers such a security ….; and

(b) the amount paid by that person in respect of his acquisition of the security exceeds the amount payable on the transfer….

(3) For the purposes of this Schedule the loss shall be taken –

(a) to be equal to the amount of the excess increased by the amount of any relevant costs; and

(b) to be sustained for the purposes of this Schedule in the year of assessment in which the transfer …. takes place.

…"

50. It was Mr Bretten's claim, which was not in dispute, that he transferred the loan notes when he gifted them to Trust 2. Paragraph 4 provided:

"**Paragraph 4**

(1) …. In this Schedule references to a transfer, in relation to a security, are references to any transfer of the security by way of sale, exchange, gift or otherwise.

…."

51. It was his case that that transfer by way of gift was to be treated as taking place at the then market value as he was connected (as settlor) to Trust 2. Paragraph 8 of Schedule 13 provided:

"Paragraph 8

This paragraph applies where a relevant discounted security is transferred from one person to another and they are connected with each other.

For the purposes of this Schedule –

(a) the person making the transfer shall be treated as obtaining in respect of it an amount equal to the market value of the security at the time of the transfer, and

(b) the person to whom the transfer is made shall be treated as paying in respect of his acquisition of the security an amount equal to that market value.

(3) Section 839 of the Taxes Act 1988 (connected persons) shall apply for the purposes of this paragraph."

52. Section 839(3) of the Taxes Act stated that a trustee of a settlement was connected to the settlor of the settlement. It was not in dispute that Mr Bretten as

settlor was therefore connected to both of the trustees of Trust 2 (himself and Mr Cox). The transfer of the loan notes was a transfer between connected parties and, it was Mr Bretten's case, that that transfer was to be treated as taking place at the then market value. This was not in dispute.

53. Paragraph 15 of Schedule 13 provided that market value had for these purposes the same meaning as given in the Taxation of Chargeable Gains Act 1992 ("TCGA"). And s 272 TCGA provided that market value meant "the price which those assets might reasonably be expected to fetch on a sale in the open market." Section 273 gave a further gloss on this definition. So far as unquoted securities were concerned, the open market was one where "there is available to any prospective purchaser of the asset in question all the information which a prudent prospective purchaser of the asset might reasonably require if he were proposing to purchase [the security] from a willing vendor by private treaty at arm's length."

54. As stated above there was no dispute between the parties as to the market value of the six loan notes on the day of the gift of them. At the date of gift of them to Trust 2 by Mr Bretten the parties were agreed that the total market value was (or was no more than) £25,000.

55. An anti-avoidance provision was in inserted into the legislation and both parties were agreed it was in effect at the relevant time. This provided as follows:

> **"Paragraph 9A**
>
> (1) Where a relevant discounted security is transferred by a person ('the relevant person') to a person connected with him and -
>
> (a) the occasion of the relevant person's acquisition of the security was its issue to him,
>
> (b) the relevant person was, at the time of issue, connected with the issuer or……, and
>
> (c) the amount paid by the relevant person in respect of his acquisition of the security exceeds the market value of the security at the time of issue,
>
> the relevant person shall be taken for the purposes of this Schedule not to sustain a loss from the discount on the relevant discounted security.

56. Mr Bretten's submission was that his arrangements were not caught by this anti-avoidance provision. The RDS were issued to him by OCL which was not a company to which he was connected. Further, the amount that he paid for the RDS did not exceed the market value of the RDS at the time of their issue.

Appellant's case

57. The appellant's case was that the statutory provisions have the same meaning irrespective of the taxpayer's motive. I do not think HMRC disputed this.

58. Applying the legislation to the facts of this case, Mr Bretten says:

- The loan notes were genuine relevant discounted securities;
- The loan notes were issued by OCL;
- Mr Bretten acquired the loan notes and transferred £500,000 of his own monies to OCL;
- OCL was a third party to Mr Bretten and would not have issued the loan notes for any less than £500,000;
- Mr Bretten transferred the loan notes to Trust 2 and at that point in time their market value was no more than £25,000.

59. None of this is disputed by HMRC and therefore, says Mr Bretten, under the terms of the legislation, he is entitled to the claimed tax relief. Put simply, the loss arises where "B" is less than "A" as the calculation in paragraph 2(2) is simply

"A minus B"

where B is the agreed figure of the actual market value when the RDS were given to Trust 2 (£25,000) and A is (in Mr Bretten's view) the amount in exchange for which OCL issued the loan notes (ie £500,000):

£500,000 minus £25,000 = £475,000 loss.

HMRC's case

60. HMRC's case is that based on a purposive construction of the legislation and a realistic view of the facts, Mr Bretten did not sustain a loss from the discount on RDSs.

61. HMRC consider this to be the case because, they say,

(a) To get within paragraph 2(2)(b) of Schedule 13 Mr Bretten must have acquired the RDSs. However, say HMRC, Trust 1 was always intended to be substituted for OCL and Mr Bretten always intended to gift the RDSs to Trust 2. Therefore, viewing the facts realistically say HMRC, Trust 1 issued the RDSs to Trust 2. Mr Bretten therefore never acquired the RDSs and is not within paragraph 2(2)(b).

(b) If HMRC are wrong on this they say that the amount "paid" by Mr Bretten within the meaning of paragraph 2(2)(b) of Schedule 13 was the value of the security *after* expiry of the first 14 days, which was £25,000 which was equal to their value on gift to Trust 2 and therefore there was no "loss" within the meaning of that sub-paragraph;

(c) And if they are wrong on this, HMRC claim that paragraph 9A applies as, looked at realistically they say, the issuer of the RDSs was Trust 1. Mr Bretten was connected with Trust 1. As (say HMRC) the RDS was issued at an undervalue the transfer is therefore deemed not to give rise to a loss.

Statutory construction

62. The appellant has always admitted that the transactions had a tax avoidance motive: they were executed in accordance with a plan and, while he intended to divest himself of £500,000 of assets in any event, he would not have done so via a convoluted scheme involving loan notes and OCL had it not been his intention to use his asset protection plan as an opportunity to avoid tax.

63. It is the appellant's case that his admitted tax avoidance motive does not rob the transactions of any effect that they would otherwise have for tax purposes. The transactions can not be ignored simply because Mr Bretten's motive was tax avoidance.

64. HMRC agree with this in general but consider that in this particular case the rules of statutory construction mean that the transactions do not have the tax effect which Mr Brettten claims. And while Mr Bretten agrees, to paraphrase Ribeiro PJ in the *Arrowtown Assets Ltd* case [2003] HKCFA 46 at [35], that the statutory provisions must be construed purposively to decide whether they were intended to apply to the transactions in question viewed realistically, he considers that there is no scope for a purposive construction to deny him the claimed relief in this case.

65. Lewison J in *Berry* [2011] UKUT 81 recently summarised the principles of statutory construction in cases where there is an avoidance motive as follows:

> "[31] In my judgment:
>
> (i) the *Ramsay* principle is a general principle of statutory construction ….
>
> (ii) The principle is two fold; and it applies to the interpretation of any statutory provision:
>
> (a) to decide on a purposive construction exactly what transaction will answer to the statutory description; and
>
> (b) to decide whether the transaction in question does so …..
>
> (iii) It does not matter in which order these two steps are taken; and it may be that the whole process is an iterative process …..
>
> (iv) Although the interpreter should assume that a statutory provision has some purpose, the purpose must be found in the words of the statute itself. The court must not infer a purpose without a proper foundation for doing so…..
>
> (v) In seeking the purpose of a statutory provision, the interpreter is not confined to a literal interpretation of the words, but must have regard to the context and scheme of the relevant Act as a whole…..
>
> (vi) However, the more comprehensively Parliament sets out the scope of a statutory provision or description, the less room there will be for an appeal to a purpose which is not the literal meaning of the words ….
>
> (vii) In looking at particular words that Parliament uses what the interpreter is looking for is the relevant fiscal concept….

> (viii) Although one cannot classify all concepts a priori as 'commercial' or 'legal', it is not an unreasonable generalisation to say that if Parliament refers to some commercial concept such as a gain or loss it is likely to mean a real gain or a real loss rather than one that is illusory in the sense of not changing the overall economic position of the parties to a transaction……
>
> (ix) A provision granting relief from tax is generally (though not universally) to be taken to refer to transactions undertaken for a commercial purpose and not solely for the purpose of complying with the statutory requirements of tax relief…..However, even if a transaction is carried out in order to avoid tax it may still be one that answers to the statutory description….In other words, tax avoidance schemes sometimes work.
>
> (x) In approaching the factual question whether the transaction in question answers the statutory description the facts must be viewed realistically …..
>
> (xi) A realistic view of the facts includes looking at the overall effect of a composite transaction, rather than considering each step individually….
>
> (xii) A series of transactions may be viewed as a composite transaction where the series of transactions is expected to be carried through as a whole, either because there is an obligation to do so, or because there is an expectation that they will be carried through as a whole and no likelihood in practice that they will not…..
>
> (xiii) In considering the facts the fact-finding tribunal should not be distracted by any peripheral steps inserted by the actors that are in fact irrelevant to the way in which the scheme was intended to operate….
>
> (xiv) In considering whether there is no practical likelihood that the whole series of transactions will be carried out, it is legitimate to ignore commercially irrelevant contingencies and to consider it without regards to the possibility that, contrary to the intention and expectation of the parties it might not work as planned….Even if the contingency is a real commercial possibility it may be disregarded if the parties proceeded on the basis that it should be disregarded….."

66. This interpretation of the many authorities on purposive construction of tax legislation is, of course, binding on this Tribunal. In any event, neither party suggested that it was not right. The difference between the parties is how the principles should properly be applied in this case.

Interpreting the statute purposively

67. Mr Bretten sees the statute as imposing an "A minus B" test where the figure for A is £500,000 and the figure for B is £25,000, resulting in a loss of £475,000. HMRC consider there is scope for a less mechanistic construction of paragraph 2(2)(b) of Schedule 13. In particular, HMRC see this as the sort of provision envisaged by Mr Justice Lewison in *Berry* at (viii) above where he referred to the statute using a

commercial concept involving a "real loss rather than one that is illusory in the sense of not changing the overall economic position of the parties to a transaction……"

Mayes

68. When the Court of Appeal looked at very different legislation in the case of *Mayes* [2011] EWCA Civ 407, they concluded that that legislation had to be applied mechanistically and there was no scope for considering whether there was a real commercial gain. In that case, the legislation referred to something being "treated as a gain", and the Court found these very words implied that the gain might not be a real gain at all. Toulson LJ said of the legislation under consideration in that case:

> "[102] ….[the legislation in question] creates a complex set of rules for determining when a gain is to be treated as arising in connection with a life insurance policy.
>
> [103] Inherent in the scheme is the possibility of a disconnection between what would be regarded as a gain on an ordinary commercial view and what is to be treated as a gain for the purposes of the statute.
>
> [104] In some cases, a taxpayer may be liable for a gain which the statute requires him to be treated as having made, although the chargeable event giving rise to the deemed gain has no caused him to make an equivalent gain in real terms.
>
> [105] In the present case the opposite has occurred…."

69. But so far as the RDS legislation in Schedule 13 was concerned, the Court of Appeal has not applied a mechanistic approach. In *Astell & Edwards* [2009] EWCA 1010 it clearly considered Schedule 13 to be legislation where Parliament intended the reality of the transaction to be considered. Unlike the legislation in *Mayes,* Schedule 13 does not refer to something being *treated* as a loss or a gain.

Astell

70. Although *Astell* involved the same provisions as this case, the scheme was very different. In Mr Bretten's case, there was no intention for the RDS to be redeemed before it has run its full term: but in *Astell* (at least in so far as Mr Edwards was concerned) the scheme involved the early redemption of the security at a loss. The Tribunal found as a fact that so far as Mr Astell was concerned there was real uncertainty whether the security would be redeemed before it had reached full term.

71. There were two aspects to the *Astell* case. Firstly, there was the question whether the security issued to Mr Edwards was an RDS because there was no real likelihood of it going to full term and therefore being redeemed at a gain. The Court held that:

> "[46]….it is implicit in the statutory purpose that the agreed terms which might cause a deep gain to arise have to have a reality beyond the printed page…."

72. In other words, the security issued to Mr Edwards was not, under paragraph 3, an RDS, because, seen as a preordained series of transactions, or a single multi-facted transaction, there was no real possibility that the security would ever be redeemed at a gain.

73. The second aspect was whether the securities (identical in terms) actually involved a "deep gain" as defined because in both cases the "gain" could only realistically be paid by the issuers of the security (which were trusts set up by the taxpayers and of which they were the main beneficiaries) out of capital provided to the trusts by the taxpayers. In other words, were the securities to be redeemed at full term, the money would go around in a circle: the gain would only be realised by the taxpayers because they had earlier given the trusts the funds to pay it.

74. The Court held that:

> "[61]….The question was whether on the facts the terms of redemption resulted in a redemption at a deep gain for the purposes of paragraph 3 of Schedule 13….
>
> [62]…the court is entitled…to have regard to the full sequence of the transaction….Accordingly, the court can take into account the fact that the appellants are no better off under the transaction if the right of early redemption is exercised. They therefore made no overall gain….."

75. The issues in the case were therefore different to those in this case. It is accepted that the security in this case was a relevant discounted security. This was not accepted in *Astell* and the Court agreed with HMRC that the securities in that case were not RDSs.

76. What is relevant is that the Court of Appeal interpreted paragraph 3 of schedule 13 as involving what I will describe as a "real" deep gain. It was not a "real" deep gain if either there was no realistic prospect of the RDS being realised or if it was not, realistically speaking, a gain at all, because the money went around in a circle. The taxpayers lost their appeal.

77. It is a short leap of logic from *Astell* to say that if paragraph 3 of Schedule 13 involves only "real" deep gains, then paragraph 2 of the same schedule involves only "real" losses. There must be a realistic prospect of a loss being realised and there must, realistically speaking, be a loss. Is it right to make this leap of logic? The meaning of paragraph 2(2)(b) itself was considered by tribunals in two cases, *Campbell* [2004] STC (SCD) 396 and *Audley* [2011] SFTD 597.

Campbell

78. The case of *Campbell* concerned a subscription to a company owned and controlled by the taxpayer in return for the issue of RDS at an overvalue. The RDS were then given away to the taxpayer's wife so that the transfer value (or the "B" in the calculation "A minus B") was the market value on the date of transfer, as in this case. The taxpayer had an independent purpose in subscribing for the RDS in that he wished to put his company in funds for the purpose of its business.

79. It was put to the Special Commissioners in *Campbell* that "loss" in the RDS provisions was a legal concept rather than a commercial one and therefore not susceptible to purposive interpretation. The Special Commissioners did not necessarily accept this but what they did say was this:

> "[87] Once an amount paid in respect of a relevant discounted security is ascertained and the amount received (or deemed to be received) on transfer or redemption is determined, there is a 'loss' where the former exceeds the latter. There is no room for the purpose of the holder of the relevant discounted security to inform the construction of the term 'loss'….."

80. So in the view of the Special Commissioners, "loss" does not have a real meaning in this context. Is that right? It is difficult to reconcile with the Court of Appeal's decision in *Astell.* "Deep gain" also had a mechanistic meaning in the sense of "A is less than B". In paragraph 3(3) it is stated to be:

> "..the amount payable on redemption of a security involves a deep gain if – (a) the issue price is less than the amount so payable…."

81. Compare this to the "A minus B" meaning of loss in paragraph 2(2):

> "…a person sustains a loss…where – (a) he transfers such a security ….and (b) the amount paid by that person in respect of his acquisition of the security exceeds the amount payable on the transfer or redemption"

82. *Campbell* was decided before *Astell* and without the benefit of it. The Court of Appeal in *Astell* itself made no comment on the rightness or otherwise of the decision: it was, after all, not directly in point. *Campbell* was, however, considered by the Upper Tribunal in *Berry.*

83. *Berry* concerned a slightly different taxation provision and very different facts. It involved gilt strips which were sold by the taxpayer on a forward contract (the consideration "x" was payable at a future date) with an immediate grant back, for consideration of "y" paid to the taxpayer, of an option to repurchase the gilt strips for "x – y". In other words, the transaction was in effect self-cancelling. The taxpayer claimed a loss because he paid "x" but only received "x-y", but there was no real loss as he had already been paid the "y" when he granted the option.

84. The relevant law was paragraph 14A(3) of Schedule 13, a provision which replaced paragraph 2. As with this case, and the *Campbell* case, the *Berry* case turned on whether there was a loss. The provision dealing with this provided:

> **Paragraph 14A (3)**
>
> "For the purposes of this paragraph a person sustains a loss from the discount on a strip where –
>
> (a) he transfers the strip or becomes entitled, as the person holding it, to any payment on its redemption; and

> (b) the amount paid by him for the strip exceeds the amount payable on the transfer or redemption…
>
> The loss shall be taken to be equal to the amount of the excess….."

85. While not identical, this is similar to the mechanistic calculation of loss on an RDS under paragraph 2 of Schedule 13 in the sense it is "A minus B = loss". Lewison J said:

> "…in *Astell*…Arden LJ rejected the submission that a purposive construction should not be applied to paras 1, 2, and 3 of Sch 13. Paragraph 14A is the replacement of para 2, and is expressed in much the same terms, so the same principle must apply. If and in so far as the Special Commissioners held otherwise in *Campbell*…I should follow the Court of Appeal by whose decision I am bound. I therefore reject the submission that the *Ramsay* principle is to be disapplied in interpreting para 14A."

86. However, he then went on to consider whether, even applying *Ramsay*, there was no room for a "real" loss because the statute was prescriptive on how the loss was calculated. He considered the *Campbell* case in detail. He said that properly understood, the Tribunal had not said that the reality of the situation should be ignored: the reality was that Mr Campbell had suffered a loss as he had borrowed the money to buy the loan notes and then given the loan notes to his wife. He said *Campbell* was properly distinguished from *Berry* because in *Campbell* it had been <u>conceded</u> by HMRC that the loan notes were not subscribed at undervalue.

87. Mr Justice Lewison upheld the FTT's decision against the taxpayer. He said a realistic view of the facts was that the option fee was no more than a refundable deposit and it was a self-cancelling scheme with no loss being realised. So far as paragraph 14A was concerned he held:

> "[51] As I have said, the FTT held that the purpose of para 14A was the general proposition stated in sub-para (1) viz:
>
> > 'A person who sustains a loss in the year of assessment from the discount on a strip shall be entitled to relief from income tax on the amount of his income for that year according to the amount of the loss.'
>
> [52] In my judgment the FTT were right to identify the purpose of the paragraph in that way. This is not a case in which Parliament has used algebra (amount A and B) to create a notional profit or loss. It has used words which have a recognised commercial meaning; and it is to be expected that Parliament intended to tax (or relieve) real commercial outcomes. The FTT were right not to adopt a slavishly literal 'tick-box' interpretation of the legislation. This is precisely how the *Ramsay* principle is meant to operate. I thus conclude that the FTT made no error of law in identifying the purpose of the legislation."

88. I agree with HMRC that Mr Justice Lewison's view of *Campbell* is that the case might well have had a different outcome if HMRC had not conceded the loan notes were issued at full value. I also agree that *Campbell* is distinguishable from this

case as the Special Commissioners found that subscription to the company had a real commercial purpose. That is clearly not the case here where it is conceded OCL's involvement served no commercial purpose.

Summary

89. In summary, where the intention of Parliament is only to tax real gains, then the courts and tribunals are free only to recognise real losses.

90. I find that *Campbell* is not authority that paragraph 2(2) should be given a mechanistic interpretation: in so far as that was the basis of the decision, it was wrongly decided (see the citation from *Berry* above). However, Mr Justice Lewison considered that the case was correctly decided. As both the Court of Appeal in *Astell* and the Upper Tribunal in *Berry* decided that provisions related to and very similar to paragraph 2(2) were intended to apply to commercial reality, the explanation for this view is that the formula "A minus B" must be applied mechanistically, as it was in *Campbell,* once the figures for "A" and "B" are known, but the calculation of "A", at least, and perhaps "B", must be consistent with commercial reality. The calculation must have been intended to give effect to the notion of a "real" loss envisaged by Parliament when it legislated the phrase "…a person sustains a loss…"

91. Is it right that *Campbel l*is to be distinguished solely because HMRC conceded the figures for "A" and "B", and would the outcome the case have been different if they had not? Mr Justice Lewison did refer to the fact (see paragraph 86 above) that the taxpayer in *Campbell* made a "real" loss in the sense he was worse off after the planned series of transactions than he was before. Is this also a point of distinction?

92. I think not. The logic of a loss being a "real" loss is that it can't have been a loss that was intended to arise. If a party intends to give away some of his assets, the act of giving away is not a commercial loss as it is intentional. The situation of a taxpayer choosing to give away assets as part of tax avoidance scheme arose in the recent FTT case of *Audley.*

Audley [2011] UKFTT 219 (TC)

93. As part of a tax avoidance scheme, the taxpayer gave away his home with a true value of £1.8million plus £250,000 in cash to a family trust. The trustees issued to him RDS in return with a face value of £2,050,000. Because of the terms of the RDS, for instance that it was only repayable in 60 years, the value of the RDS at date of issue was only £35,700. A few days later, and in accordance with the pre-planned scheme, the taxpayer gave the RDS to a second family trust.

94. The taxpayer claimed a loss on the basis that A = £2.050,000 and B = £35,700 so that "A minus B" left him with a loss of £2,014,300 for the purpose of paragraph 2(2)(b). The Tribunal dismissed his appeal against HMRC's refusal of the loss relief, holding that what the taxpayer *paid* for the loan note was its true value (£35,700) and the excess was given as a gift to the first family trust:

> "[88]…This was not a subscription of £2.05m for a loan note issued by the trustees of a family trust; rather it was a gift of the house and a significant amount of cash to the trustees….The only thing obtained in return was the loan note which had a market value of £35,700.
>
> [89] ….To the extent that any amount can be said to have been paid for the acquisition of the loan note, it is limited to the true value of the loan note when issued: £35,700."

95. I consider that this case was correctly decided in line with *Astell* and *Berry*. It is implicit in the decision that it was irrelevant that the taxpayer was worse off after the planning that before it: before the planning was executed he owned a house and some cash. After it was executed, he only possessed a life interest in the house and cash. That this "real" decrease in assets is irrelevant to the question of whether there has been a real loss has to be right for a number of reasons.

96. Firstly, it is planned. It is part of the planning scheme. It does not arise by chance. It is implicit in the RDS legislation that Parliament envisaged that an RDS involved risk: a deep gain might arise or it might not. The "loss" envisaged by Parliament in paragraph 2 was not one that was intended to arise from the outset. A planned loss is not a commercial loss: commerce involves an intention to make a profit and a risk that the intention won't be realised.

97. Secondly, Parliament intended the loss in paragraph 2(2) to be "A minus B". Whereas the decrease in the value of the taxpayer's assets in *Audley* in no way matched the "A minus B" and therefore that decrease in the value of the taxpayer's assets was not the "loss" intended by Parliament.

98. *Audley* suggests, and I consider, that the only proper distinction with *Campbell* is that HMRC (mistakenly) conceded the value of "A" in that case.

Pike

99. A similar view to the decision in *Audley* was expressed obiter (by myself and Mr Thomas), without the benefit of argument, in the case of *Pike* [2011] UKFTT 289 (TC):

> "[91]Mr Pike gave £6m to the company and in return he got a security with a face value of £6m. But he did this knowing that in return he would get an asst worth approximately £2.5m. This was not a case of making a bad bargain: Mr Pike did not pay £6m hoping it was worth £6m or more. It was an integral part of the tax avoidance scheme that the security was in fact wroth considerably less than this and the scheme could not have worked if Mr Pike had paid what the security was actually worth.
>
> …
>
> [93] We have not had the benefit of submissions on this point and it is not necessary for our decision, but we express the preliminary view that it may be that Mr Pike *paid* what the security was worth (approximately £2.5m) for the purposes of para 2(2). The rest of the

> £6m was to capitalise his wholly owned company and was not actually *paid* for the security….."

100. As can been seen, *Pike* was on the facts virtually indistinguishable from the facts in the case of *Campbell.* However, following *Berry* and *Astell, Campbell* has to be seen as decided on the basis that HMRC had conceded that the acquisition price of the RDS was its face value rather than market value, and on the facts of the case HMRC were ill-advised to make that concession.

101. Unlike *Audley,* the taxpayer in *Pike* did not suffer any decrease in the value of assets when the RDS was issued: as with the taxpayer in *Campbell,* he paid an excessive price for the RDS and effectively gave away money to his wholly owned company. In such a case, in reality, the donor or subscriber has not given away assets at all, but simply swopped cash for a different type of asset (a more valuable wholly owned company). There was of course a further decrease in the value of the taxpayer's assets when he made the later, planned, gift of the RDSs to a family trust. But as I have already said, I do not consider that this can be seen as a loss as it was a planned gift.

Summary

102. After this survey of the authorities, I find that "loss" in the RDS legislation and in particular in paragraph 2 refers to a "real" loss and that therefore to the extent that paragraph 2(2)(b) requires a mechanistic A minus B calculation, the figures used for A & B must be realistic figures, so that the amount "paid" is viewed realistically and a "real" loss is calculated. Further, *Campbell* is to be distinguished because HMRC conceded the figure for "A" and not because it involved any real loss, even though it did involve a decrease in the real value of the taxpayer's assets because he gave away an asset to a family trust. This decrease in the real value of the taxpayer's assets was also true in *Audley* and *Pike,* but I consider it irrelevant because it was part of the planning scheme. A planned loss is not a real loss as envisaged by Parliament in paragraph 2.

Real commercial purpose

103. *Campbell*, *Pike*, *Audley* and this case all involve a situation where the *reality* is that, at least on one level, the taxpayer is worse off after the series of transactions is executed than before. These were not self cancelling transactions as in the *Berry* case. They all involved situations where the taxpayer had a real commercial purpose other than tax avoidance, in divesting themselves of assets.

104. In *Campbell* and *Pike* the taxpayers wished to capitalise their companies. They could have achieved this purpose by subscribing for share capital. They chose instead to purchase RDSs (at an undervalue) solely for tax avoidance reasons. In *Audley* the taxpayer appeared, at least, to have a genuine, altruistic, intention to give away capital to his family although, since he was the income beneficiary and trustee, largely the transaction was self cancelling.

105. Does having a real commercial purpose, or at least a purpose other than tax avoidance make a difference? It is difficult to see why it would make any difference at all in the sense that, whatever the ultimate purpose was, the only purpose to the issue of the RDS was tax avoidance. And anyway, properly the question is not the taxpayer's motive and whether there is a real commercial purpose. The question is whether the legislation purposively interpreted was intended by Parliament to apply to the transactions viewed realistically. Paragraph 2 of Schedule 13 was intended to apply to real losses: whether or not there was a non-tax avoidance motive to the achievement of the end result (such as capitalising a company) rather than the transactions being self cancelling (as in *Berry)* makes no difference if the subscription for the RDS was at an intentional undervalue.

Viewing the facts realistically

106. Having interpreted the legislation, I need now to view the facts of Mr Bretten's case realistically. I have moved on to point (x) in Mr Justice Lewison's summary of what might be called the *Ramsay* line of authorities.

> In approaching the factual question whether the transaction in question answers the statutory description the facts must be viewed realistically …..
>
> (xi) A realistic view of the facts includes looking at the overall effect of a composite transaction, rather than considering each step individually….
>
> (xii) A series of transactions may be viewed as a composite transaction where the series of transactions is expected to be carried through as a whole, either because there is an obligation to do so, or because there is an expectation that they will be carried through as a whole and no likelihood in practice that they will not…..

A series of transactions?

107. Point (xi) requires the Tribunal to look at the overall effect of a composite transactions so I first have to determine whether the facts involved a composite transaction, and what that composite transaction comprised, and what was its overall effect.

108. Looking at (xii), a composite transaction is a series of transactions where there was either an obligation to carry out the various steps *or* it was merely *expected* that the series would be carried out and no real likelihood that they would not be.

109. There was no *obligation* on Mr Bretten to substitute Trust 1 as issuer of the loan notes, nor to gift the loan notes to Trust 2. In that sense it was not a series of transactions. Mr Bretten's point was that he was not *bound* to nor was he under any obligation to dispose of the loan notes.

110. While I accept Mr Bretten was not obliged to carry out the steps in this transaction, it is still a series of transaction if the various steps were expected to be carried with no real likelihood that they would not be carried out.

111. It is not in dispute that before the expiry of the first 14 days, Mr Bretten would either have caused Trust 1 to be substituted as creditor *or* exercised his right to redeem the loan notes. This has to be right as otherwise Mr Bretten would in effect have given £500,000 to OCL and it was no part of his plan to give away half a million pounds to an unconnected third party.

112. Further, once the 14 days had passed, I find there was no real likelihood that the transactions would not proceed and in particular no real likelihood that the gift to Trust 2 by Mr Bretten would not take place. This was because the entire objective of using RDS was tax avoidance, and once the scheme was put in motion there was no real likelihood Mr Bretten would not see it through to the end. While he might have got cold feet, this was only remote possibility and in any event he would have done what he did, which was to complete the series of transactions and then consider whether or not he wanted to claim the relief in his tax return.

113. There were other elements of uncertainty. Clause 5, outlined, above, would have put an end to the planned series of transactions if the chance inbuilt into that clause (of the FTSE 100 index reaching 4000) had come to pass. Mr Bretten did not rely on this clause in the hearing. I consider this a concession well made. As Mr Justice Lewison said at (xiv) unlikely contingencies inserted to introduce an element of chance should be ignored and even where the contingency is "a real commercial possibility it may be disregarded if the parties proceeded on the basis that it should be disregarded….." So far as clause 5 is concerned, both parties are agreed it could be ignored. Had this not been conceded I would find that it ought to be ignored as Mr Bretten's evidence was that clause 5 was inserted solely as a sort of window dressing to make the scheme look better but with no real expectation that the uncertain event would ever occur to disrail the planning scheme.

The first 14 days

114. The critical difference between the parties is how the first 14 days should be viewed. I have already found as a fact (see 42-43) that the main purpose of the right to redeem at face value for the first 14 days was to bolster the tax avoidance scheme. It was only a remote possibility that it would ever be exercised.

115. HMRC's view is that from moment of issue to OCL always intended that scheme would be followed through and although there was a possibility of redemption this was not intended or expected and cite *Scottish Provident Society* [2004] UKHL 52 where Lord Nicholls said:

> "[23] We think it would destroy the value of the *Ramsay* principle of construing provisions…if [the] composite effect [of composite transactions] had to be disregarded simply because the parties had deliberately included a commercially irrelevant contingency, creating an acceptable risk that the scheme might not work as planned. We would be backing the world of artificial tax schemes, now equipped with anti-*Ramsay* devices. The composite effect of such a scheme should be considered as it was intended to operate and without regard

> to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned."

116. I agree with HMRC's view, and therefore, so far as the test in (xii) is concerned, I find that there a series of transactions which included the initial creation of the loan notes by OCL, incorporated the substitution of Trust 1 as debtor and did not come to an end until after Mr Bretten gifted the loan notes to Trust 2. This was the scheme envisaged by Mr Bretten, by OCL and by Mr Harris. It was executed as expected, and while Mr Bretten had a real choice in the first 14 days to redeem the loan notes and bring the scheme to an end, for the reasons given I above I find there was no real likelihood that this would happen.

117. Further, even if I thought as a matter of fact the first 14 days did involve a real likelihood that Mr Bretten would chose to redeem the loan notes and bring the scheme to a premature end, I would still consider that there was a planned series of transactions from the moment the loan notes were issued.

118. This is because the right of redemption (in so far as it can be seen as a right that would actually be exercised rather than a right that existed simply to establish a high value for the RDS) did not more than give Mr Bretten the chance to change his mind and unwind the scheme.

119. Mr Justice Lewison did not explicitly consider what might be described as a "cooling off clause" at his paragraphs (x) – (xvi) above (my paragraph 65). Rather, he was considering clauses such as the clause 5 where the element of uncertainty was something outside the control of the parties. I do not think that he meant the question whether there is "no real likelihood" of it coming to pass as the right test to apply where it is within the control of the tax avoider and amounts to no more than an option to unwind the planning. In any planning, there is always the possibility, whether express on the terms or not, of the tax avoider deciding not to go through with the scheme and unwinding it after it has commenced (although sometimes to do so might require the cooperation of a third party). Logically, this ability to unwind it can not mean that the scheme is any less than a planned series of transactions. So even where the right to unwind the planning is express, and because it was agreed in advance and involves no cooperation from any other party in order to execute it, it should make no difference to the assessment of the scheme as a planned series of transactions: whether the scheme is a series of transactions cannot depend on an assessment of the state of the tax avoider's nerves and in particular how likely he was to develop cold feet.

120. Therefore, in my view, the existence of such an opt out should be entirely discounted when considering whether there was a composite transaction.

121. Another way of looking at it is that the planned series of transactions includes any preliminary scene setting without which the planning would not work as intended. For instance, as Mr Bretten said, he would not have paid £500,000 to OCL at the time OCL issued the loan notes unless OCL had first given to Trust 1 the option for Trust 1 to elect to substitute itself as debtor. Yet at the time of the grant of the option, Mr Bretten clearly was not committed to seeing the planning through to its intended end.

But the option was nevertheless an integral part of the planning. Mr Bretten could have opted out of the planning *after* the option was granted but *before* the RDS were issued. This does not make the grant of the option any less a part of the composite transaction. So the fact he could have opted out at any time during the first 14 days after the loan notes were actually issued does not mean that the issue of the loan notes was any less an integral part of the planning scheme.

122. So I find that there was a series of transactions from the moment OCL issued the option to Trust 1, through the issue of the loan notes to Mr Brettten, including the substitutes of Trust 1 as debtor, and finally including the gift of the loan notes to Trust 2.

123. Having viewed the facts realistically I move on to consider HMRC's case. I look at HMRC's second argument first, as this is closest to existing case law.

Conclusions

HMRC's second argument

124. HMRC's second argument, if it failed on its argument that Mr Bretten did not really acquire the RDSs, is that that the amount "paid" by Mr Bretten within the meaning of paragraph 2(2)(b) of Schedule 13 was the value of the security *after* expiry of the first 14 days, which was £25,000, which was equal to the value of the RDS on gift to Trust 2, and that therefore there was no "loss" within the meaning of that sub-paragraph.

125. Here the question is what is the amount Mr Bretten "paid …in respect of his acquisition of the security….." This is the figure of "A" in the sum "A minus B".

126. And as I have said in paragraph 102, the word "paid" means what was really paid for the RDSs. Mr Bretten emphasised that £500,000 was really paid: £500,000 left his bank account and arrived in that of OCL's. And I am quite satisfied that the deal with OCL was at full value. For its first 14 days the loan notes would really have been worth a figure approaching half a million pounds (as explained above in paragraph 20 they would not have been worth quite this figure). OCL would certainly not have issued the loan notes for any less than £500,000. Mr Bretten and OCL traded at arm's length.

127. But as I have said, the legislation lends itself to a purposive interpretation and the question is what Mr Bretten really paid for the loan notes; and to decide that I am entitled to look at the facts realistically. Realistically, a series of transactions was intended and expected to take place. It was intended and expected that in 14 days' time the loan notes would radically decrease in value (because the right of early redemption at issue price would expire) but before that happened Trust 1 would be the debtor (and in effect the beneficiary of the huge decrease in value of the loan notes). Realistically speaking, I agree with HMRC, Mr Bretten only *paid* £25,000 to acquire these loan notes because he knew and intended that when he paid £500,000 that 14 days later they would only be worth £25,000, and he intended Trust 1 to be the debtor

on the loan notes immediately before the devaluation took place. I find that viewing the planned transactions as a whole, Mr Bretten *gave* away £475,000 to Trust 1 and only *paid* only £25,000 for the loan notes.

128. Put it another way, HMRC's case is that it was a series of transactions planned and which was executed as intended from the moment OCL issued the option to Trust 1. As it was part of the plan that at Day 15 the RDS would suffer a radical decrease in value, on a realistic view of the facts, taking into account that the decrease in value was planned, Mr Bretten should be seen as having only paid at Day 1 the £25,000 the RDS were worth on and after Day 15, and as in effect to have given away the remainder of the £500,000 to a family trust. Because that was the effect of the planned series of transactions.

129. Viewed realistically, there was no chance whatsoever that (unless the scheme was collapsed by early redemption) the substitution option would not be exercised. Viewed realistically there was absolutely no chance of Mr Bretten realising a "real" loss vis-à-vis OCL: there was never any chance that OCL would be left holding the £500,000 and Mr Bretten left with notes worth a mere £25,000. We have said the possibility of early redemption was remote and did not happen and should be ignored. Had it been exercised, no loss would have been sustained (or only a minimal loss of £500). Viewed realistically Mr Bretten did what he intended: he gave £500,000 to family trusts. He intended a gift to Trust 1 of £475,000, and this is in effect what he achieved in a roundabout fashion via OCL and a 15 day delay.

130. Therefore, mechanistically A minus B is £25,000 minus £25,000. Mr Bretten's loss was nil. HMRC were correct to disallow his claim for a loss. That is sufficient to dispose of the appeal but I have further comments to make.

131. I have already dealt with the 14 day right to redeem the loan notes for issue price or nearly issue price. I have said it should be disregarded as a remote contingency and/or because opt outs should be ignored when assessing whether there is a composite transaction. Therefore, the whole scheme, from the grant of the option by OCL to Trust 1 through to the gift by Mr Bretten to Trust 2, should be seen as a single composite transaction.

132. My comment is that even if I am wrong on this, I do not see it as being of any help to Mr Bretten. If there was a realistic chance that once the RDS were issued they would be redeemed without the scheme being seen through as planned, then again the question would be, viewing the facts realistically, what has Mr Bretten "paid …in respect of his acquisition of the security….." ? In this scenario, realistically speaking, Mr Bretten did not really acquire the RDS until he lost the right to cancel them. If the 15 days should be seen as a cooling off period, in which Mr Bretten was uncertain whether to proceed with his plan or not, then viewed realistically the cooling off period was like an option. He was not committed the transaction until his right (or the right of the intended new owner, Trust 2) to cancel the RDS expired. And that only happened on Day 15. And at that point the RDS were, as planned, worth only £25,000. So even on this view, Mr Bretten only *paid* £25,000 to *acquire* the RDS.

133. In other words, incorporating the 14 day rights to redemption and inserting a third party (OCL), while it distinguishes this case from others that have gone before, such as *Audley,* fails to save the scheme. There was never any intention or expectation that OCL would ever benefit from the scheme to a greater extent than £500. It was always intended that the loan notes' value would decrease to £25,000 on day 15. OCL and the 15 day redemption plus security were just steps inserted into the transaction which resulted in an artificially inflated value for a limited period.

134. Further, as I have also already said, an intentional gift cannot be equated with a loss. Mr Bretten intended to give away £500,000 to family. And the effect of his complicated scheme is that that is what he achieved. He entered into a scheme that resulted in Trust 1 having a "gift" of £475,000 (in that it received £500,000 for assuming the role of debtor to the loan notes, but the value of the loan decreased to £25,000 shortly after it assumed the role of debtor). And he gave the loan notes (now worth £25,000) to Trust 2. In total he gave away £500,000, as planned, to his family. An intentional gift is not a loss within the meaning of paragraph 2(2). If and to the extent *Campbell* suggests otherwise I do not agree with it: I prefer the decision in *Audley.*

135. Similarly, the fact Mr Bretten's intention to give away £500,000 to his family was a genuine desire borne out of commercial considerations and uninfluenced by tax, does not save the scheme. As I have already said, the question is whether the facts viewed realistically answer the statutory description. "Loss" refers to a real loss. While Mr Bretten's gift was entirely genuine and reasonable, a planned gift is not a commercial loss and was not intended by Parliament to be relieved by the provisions of Schedule 13.

HMRC's first argument

136. I have already dismissed the appeal but for the sake of completeness I express my findings on HMRC's other arguments.

137. HMRC's first argument is that to get within paragraph 2(2)(b) of Schedule 13 Mr Bretten must have acquired the RDS. However, say HMRC, Trust 1 was always intended to be substituted for OCL and Mr Bretten always intended to gift the RDS to Trust 2. Therefore, viewing the facts realistically, say HMRC, Trust 1 issued the RDS to Trust 2. Mr Bretten, therefore say HMRC, never acquired the RDS and he is not within paragraph 2(2)(b) which required him to have paid an amount "in respect of his acquisition of the security".

138. In other words, HMRC's case is that the issue by OCL should be ignored and Trust 1 should be treated as the issuer. The purchase by Mr Bretten should also be ignored and Trust 2 should be treated as the noteholder from the start. Thus Mr Bretten's asset protection scheme worked as intended but the tax avoidance scheme failed as

139. steps inserted solely with a tax avoidance motive should be ignored.

140. This argument seems a radical interpretation and I bear in mind that the doctrine in *Ramsay* etc is not a licence to disregard steps inserted solely with a tax avoidance motive (see paragraph [78] in *Mayes* and also paragraphs [36-37] of *Barclays Mercantile v Mawson* [2004] UKHL 51*)*. One must look at the legislation and ask if the transaction viewed realistically answers the statutory description.

141. Mr Bretten wants me to look at each transaction individually and maintains that I cannot disregard the fact that the loan notes were actually issued by OCL and issued to him. But as set out above, there was a series of transactions here and, as Mr Justice Berry said at (xi) above "[a] realistic view of the facts includes looking at the overall effect of a composite transaction, rather than considering each step individually…." I find that the effect of the series of transactions, or the single composite transaction, was to leave Trust 2 as the noteholder. This was intended from the start.

142. Is it right to say, therefore, that Mr Bretten never acquired the security or that he acquired it on behalf of Trust 2? *Ramsay*, *Berry*, *Astell* and other cases looked at what Parliament really intended by its reference to gains and losses, so I must consider what Parliament really intended by "acquisition". As those cases decided that Parliament intended to refer to "real" gains and losses it is a short leap of logic to say Parliament also intended to refer to a "real" acquisition.

143. Mr Bretten agrees that I must give "acquisition" a purposive interpretation. His view is that by "acquisition" Parliament meant that he became the legal and beneficial owner of the RDSs. He suggests that he would not have acquired the RDSs if he had only become the legal owner, holding the shares on behalf of Trust 2, or restricted in what he could do with them. But as a matter of fact this was not the case: on the issue of them to him, he became the legal and beneficial owner of the RDSs, and could do what he liked with them. Although he did deal with them in accordance with his pre-determined plan, he had the option to change his mind at any time.

144. I have already said that in the legislation there is implicit the element of chance: there must be a chance of a real deep gain and the chance of a real loss. Even if the terms of the RDS were a guaranteed deep gain on maturity, implicit in the legislation is the assumption that the holder of the RDS is at risk and might nevertheless realise a loss (perhaps because of a default). The legislation was not contemplating a situation where the noteholder's entire period of ownership from the moment of acquisition, including the exact terms of his disposal of the RDS, would proceed accordingly to a plan laid out in advance. Where there is such a plan, it seems to me that the person to whom the RDS is issued does not "acquire" the RDS in the sense intended by Parliament of taking on the risk of changes in value inherent in ownership of an RDS. Such a person does not acquire the RDS in order to deal with it freely as a true owner would.

145. Mr Bretten points out that he had free will and he did not have to proceed in accordance with his pre-determined plan: he chose to do so. But on authority, including that of *Berry,* when looking at the facts realistically, I should ignore the possibility that the plan might not be carried out if there was an expectation it would be and no likelihood it would not be carried out (point (xii) of *Berry*). As I have

already said, the chance of the scheme in this case not being carried through was remote.

146. So, as this was a case where I should view the facts as if Mr Bretten had no free will because, in reality what he would do with the RDSs was already determined before he acquired them, I find Mr Bretten, although he became the owner of the RDS for some 9 days, did not "acquire" the RDS in the sense intended by Parliament because he did not in effect have the full rights of an owner nor did he take on the risk inherent in ownership of an RDS of a change in value.

147. So there was no real acquisition by Mr Bretten of the RDSs. As "paid" in paragraph 2(2)(b) refers to what was really paid, then "acquisition" in the same sub-clause refers a real acquisition where the acquirer takes on real choice in how to dispose of the asset and the risk of change in value that goes with ownership of assets.

148. So I agree with HMRC that the true acquirer of the RDS was Trust 2 and that, therefore, Mr Bretten, although he paid £500,000 to become the owner of the RDSs, did not pay an amount in respect of his *acquisition* of the securities within the purposively construed meaning of paragraph 2(2)(b). His appeal fails on this ground too.

HMRC's third argument

149. I will consider HMRC's third argument too, for the sake of completeness, although I recognise it is not necessary for my decision. This is the claim that paragraph 9A applies if the transactions are looked at realistically.

150. Paragraph 9A is an anti-avoidance provision which I have set out above at paragraph 55. There are a number of pre-conditions to its operation:

(a) The RDS must be issued to the taxpayer;

(b) The taxpayer must be connected to the issuer;

(c) The taxpayer must transfer it to a connected person;

(d) The amount paid for the RDS on issue must exceed its market value at that time.

151. This provision would have caught the planning schemes in cases such as *Campbell, Audley* and *Pike* had it been in force at the time. Read literally, it does not catch the planning in this case as Mr Bretten was not connected to OCL which issued the RDS. Mr Bretten also says that the issue price of the RDS was not at an overvalue.

152. HMRC's case is that viewed realistically Trust 1 was the issuer and it is not in dispute that Mr Bretten was connected with Trust 1. They say Trust 1 should be viewed as the issuer because Trust 1 was always intended to be substituted for OCL as debtor on the loan notes. OCL's role was always intended to be fleeting and without risk and OCL was only inserted into the transaction for tax avoidance purposes and in particular to ensure the issue was by a company.

153. I agree with HMRC that Paragraph 9A should be interpreted purposively. Paragraph 9A was an anti- tax avoidance provision which had the purpose of preventing persons artificially generating a loss for tax purposes. It cannot have been intended by Parliament that it would be interpreted mechanistically or overly literally.

154. Mr Bretten's position is that "issuer" cannot have been intended to mean any one other than the actual issuer and that to try to attribute any broader meaning to the language is to strain it beyond what it can bear. I am unable to agree with this.

155. As Paragraph 9A was clearly aimed at situations where a person would pay more for an asset than it was actually worth in order to generate an artificial loss for tax purposes. It is obvious, and the section contemplates, that a person would only be wiling to do this in a transaction with a connected party. Parliament must have intended "issuer" in Paragraph 9A(1)(b) to refer to the person who was, in reality, looking at the overall composite transaction, the issuer, and that the real issuer would be the person who was intended to receive the benefit of the fall in value of the RDS.

156. Looking at the reality of the planned transactions, Trust 1 was always intended to be substituted for OCL. And further, it was always intended that the loss – the devaluation of the RDS - would only arise once Trust 1 had been substituted. The only occasion on when there was any chance that Trust 1 would not be substituted, was if Mr Bretten chose to collapse the scheme early by exercising the right to redemption. And as I have said before this should be discounted as (a) there was only a remote likelihood of it occurring, (b) opt outs should be irrelevant when considering whether there was a composite transaction and (c) it acted like an opt out so that *if* account is taken of it, realistically the scheme should only be seen as commencing at the time at when it was clear the opt out would not be exercised, which was *after* Trust 1 had been substituted as debtor on the loan notes. So either way, realistically speaking, Trust 1 was the issuer of the loan notes.

157. There was never any intention whatsoever that OCL would own the RDSs at the time their market value decreased from approximately face value to 5%. Contrary to self-interest, if Mr Bretten had intended OCL to benefit from the fall in value, then I think OCL would have to be seen as the issuer for the purposes of Paragraph 9A. But this was not the case. Trust 1 was intended to be the debtor on the RDSs at the time of their decrease in value: and it was the person intended to be the debtor at the time of the devaluation that Parliament intended to be within the meaning of issuer. So Trust 1 was the issuer.

158. And Mr Bretten was connected with Trust 1. He was settlor, a trustee and a beneficiary of it. His connection with Trust 1 was not in dispute, but for completeness this can be seen from paragraph 9A(5) which incorporates the definition of "connected" from s 839 Taxes Act 1988. And that section provides that at (3) that a trustee is connected with the settlor. In this case one of the trustees *is* the settlor, and the other trustee is connected with the settlor.

159. But for Paragraph 9A to bite, HMRC have to go further and show that the loan notes were issued at a value exceeding their market value at that time. Mr Bretten

accepted at the hearing, as mentioned above in paragraph 20, and relying on the definition of market value explained in paragraph 53, that the market value at time of issue was a little less than the issue price.

160. However the difference in market value and face value at the date of issue would not be very great because the securities were, it is accepted, issued at full value, and it is just that the hypothetical willing purchaser would expect a small discount to reflect its trouble and expense in being involved in the purchase and then immediate redemption of the loan notes, that means its market value is a little lower.

161. HMRC's case is that this slight undervalue is enough to capture Mr Bretten's transaction because he should be regarded as connected with the issuer. But if HMRC were right on this, it would mean that even RDS issued at arms length in transactions which were not part of a pre-ordained tax avoidance scheme, would also not be issued at arms length. I agree with Mr Bretten that viewed *realistically,* Parliament cannot have intended paragraph 9A(1)(c) to capture a situation where the RDS was not issued at an undervalue, but because there would be a slight discount on a hypothetical resale on the open market, the issue price nevertheless slightly exceeds the market value as defined.

162. However, as I have said before one cannot view the facts realistically without considering whether the legislation lends itself to a purposive construction. "Market value" is a defined term and it seems this must be interpreted mechanistically because it is a deeming provision. However the word "exceeds" in paragraph 9A(1)(c) is not a deeming provision. Realistically speaking, the amount paid must exceed market value and in a case where this is only strictly true because market value is assessed by looking at a hypothetical purchaser rather than actual issue, it cannot realistically be said issue price exceeds market value.

163. HMRC's alternative case is that I should take the market value as at day 15, after the RDS fell to its real value rather than the artificially inflated value of the first 14 days. They cite the First Tier Tribunal (Judge Brannan and Ms Redston) decision in *Blumental* [2012] UKFTT 497 (TC), which was a case involving a tax avoidance scheme around qualifying corporate bonds, where the Tribunal said:

> "Construing sections 116(10) and 272 TCGA purposively, the references in those provisions to "market value" and the "price which those assets might reasonably be expected to fetch on he sale in the open market" do not refer to a value or price which has been artificially manipulated, solely for tax purposes, in a wholly un-commercial fashion to produce a temporarily depressed value. There was no commercial or economic reason why the value of the Loan Notes should have been reduced to [figure]. The value thus manipulated is not the value or the price which the relevant statutory provisions, construed purposively envisage."

164. I have sympathy with HMRC's view that s 272 TCGA was intended to provide an open market valuation and so (looking at a pre-determined series of transactions) where the value of an asset is artificially inflated or depressed as part of that pre-determined series of transactions, the market value was intended by Parliament to be

measured before or after the artificial manipulation. However, I don't think I need to determine this because I think HMRC's third case fails for another reason.

165. This is that where paragraph 9A(1)(c) refers to "the amount paid by the relevant person in respect of his acquisition of the security…", this must have been intended to have exactly the same meaning as "the amount paid by that person in respect of his acquisition of the security.." in paragraph 2(2)(b) as it is in the same Schedule and refers to the same event.

166. However, in respect of HMRC's second argument, I have already said that the amount "paid" in Paragraph 2(2)(b) was £25,000. £25,000 clearly does not exceed £500,000 or the market value of the RDS on the date of issue or even the market value at day 15 (which was £25,000). Therefore the amount paid in Paragraph 9A(1)(c) does not exceed the market value of the security.

167. And this cannot be a surprising conclusion. Paragraph 9A is an anti-avoidance provision predicated on the basis that a scheme of the sort in *Audley* actually worked if the legislation were left unamended. But *Astell* and *Audley* show that on a proper interpretation of paragraph 2, these schemes don't work. Paragraph 9A is superfluous. It can't bite. The sort of scheme it was intended to bite on doesn't even get as far as paragraph 9A because the amount "paid" was what was really paid and that (in an avoidance case) will not exceed its actual value.

168. In conclusion, HMRC succeed in their first and second but not their third arguments. In any event, the appeal is dismissed.

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

BARBARA MOSEDALE
TRIBUNAL JUDGE

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