Neutral Citation: [2023] UKFTT 61 (TC)

Case Number: TC08703

FIRST-TIER TRIBUNAL
TAX CHAMBER

By remote video hearing

Appeal reference: TC/2020/01204

Employee shares - subscription price outstanding – cease employment – structure to protect employees where share value less than outstanding debt including indemnities – later restructure in the context of a share sale including payment to employees to enable their debts to be repaid – whether the payment was taxable as earnings from employment – section 62 ITEPA – Murphy.

Heard on: 9-11 May 2022 with written submissions dated 24 August 2022, 16 September 2022 and 27 September 2022
Judgment date: 19 January 2023

Before

TRIBUNAL JUDGE BOWLER
MR JULIAN SIMS

Between

GAIN CAPITAL LTD

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Christopher Stone of counsel, instructed by RSM Tax and Accounting Limited

For the Respondents: Georgina Hirsch of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. The Appellant appeals against a determination dated 26 March 2019 issued under regulation 80 of the Income Tax (Pay As You Earn) Regulations 2003 (the "Determination"). The Determination charges the Appellant to tax of £2,666,188.45 for the 2014/15 tax year on gifts made to two former employees, Mr Clive Cooke and Mr Roger Hambury. The issue is whether the gifts constituted earnings of Mr Cooke and Mr Hambury under s.62 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA").

2. The gifts were made to Mr Cooke and Mr Hambury so that they could repay loans that had been previously made to them to pay up shares that they had acquired as a result of their employment. Those shares had fallen significantly in value because of the global financial crisis. The gifts were made in the context of the Appellant being purchased by an American company. The core issue is whether the gift amounts were payments received by Mr Cooke and Mr Hambury from their employment.

FORM OF HEARING

3. The form of the hearing was video using the Tribunal video hearing system. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

GROUNDS OF APPEAL

4. The grounds of appeal (so far as still relied upon by the Appellant at the time of the hearing) can be summarised as follows:

   (1) the gifts made in 2014 were not payments in return for acting as, or being, an employee and were not paid to Mr Cooke and Mr Hambury in their capacity as employees.

5. More particularly, the employments of Mr Cooke and Mr Hambury were not the reason why the gifts were made. Their employments were terminated years earlier and the payments were made as a result of the commercial need to address the Appellant's contingent liabilities under indemnities it had given to Mr Cooke and Mr Hambury and which were an obstacle to the sale of the group of which the Appellant was a member. The source of the payments was the rights that Mr Cooke and Mr Hambury held under arrangements entered into in 2011 and not their former employments. The arrangements entered into in 2011 were not a reward for services. While it may be argued that Mr Hambury and Mr Cooke would not have received the 2014 gifts "but for" their past employments, they were not the cause of the payments and reliance is placed upon the case of *Hochstrasser v Mayes* [1960] AC 376.

BURDEN OF PROOF

6. The burden of proof rests with the Appellant and the usual civil standard of balance of probabilities applies.

AGREED FACTS

7. The parties provided the following agreed statement of facts.

Corporate Structure of the Appellant

8. The Appellant is a private limited company incorporated on 17 October 1983, and was known as City Index Ltd ("CIL") until 1 June 2015.

9. On 1 June 2015, the Appellant's name was changed to Gain Capital UK Ltd.

10. CIL was the 100% subsidiary of City Index Holdings Limited ("CIHL") which was, in turn, the 100% subsidiary of City Index Group Ltd ("CIGL"). The majority shareholder in CIGL was Incap Gaming BV ("IGBV") which was part of the IPGL Group. The IPGL Group also included Incap Netherlands (Holding) BV ("INBV").

11. In April 2015, the entire shareholding in CIHL was acquired by an American company, Gain Capital Holdings Inc.

Acquisition of shares

12. In or around 2007 or early 2008:

(1) Mr Hambury subscribed for 112,500 ordinary shares in CIHL which were nil paid, and 11,560 shares in CIGL which were also nil paid.

(2) Mr Cooke subscribed for 187,500 ordinary shares in CIHL which were nil paid, and 5,481 shares in CIGL which were also nil paid.

13. Pursuant to the terms of agreements dated 18 January 2008 with INBV:

(1) A loan in the sum of £1,912,500 was made available by INBV to Mr Hambury to enable him to pay the outstanding subscription price of the 112,500 ordinary shares in CIHL (the "First Hambury Loan").

(2) A loan in the sum of £3,187,500 was made available by INBV to Mr Cooke to enable him to pay the outstanding subscription price of the 187,500 ordinary shares in CIHL (the "First Cooke Loan").

14. On 5 February 2008, having paid up their shares in CIHL, Mr Cooke and Mr Hambury exchanged their shares in CIHL for fully paid ordinary shares in CIGL on a share-for-share basis.

15. On 30 May 2008 INBV made a further £500,000 available to Mr Hambury, with additional accumulated interest of £45,701 thereon (the "Second Hambury Loan").

Events in 2010-2011

16. On 9 March 2009 Mr Cooke resigned as a director of CIL. Mr Cooke remained an employee of CIL until 31 March 2010.

17. On 11 February 2011 Mr Cooke entered into a call option agreement.

18. On 25 November 2011 Mr Hambury resigned as a director and ceased to be an employee of CIL.

19. On 2 December 2011 Mr Hambury entered into a call option agreement.

Events in 2014

20. On 28 October 2014, Mr Hambury and Mr Cooke entered into Framework Agreements with IGBV and IPGL Ltd, the parent company of INBV.

21. Pursuant to the terms of further agreements dated 28 October 2014 with INBV:

(1) A loan in the sum of £231,200 was made available by INBV to Mr Hambury to enable him to pay the outstanding subscription price of the 11,560 shares in CIGL (the "Third Hambury Loan").

(2) A loan in the sum of £109,620 was made available by INBV to Mr Cooke to enable him to pay the outstanding subscription price of the 5,481 shares in CIGL (the "Second Cooke Loan").

22. Pursuant to agreements dated 29 October 2014 with IGBV:

(1) It was agreed that Mr Hambury would sell and IGBV would purchase 124,060 (112,500 + 11,560) fully paid shares in CIGL for the price of £620.30.

(2) It was agreed that Mr Cooke would sell and IGBV would purchase 192,981 (187,500 + 5,481) fully paid shares in CIGL for the price of £964.90.

23. Pursuant to Deeds of Gift dated 30 October 2014 with IGBV:

(1) It was recorded that Mr Hambury had outstanding loans to INBV in the total sum of £2,458,201 (the First and Second Hambury Loans with interest), that IGBV wished to make a gift to Mr Hambury of this sum in order to allow him to repay the outstanding amount, and that the gift was thereby given by IGBV and accepted by Mr Hambury. On Mr Hambury's behalf, the sums were paid to INBV.

(2) It was recorded that Mr Cooke had outstanding loans to INBV in the total sum of £3,187,500 (the First Cooke Loan), that IGBV wished to make a gift to Mr Cooke of this sum in order to allow him to repay the outstanding amount, and that the gift was thereby given by IGBV and accepted by Mr Cooke. On Mr Cooke's behalf, the sums were paid to INBV.

24. Further agreements dated 30 October 2014 were entered into with INBV to:

(1) Release Mr Hambury from any obligation to repay the Third Hambury Loan in return for a payment of £620.30 as "a prepayment in reduction of the loan".

(2) Release Mr Cooke from any obligation to repay the Second Cooke Loan in return for a payment of £964.91 as "a prepayment in reduction of the loan".

25. On 26 March 2019, the Respondents ("HMRC") issued the Appellant with a determination under regulation 80 of the Income Tax (Pay As You Earn) Regulations 2003 (SI 2003 No 2682) assessing the Appellant to income tax of £2,666,188.45 for the year ended 5 April 2015. In letters dated 16 May 2019 and 18 July 2019, HMRC explained that the determination was issued on the basis that the amount of £5,986,521 comprising:

(1) £2,689,401 (£2,458,201 + £231,200) in respect of Mr Hambury; and

(2) £3,297,120 (£3,187,500 + £109,620) in respect of Mr Cooke,

should have been subjected to PAYE as a payment of employment income to Mr Hambury and Mr Cooke respectively under s.62 ITEPA.

AGREED APPROACH

26. HMRC and the Appellant have accepted that the payments made to Mr Cooke and Mr Hambury should be treated in the same way. We have been provided with documentary evidence involving Mr Hambury but no Witness Statement from him and he did not attend the hearing. We have therefore proceeded on the basis of addressing the evidence provided for and by Mr Cooke recognising that HMRC have agreed that the same consequences will follow for the appeal so far as it relates to payments made to Mr Hambury.

SUBMISSIONS

27. Very shortly after the hearing the decision of the Court of Appeal in *Murphy* was released. The parties submitted written submissions addressing that decision. Our summary of the parties' submissions reflects their original submissions at the hearing as updated by the submissions regarding *Murphy*.

The Appellant's case

28. The Tribunal has to consider whether the gifts were earnings from the employments of Mr Cooke and Mr Hambury, which is not determined by asking if the recipients received benefits in 2011 and, if so, whether they were earnings. There must be some form of financial benefit to the recipient from the 2014 gifts. The recipients were left 'flat', with the gifts reflecting the fall in value of the shares and being used to repay the 2008 Loans. That "flat" position was achieved as a result of the 2011 call options under the "Call Option Agreements". The 2014 gifts provided no additional benefit.

29. The 2014 gifts do not satisfy the definition of earnings because they were not 'from' the recipients' employments. The significant period of time since they had ceased employment with the Appellant had broken the causal link and the reason the gifts were made was to facilitate the sale of the business by removing a genuine blockage. If they were linked back to the 2011 arrangements, those arrangements should be seen as an act of largesse or generosity by Mr Cooke's and Mr Hambury's boss, Mr Spencer, and therefore also not a reward for services.

30. Even if the 2014 gifts were linked back to the Call Option Agreements, the rights of the parties under those agreements were not rights derived from the employment contracts of Mr Cooke and Mr Hambury and were outside the terms of the incentive scheme and share plan). Accordingly, even if (which is denied) the 2014 gifts can be treated as a "manifestation" of the Call Option Agreements, the source of any benefits contained in the Call Option Agreements was not therefore the recipients' employment (and HMRC have confirmed that they are not pursuing an alternative argument under the termination of employment provisions contained in s. 401 ITEPA).

31. The Call Option Agreement was a negotiated contract between Mr Cooke and several companies in the IPGL group. The rights and obligations under the Call Option Agreement, and the economic position of the parties, do not reflect the rights and obligations of the parties under Mr Cooke's employment contract (taken with the share plan rules). It was not suggested to Mr Cooke in cross-examination that he had any expectation of the final position that was reached under the Call Option Agreement prior to resigning and it would be inconsistent with the evidence he gave.

32. The Court of Appeal in *Murphy* accurately identified the general test for determining whether a payment is from employment. In contrast to the case here, the facts in *Murphy* illustrate an example of a sum comprising taxable earnings because it is clearly and expressly related to actual rewards that an employee was owed directly in respect of their work.

33. Following the Court of Appeal judgement in *Murphy* the Appellant accepts that the Tribunal should not consider the question of whether there is sufficient element of bounty to give rise to a 'profit' as a distinct issue from the question of whether the gifts were emoluments from the former employments of Mr Cooke and Mr Hambury. However, the question of whether there was a "financial benefit" for the recipient still forms part of the determination of whether there was a reward or remuneration from the employment. In this case the 2014 gifts gave nothing to Mr Cooke and Mr Hambury that they had not already achieved through the 2011 Call Option Agreements.

34. Reliance is placed on the case of *Murphy* and the requirement for an emolument to be a "reward" for the employee's services. The gifts were not made under the employees' contracts, but were made several years after the termination of their employments, in relation to arrangements entered into after termination. They were paid following two separate commercial negotiations and were not made by reference to or as a reward for the services that the employees had performed or in their capacity as former employees.

35. The passage from [49] of Asplin LJ's judgment in *Murphy* emphasises that the 'but for' analysis adopted by HMRC in this case cannot be correct. As that paragraph specifies, even if a taxpayer were required to be an employee in order to enter into a collateral agreement, if the payment is received under the collateral agreement and is not remuneration for the services provided as an employee, it will not be an emolument. The present case is stronger still. The evidence demonstrates that the gifts were made to Mr Cooke and Mr Hambury because of their status as people with the benefit of indemnities that needed to be resolved in order to let the deal go ahead; their status as former employees was incidental to the making of the gifts. The reliance by HMRC on the case of *Charman v HMRC* [2022] STC 157 is misplaced as the Court of Appeal was addressing the concept of "by reason of" not "from". However, the Upper Tribunal's decision in that case illustrates that "from" should be interpreted more narrowly.

36. Moreover, a payment received following a termination will not be an emolument unless it is by way of deferred remuneration and relates to the services rendered by the individual when an employee (*Mairs v Haughey* [1994] 1 AC 303).

HMRC's case

37. HMRC are not relying upon s188 ITEPA (which deals with the release of employment related loans) in this case because of the way in which the case was presented/stated in the course of the litigation. Were it not for that process limitation they have said that they would be relying upon s188 combined with the application of the *Ramsay* principles and the case of *Mairs v Haughey*.

38. HMRC accept that s9 ITEPA requires the taxable payment to be "from" employment and *Hochstrasser* makes clear the link to a reward for services. They rely on the definition of "earnings" in s62 ITEPA and in particular s62(2)(b) "incidental benefit of any kind obtained by the employee if it is money or money's worth". A payment which protected the former employees from having to cover the gap between what they could sell the shares for and the full value of the loans they had received for the original price of the shares was clearly a significant payment of "money or money's worth". This was a financial benefit for the individuals.

39. The test of whether the incidental benefit of monies worth comes within the s62 meaning of "earnings" is whether the link between the incidental benefit and the recipient's former employment was a substantial cause for the benefit being conferred. HMRC do not deny that Gain Capital wished to purchase CIHL free from the liabilities associated with former employees' share rights and the liabilities associated with them. However, the gifts were only needed, and only made, because the former employees had share rights and loans, both of which directly arose from their employment with the company within the group. Accordingly, the former employment was a substantial cause for the gifts. Reliance is placed on the Court of Appeal's decision in *Charman v HMRC* [2022] STC 157. The fact that the individuals were no longer employees at the time the gifts were made does not stop the gifts being employment related as shown by the approach adopted in s 188(2) ITEPA.

40. The parties agree that on interpreting tax statutes the court should take a purposive approach. The Appellant has admitted that but for the sale to Gain Capital, IPGL were aware that they may have a significant tax liability if IGBV had exercised its option under the Call Option Agreement. If the commercial pressure of the sale of CIHL to Gain Capital was seen as the source of the gifts such that it was not viewed as being from the individuals' employment, Gain Capital would benefit from a windfall when the transactions were compared with the underlying situation involving the Call Option Agreement.

41. The evidence, including oral evidence from Mr Cooke, showed that the benefits conferred by and manifested in the 2014 agreement were a "reward for services". The commercial motivation for the 2014 agreement does not prevent the former employment of the recipients being the "sufficiently substantial" cause of the payment, as required by the authorities, and as set out at paragraphs 17 to 21 of the Respondents' skeleton argument. Nor does the fact that the rights were maintained through a series of contracts. Each of those subsequent contracts was drafted and entered into for reasons pertinent at the time. While those reasons were substantial in themselves, they did not prevent the original motivation for the benefits – arising from the recipients' employment – still being "sufficiently substantial" to satisfy the "from employment" test.

EVIDENCE

42. We were provided with a PDF bundle of 783 pages. We heard oral evidence from: Mr Cooke, Mr Gelber, a non-executive director of the ultimate parent company of the Appellant, IPGL, at the time of the relevant transactions; and Mr Rotsztain, head of corporate development, general counsel and company secretary of Gain Capital Holdings Inc ("Gain Capital") at the time of the sale of CIHL to Gain Capital.

43. Mr Cooke had very little memory of what happened in 2009 when his relationship with CIL was ceasing. He was unable to tell us much about the circumstances of his departure from CIL; what he asked for at the time; or even what his notice terms were. He also had little knowledge of the documents he had signed at various stages between 2009 and 2014 or the transactions which occurred despite descriptions in his Witness Statement. We therefore reduced the weight given to the evidence in his Witness Statement where it was clear that he was unable to explain it in cross-examination. However, he did not attempt to hide his lack of detailed knowledge; he was clear that from 2009 when he ceased working for CIL he simply wanted the problems caused by the deferred share plan and loan to be dealt with and he had professional advisers to ensure that his position was appropriately addressed. Overall, his oral evidence was broadly consistent and reliable.

44. Mr Gelber's oral evidence showed that he had little knowledge of what was done in 2014 or indeed, before then, beyond understanding that issues concerning the two CIL employees were dealt with. Some of his Witness Statement is inconsistent with what he said at the hearing in that he suggests a greater understanding of what occurred. Overall, however his evidence was consistent with other evidence that in 2014 IPGL needed to get the issues concerning the indemnity given by CIL to Mr Cooke and Mr Hambury sorted.

45. However, statements made by him that the amounts paid were solely in order that the indemnities could be released are seen by us as falling clearly within the *Gestmin* principles.

46. In relation to the reliability of witness statements prepared some time after relevant events, we start with referring to the oft-quoted principles stated by Legatt LJ in *Gestmin SGPS SA v Credit Suisse (UK) Ltd* [2013] EWHC 3560 (Comm) (at paras 15-22) which, in particular, identify that:

> "Memory is especially unreliable when it comes to recalling past beliefs. Our memories of past beliefs are revised to make them more consistent with our present beliefs… Considerable interference with memory is also introduced in civil litigation by the procedure of preparing for trial…
>
> …[So that] "it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth."

47. However, as the Court of Appeal made clear in *Kogan v Martin & Ors (Rev 1)* [2019] EWCA Civ 1645 (at para 88), the *Gestmin* guidance does not prevent reliance upon witness statements.

> "A proper awareness of the fallibility of memory does not relieve judges of the task of making findings of fact based upon *all* of the evidence."

48. The same emphasis on the duty to consider all of the evidence and determining the weight to be given to it was stated in *BXB v Watch Tower and Bible Tract Society of Pennsylvania and Trustees of the Barry Congregation of Jehovah's Witnesses [2020] EWHC 156 (QB)* although the fallibility of memory should be recognised.

49. We have therefore considered the evidence overall in assessing the weight to be given to Mr Gelber's description of the payments made in 2014. It is clear from the documents and the amount paid (as we describe later) that the gifts were not amounts paid to release the indemnities and we conclude that Mr Gelber's statement is an ex post facto rationalisation developed over the years in the context of this litigation.

50. Mr Rotsztain's oral evidence showed that he had little personal knowledge of the details of the transactions and payments involved in this case. However, his evidence was consistent that the indemnity given to Mr Cooke and Mr Hambury by CIL was a problem for the sale to Gain Capital and our findings reflect that.

51. A Witness Statement of Ms Kilmister-Blue, who was the Chief Executive Officer of IPGL at the time of the sale of CIHL to Gain Capital, was included in the bundle but she did not attend the hearing. Mr Stone recognised that less weight should be given to the evidence in her Witness Statement as a result of the fact that her evidence could not be tested in cross-examination. In fact, much of her evidence in her Witness Statement adds little to the documentary evidence in the bundle. However, she alone provides some reference to consideration of other options in 2014. While we have reduced the weight given to her evidence, we have still addressed it, particularly where it relates to matters which are not otherwise dealt with.

52. However, there is a lacuna in the evidence before us. There was no one from City Index/the IPGL group to give evidence about the context of deferred share plan and expectations/negotiations in 2011. In addition, there was no evidence beyond limited references made by Ms Kilmister-Blue as to why the particular set of transactions was entered into in 2014. None of those attending the hearing were able to engage with questions about why the 2014 transactions involving Mr Cooke and Mr Hambury took place as they did beyond referring to the circumstances of the sale of CIHL to Gain Capital. We have therefore made findings regarding the background to the disputed payments (as the authorities make clear we must do) from the evidence overall, as we explain later in this decision.

OUR FINDINGS OF FACT

53. We set out the agreed facts in italics for ease of reading.

Background

54. Until he resigned in 2009, Mr Cooke was the CEO and Deputy Chairman of CIL. Companies House records show him as having resigned on 9 March 2009 as a director.

Deferred share plan 2007

55. In or around 2007:

> *(1) Mr Hambury subscribed for 112,500 ordinary shares in CIHL which were nil paid and*

(2) Mr Cooke subscribed for 187,500 ordinary shares in CIHL which were nil paid.

56. The acquisition of the shares in 2007 was under the terms of a deferred share scheme, an incentive scheme for eligible employees. Mr Cooke acquired the 187,500 ordinary shares in CIHL at a subscription price of £17 per share.

57. The deferred share scheme had been established in November 2006 and provided that:

(1) eligible employees could be invited by the directors of CIHL to apply to subscribe for ordinary shares in the company. The subscription price was stated to be the market value of the shares at the date of the invitation to subscribe (but not less than their nominal value);

(2) two years after subscription the shares became "Vested Scheme Shares". Once they had become Vested Scheme Shares the subscription price of the shares was to be paid in full within 30 days of the earliest of:

(a) the cessation of employment of the participant in whom the shares had vested;

(b) the transfer of such shares;

(c) an exit event (defined as a listing of CIHL or a takeover, reconstruction, amalgamation or winding up of CIHL);

(d) the 10th anniversary of the subscription date.

(3) if a participant's employment with the group terminated for any reason other than death, they were required to transfer any non-vested scheme shares to the Company at a price equal to the lower of the subscription price or the market value at the date of such transfer.

58. On 20 December 2006 Mr Cooke became the holder of an option to acquire 187,500 shares in CIHL. The option was stated to lapse within 30 days after the date of grant. An undated notice of exercise of the option has been provided together with a subscription agreement dated 10 January 2007 ("the Subscription Agreement") reciting that Mr Cooke agreed to subscribe for the 187,500 shares. He agreed to pay the amount unpaid on the shares when called for by CIHL. Under the Subscription Agreement the shares would be forfeited if Mr Cooke's employment with the group ended within two years of the subscription date.

59. Different provisions concerning vesting of the shares (including timing of vesting) were provided under the Subscription Agreement. However, as we explain later the vesting rules and their application in the context of Mr Cook's termination of employment were overridden by the terms of the Call Option Agreement entered into in 2011. We therefore say no more about the vesting rules here save to note that there were rules and restrictions reflecting the usual design of such schemes to link the ability to benefit from the shares to continued employment with the company or group.

Reorganisation and further deferred share plan 2008

60. Pursuant to the terms of agreements dated 18 January 2008 with INBV:

(1) A loan in the sum of £1,912,500 was made available by INBV to Mr Hambury to enable him to pay the outstanding subscription price of the 112,500 ordinary shares in CIHL (the "First Hambury Loan").

(2) A loan in the sum of £3,187,500 was made available by INBV to Mr Cooke to enable him to pay the outstanding subscription price of the 187,500 ordinary shares in CIHL (the "First Cooke Loan").

61. On 5 February 2008, having paid up their shares in CIHL, Mr Cooke and Mr Hambury exchanged their shares in CIHL for fully paid ordinary shares in CIGL on a share-for-share basis.

62. On 30 May 2008 INBV made a further £500,000 available to Mr Hambury, with additional accumulated interest of £45,701 thereon (the "Second Hambury Loan").

63. Mr Hambury subscribed for 11,560 shares in CIGL and Mr Cooke subscribed for 5,481 shares in CIGL which in each case were nil paid

64. The 2008 transactions were part of a share reorganisation in which Mr Cooke's shares in CIHL were exchanged for shares in CIGL. In order for that to take place it was necessary for the shares in CIHL to be fully paid up. Board minutes of CIGL show that the reorganisation occurred for reasons relating to the terms and structuring of CIGL's purchase of an American company called FXS Holdings Inc.

65. To enable the reorganisation, Mr Cooke entered into a loan with INBV for £3,187,500 (the "First Cooke Loan").

66. The terms of the First Cooke Loan were set out in a letter from INBV to Mr Cooke on 18 January 2008. Those terms included provisions that:

(1) the loan would be used by Mr Cooke solely for the purpose of paying up the outstanding subscription price due on the CIHL shares;

(2) the loan would be interest free;

(3) the loan was conditional upon Mr Cooke agreeing to enter into a new subscription agreement in relation to the CIGL shares (and an agreement involving the Francisco Partners regarding the American acquisition).

67. It is also stated that the loan would be repayable in the circumstances set out in the deferred share scheme and the new subscription agreement, although this makes little sense as there are no known repayment circumstances or even reference to the loan in those documents.

68. However, we have relied upon the evidence generally to conclude that the assumption of those involved was that the shares would be sold at an increased value such that Mr Cooke would be able to repay the loan and retain the excess as a reward which would reflect his contribution to the business' success.

69. After the share exchange which took place on 5 February 2008, Mr Cooke was a shareholder in CIGL. Instead of owing monies to CIHL for the subscription of shares in that company, Mr Cooke owed the First Cooke Loan to INBV.

70. In January 2008 CIGL had set up another deferred share plan on terms which were in essence the same as those of the CIHL plan. However, the vesting rules were different and the evidence contained in the Subscription Agreement under which Mr Cooke subscribed for shares in CIGL under the plan shows that one third of the shares had vested on 10 January 2009. One third was due to vest on 10 January 2010 and the remaining third was due to vest on 10 January 2011. It is not clear whether the second and third tranche of vesting in fact took place given that Mr Cooke stopped working for City Index in 2009.

71. The Board of CIGL decided on 18 March 2008 to change the rules of the deferred share plan. It was now provided that if a participant in the plan ceased to be an employee and sold any shares the price would be determined in accordance with CIGL's articles of association. In a letter to the participants it was noted that if the price at which the shares were sold was more than the "tax market value" of the shares then the employee would have a liability to

income tax and NICs on the difference. On change of control of CIGL the plan shares would vest in full.

72. In April 2008 pursuant to the later deferred share plan Mr Cooke acquired a further 5,481 shares in CIGL, the subscription price for which was left outstanding.

73. By this stage Mr Cooke therefore held one tranche of shares in CIGL which were fully paid-up and one unpaid tranche of shares in the company; and owed the First Cooke Loan of £3,187,500 to INBV.

Mr Cooke's employment ceasing 2009

74. On 9 March 2009 Mr Cooke resigned as a director of CIL. Mr Cooke remained an employee of CIL until 31 March 2010.

75. On 11 February 2011 Mr Cooke entered into a call option agreement.

76. On 25 November 2011 Mr Hambury resigned as a director and ceased to be an employee of CIL.

On 2 December 2011 Mr Hambury entered into a call option agreement.

77. Mr Cooke had discussions with Mr Spencer regarding his employment in 2009. Mr Cooke's own evidence at the hearing was somewhat vague and we have placed greater weight on a letter sent from his adviser to the head of human resources at CIL. That letter shows that Mr Cooke was advised by Mr Spencer on 17 July 2009 that Mr Cooke was no longer required to attend the offices of CIL and other employees had been told that Mr Cooke no longer had any executive responsibilities and was no longer engaged in the management and conduct of the business. The letter shows that termination arrangements had not been agreed by this stage; the adviser set out key points from Mr Cooke's perspective regarding the termination. Those points included an assumption that Mr Cooke would continue to be indemnified against tax liabilities in relation to the deferred share plan. Furthermore, it was stated that Mr Cooke would not accept any employment or engagement restrictions during any period for which Mr Cooke was not paid. The letter specifically noted that at a meeting on 17 July 2009 Mr Spencer had advised Mr Cooke that Mr Cooke could retain both the shares and the benefit of the loan as an interest-free loan and commented that Mr Cooke would be open to consider any offer which the company might make for the repurchase of the shares.

78. There is no evidence that Mr Cooke left in circumstances where his performance was considered to be lacking. Instead, the evidence is that his departure was driven by the circumstances affecting City Index and in particular the impact of the financial crisis.

79. Mr Cooke's evidence at the hearing shows that when he left he did not know what the share value was but thought that there might be some "residual value" and he would be told that having done a good job he would be paid that value. However, at some point of time later he came to realise that the company had such issues that there was no value to be paid to him.

80. Mr Cooke was therefore exposed. He held shares with a lower value than the liabilities under the INBV loans.

81. Under the rules of the share plan, CIL could have acquired at least some of Mr Cooke's shares for their market value, leaving him significantly out of pocket. Further, under the terms of the share plan, Mr Cooke would have been liable for any income tax and NICs.

82. Mr Cooke was separately and independently advised by a solicitor in his discussions with CIL about how to resolve the shareholding in CIGL and outstanding loan from INBV. It

was agreed that he could retain the shares (which were at the time worth very little) and the benefit of the First Cooke Loan. He was keen to obtain a full indemnity against any tax liabilities associated with any subsequent release of the 2008 Loan. The discussions resulted in the Call Option Agreement, but that was not signed until 2011.

83. We rely upon Mr Cooke's evidence to find that the reason for the gap between leaving in 2009 and the 2011 agreements was that in the period there were heavy losses incurred by the company as a result of customer non-payments and there was a substantial reorganisation. Mr Cooke was not in a hurry to move matters along because, as he explained to us, he knew it would all be dealt with at the right time.

The 2011 Call Option Agreement

84. This agreement was entered into on 11 February 2011.

85. In the Call Option Agreement it was noted in the recitals that the Articles of Association of CIGL and the deferred share plan documents contained restrictions regarding the transfer of the shares for which Mr Cooke had subscribed, but with the agreement of CIL, CIHL and CIGL, Mr Cooke had agreed to grant IGBV an option to call for the sale of the shares on the terms set out in the agreement. Those terms provided that the option to call for the sale of the shares in CIGL was exercisable at their original subscription price and if it was exercised the proceeds would be used by Mr Cooke to repay the First Cooke Loan and to pay the subscription price of the unpaid shares in CIGL. If the option was not exercised by a long stop date (five years from the date of the agreement), INBV agreed to release Mr Cooke from the obligation to repay the First Cooke Loan.

86. Further provisions in the Call Option Agreement provided:

(1) A standard set of post-employment restrictive covenants given by Mr Cooke under which he promised not to engage with, or seek employment with, competing businesses from 12 months from the date of the agreement. No restrictive covenants had been entered into by Mr Cooke prior to this document;

(2) Subject to Mr Cooke performing his obligations:

(a) An undertaking and agreement from INBV not to call for payment of all or any part of the First Cooke Loan before the long stop date other than on completion of any exercise of the option; and to release Mr Cooke from any obligations in respect of the balance of the loan outstanding at the long stop date if the option had not been exercised by that date;

(3) a tax indemnity from CIL to Mr Cooke, indemnifying him against any liability to income tax and NICs in relation to the acquisition and disposal of the shares over which he had granted the option and the acceptance, subsistence, release or writing off of the First Cooke Loan;

(4) CIGL and CIHL confirmed that the directors of the two companies had exercised their discretion under the deferred share scheme rules to permit Mr Cooke to retain the shares and for the unpaid shares to remain unpaid until the time of transfer, notwithstanding the termination of his employment by CIL.

87. As a result of this document Mr Cooke could therefore expect to be in an economically 'flat' position from his participation in the share schemes: he would not benefit financially, but neither would he be worse off, because at the end of five years the Call Option would have been exercised, or the First Cooke Loan would be released and he would have no liability; and he was protected from any charge to tax arising from his share participation, including a charge arising on a release of the First Cooke Loan.

88. Mr Cooke obtained financial benefit when the Call Option Agreement was entered into. Prior to that point he was exposed to a very significant liability in relation to the First Cooke Loan. Now that exposure was removed.

89. The Call Option Agreement was the only document setting out restrictive covenants to apply to Mr Cooke even though it was not entered into for some two years after Mr Cooke's departure from the business.

90. Mr Cooke's evidence showed that he considered that Mr Spencer, who was one of the senior leadership team at City Index, felt a sense of obligation not to leave Mr Cooke significantly out of pocket as a result of holding the shares. Mr Cooke said that in light of his 7 years of service to the company, his close relationship with Mr Spencer and all the efforts he had made in his time with the business Mr Spencer did not want him to be financially burdened. It had never been the intention that he would be out-of-pocket as a result of the deferred share plans and Mr Spencer knew that Mr Cooke did not have the money to repay the loans in any event.

91. However, Mr Cooke's evidence showed that at the same time as feeling he should not have any liability as a result of taking part in the share plan, Mr Cooke accepted that he should not expect to profit from someone else's success after he left the organisation. That was reflected by the Call Option Agreement.

92. Mr Gelber gave evidence about Mr Spencer and his "generosity". He said that he was a very generous and loyal man who always rewarded loyalty. It was therefore not out of his character to take the steps in 2011, particularly as Mr Cooke and Mr Spencer went back a long time. Otherwise however, he could not comment on Mr Spencer's thinking and the extent to which his loyalty derived from Mr Cooke's work at CIL. He was taken to Ms Kilminster-Blue's Witness Statement, where she states that her understanding of the 2011 arrangements was that Mr Spencer felt it would not be right to leave the individuals potentially on the hook to pay hundreds of thousands of pounds in respect of shares that might never recover their value. He said that he could not attest to what she said because he was unaware of the arrangements made in 2011. When asked if it was consistent with knowledge of Mr Spencer he said that it was "not inconsistent", but he could not identify any previous instances of "generosity". However, when asked about whether the arrangements were an act of generosity by Mr Spencer, Mr Cooke was clear that it was more an act of honour given his service to the company and understanding of the basis of the share plans.

93. We conclude, given the clear limitations in his evidence that Mr Gelber's comments about Mr Spencer's generosity are insufficient to conclude that the Call Option Agreement was put in place as a matter of generosity. We give greater weight to the evidence of Mr Cooke. We are therefore satisfied that the evidence was of Mr Spencer acting as a man of honour given Mr Cooke's time at CIL. Mr Spencer was not acting out of generosity or largesse. The Call Option Agreement was entered into in order to reflect the fact of Mr Cooke's service for CIL and the original intention when the shares were initially awarded to him that Mr Cooke would not be out-of-pocket as a result of the share plan.

Sale of CIHL

94. On 28 October 2014, Mr Hambury and Mr Cooke entered into Framework Agreements with IGBV and IPGL Ltd, the parent company of INBV.

95. Pursuant to the terms of further agreements dated 28 October 2014 with INBV:

(1) A loan in the sum of £231,200 was made available by INBV to Mr Hambury to enable him to pay the outstanding subscription price of the 11,560 shares in CIGL (the "Third Hambury Loan").

(2) A loan in the sum of £109,620 was made available by INBV to Mr Cooke to enable him to pay the outstanding subscription price of the 5,481 shares in CIGL (the "Second Cooke Loan").

96. Pursuant to agreements dated 29 October 2014 with IGBV:

(1) It was agreed that Mr Hambury would sell and IGBV would purchase 124,060 (112,500 + 11,560) fully paid shares in CIGL for the price of £620.30.

(2) It was agreed that Mr Cooke would sell and IGBV would purchase 192,981 (187,500 + 5,481) fully paid shares in CIGL for the price of £964.90.

97. Pursuant to Deeds of Gift dated 30 October 2014 with IGBV:

(1) It was recorded that Mr Hambury had outstanding loans to INBV in the total sum of £2,458,201 (the First and Second Hambury Loans with interest), that IGBV wished to make a gift to Mr Hambury of this sum in order to allow him to repay the outstanding amount, and that the gift was thereby given by IGBV and accepted by Mr Hambury. On Mr Hambury's behalf, the sums were paid to INBV.

(2) It was recorded that Mr Cooke had outstanding loans to INBV in the total sum of £3,187,500 (the First Cooke Loan), that IGBV wished to make a gift to Mr Cooke of this sum in order to allow him to repay the outstanding amount, and that the gift was thereby given by IGBV and accepted by Mr Cooke. On Mr Cooke's behalf, the sums were paid to INBV.

98. Further agreements dated 30 October 2014 were entered into with INBV to:

(1) Release Mr Hambury from any obligation to repay the Third Hambury Loan in return for a payment of £620.30 as "a prepayment in reduction of the loan".

(2) Release Mr Cooke from any obligation to repay the Second Cooke Loan in return for a payment of £964.90 as "a prepayment in reduction of the loan".

99. IPGL Group wanted to sell the City Index business because it was loss-making and problematic. David Gelber's unchallenged evidence about the business shows that it required large amounts of subordinated debt funding from IPGL in order to meet its trading and regulatory capital requirements and that was not sustainable in the long-term. The consolidated financial reports for the group meant that City Index represented a drag on the group as a whole. The financial crisis then exacerbated the problems and the view was formed that the business was not viable as part of the IPGL portfolio.

100. Gain Capital was the only realistic purchaser at the time. Gain Capital was a completely independent company, and the sale was negotiated on a commercial basis.

101. Mr Rotzstain provided consistent evidence on which we rely regarding the perspective of Gain Capital when considering the issues connected with Mr Cooke. Gain Capital required IPGL to remove contingent liabilities related to the tax indemnities granted to Mr Cooke (and Mr Hambury) under the Call Option Agreements. The indemnities would also have left Gain Capital dealing with individuals who were historically connected with CIL, who were no longer employed by CIL, and with whom Gain Capital had no relationship.

102. There were other minority shareholders holding shares in City Index, called Francisco Partners but the evidence of Mr Rotzstain on which we rely was that there was no concern on Gain Capital's part about their shareholding.

103. Mr Cooke was separately represented during negotiations in 2014, to protect his own interests.

104. The following transactions were entered into:

(1) A Framework Agreement which, inter alia, contained a tax indemnity from IGBV in favour of Mr Cooke. Mr Cooke's advisor had obtained the agreement of the IPGL group that IPGL would also provide an undertaking to procure INCAP Gaming's payment of the indemnity. This had been sought by Mr Cooke in order to ensure that he had a full and enforceable indemnity against a company with sufficient assets to honour it if necessary;

(2) A loan agreement (the "New Loan Agreement") under which INBV agreed to make a further loan of £109,620 to Mr Cooke in order that he could pay up the remaining unpaid shares in CIGL;

(3) A share sale agreement under which IGBV agreed to purchase all of Mr Cooke's shares in CIGL for a total of £964.91 (the "Share Sale Agreement");

(4) An agreement under which INBV agreed to release the new loan provided that £964.91 was paid as a prepayment;

(5) A deed of gift under which IGBV agreed to make a gift of £3,187,500 to Mr Cooke to be used to repay the 2008 Loan ("the Deed of Gift"). The funds were paid directly to INBV rather than to Mr Cooke.

105. The parties were professionally represented, including by McFarlanes LLP who produced the documents. It is clear that the documents were not only dated but signed to show a very specific chronology as we now explain.

The Framework Agreement

106. This agreement was entered into between Mr Cooke, IGBV and IPGL on 28 October 2014 at 2:30 pm. The agreement recited that the parties entered into it in contemplation of, and so as to facilitate, the sale of CIHL by CIGL. Mr Cooke's evidence showed that from his perspective the Framework Agreement and the other documents entered into in 2014 were traceable back to the award of the shares to him in 2008,

107. The agreement was stated to be conditional on the following conditions precedent:

(1) the parties having entered into the New Loan Agreement, INCAP Gaming having advanced the funds under that agreement and Mr Cooke having used them as required by that agreement;

(2) Mr Cooke and IGBV having entered into and completed the Share Sale Agreement;

(3) IGBV having entered into and completed the Deed of Gift;

(4) IGBV having offered, in consideration of Mr Cooke agreeing to apply the sale proceeds received by him pursuant to the Share Sale Agreement in reduction of the amount owing under the New Loan Agreement, to release the balance owing by Mr Cooke under the New Loan Agreement.

108. The Framework Agreement then proceeded to set out that:

(1) IGBV indemnified Mr Cooke against any tax liability arising in respect of the acquisition or sale of the paid-up shares or the unpaid shares; the loans to him; the gift; any discharge of any notional loan under section 446S ITEPA; any release, writing off or discharge of the balance owing by him under the New Loan Agreement; and the

entering into the Framework Agreement. The indemnity was provided on a grossed-up basis in the event of the indemnity payment being taxable. The indemnity was time-limited to 10 years from the date of the agreement and provided other limitations such that Mr Cooke would, for example, be expected to deduct any allowable losses accruing to him in respect of the sale of the shares if the liability was to capital gains tax which could be so reduced;

(2) Mr Cooke would complete his 2014/2015 personal tax return in relation to the transactions in the manner notified to him by IGBV who would provide him with accounting advice in so doing;

(3) Mr Cooke agreed not to enforce the tax indemnity previously provided by CIL;

(4) in consideration of Mr C promising to fulfil his obligations under the Framework Agreement (which included therefore not enforcing the CIHL tax indemnity), IPGL undertook to him that it would procure that IGBV performed its obligations, commitments and undertakings under the agreement.

109. We are satisfied that the payment made under the deed of gift was not payment for release of the indemnity by CIL because:

(1) the gift of more than £3 million was for the full value of the loan whereas the indemnity was for the tax and there was no basis on which the tax resulting from even the release of the loan would amount to more than a fraction of that amount;

(2) the deed of gift was stated to be a condition precedent to the Framework Agreement in which Mr Cooke agreed not to enforce the tax indemnity previously provided by CIL. It is therefore inconsistent with the professionally prepared documents to interpret the gift as consideration for the release of the CIL indemnity;

(3) although the note of steps provided by Macfarlanes set out a different order of steps in the 2014 transactions, there is no indication of the £3 million being given as consideration for the indemnity release. The Framework Agreement itself does not refer to the £3 million as consideration for Mr Cooke agreeing not to enforce the indemnity. Instead, Mr Cooke's promises in the Framework Agreement were consideration for IPGL's undertaking to procure INCAP Gaming's performance.

(4) Mr Cooke started with an indemnity from CIL and ended with an indemnity from IGBV. The latter is more generous: it extends to cover income tax on the 2014 transactions as well as any capital gains tax liability relating to the shares or the 2014 transactions and specifically includes any tax on "release of the First Cooke Loan" (even though the steps were taken at least in part to avoid a release of the Loan).

The New Loan Agreement

110. This was entered into by INBV and Mr Cooke on 28 October 2014 at 2:30pm. The agreement provided that:

(1) the loan would be used by Mr Cooke to pay up the outstanding amount on the 5,481 unpaid shares held by him in CIGL;

(2) all payments to be made by INBV as lender under the agreement would be made on Mr Cooke's behalf to CIGL directly to pay out the outstanding amount on the shares.

111. On 28 October 2014 at 4pm a letter was sent by CIGL to Mr Cooke stating that following the payment of the loan amount, the unpaid shares were fully paid up.

Share Sale Agreement

112. This was entered into by Mr Cooke and IGBV on 29 October at 3:15pm.

113. Under this agreement Mr Cooke agreed to sell all of the shares held by him in CIGL to IGBV for £964.91. Completion was stated to take place immediately after signing of the agreement and a duly executed stock transfer form dated 29 October 2014 has been provided in evidence of that completion.

Side letter from INBV to Mr Cooke

114. The side letter was written on 30 October 2014 12:30 pm. It provided that INBV offered to release the balance owed by Mr Cooke on the New Loan in consideration of him first paying £964.91 as a prepayment in reduction of that loan. Provisions contained in the New Loan Agreement for five days prior written notice of a prepayment were waived by INBV. In consideration of Mr Cooke promising to pay INBV £1 the offer was stated to remain open for 14 days. However, the evidence shows that at 4:20 pm Mr Cooke signed the letter accepting the offer of the release.

Deed of Gift

115. This document was entered into between IGBV and Mr C on 30 October 2014 at 2:40 pm.

116. The recitals explained that Mr Cooke had the outstanding First Cooke Loan owing to INBV of £3,187,500; IGBV wish to make a gift at the same amount to him to enable him to repay that loan; and that Mr Cooke wished to repay the First Cooke Loan by means of IGBV acting on his behalf to pay the amount to INBV.

117. On 30 October at 3:20 pm INBV wrote to Mr Cooke to confirm that following the payment to INBV of £3,187,500, the First Cooke Loan had been repaid in full.

The tax reporting

118. The gift of £3,187,500 to repay the First Cooke Loan, and the release of the loan of £109,620 (less £964.91), were both recorded by Mr Cooke as a capital sum derived from the tax indemnity, the gain on which was matched with the capital loss on the shares (agreed by HMRC).

119. The transactions as reported therefore left Mr Cooke in a flat position overall, with no liabilities, but also no profit on the shares. It was the fact that it was concluded that the amount of £3,187,500 could be reported as a capital sum matched by a capital loss which was the "tax efficiency" referred to by Ms Kilmister-Blue in her Witness Statement.

120. In correspondence with HMRC in January 2018 Mr Hambury's advisors wrote to say that no termination agreement existed between the parties. As a result, HMRC did not pursue any more enquiries about whether the individuals had received termination packages.

121. The Determination was issued on the basis that an amount of £5,986,521 should have been introduced to PAYE as a payment of income to Mr Cooke and Mr Hambury. The £5,9866,521 comprised:

(1) £2,689,401 in respect of Mr Hambury made up of £2,458,201 in respect of a gift of that amount and £231,200 in respect of the release of the Third Hambury Loan;

(2) £3,297,120 in respect of Mr Cooke made up of £3,187,500 in respect of a gift of that amount and £109,620 in respect of the release of the Second Cooke Loan.

122. The Appellant's appeal concerns the gift elements only.

THE LAW

Taxability of earnings

123. The charge to tax on employment income under this Part is a charge to tax on "general earnings" and "specific employment income". (section 6 ITEPA)

124. In s7 ITEPA "general earnings" is defined as earnings within Chapter 1 of Part 3 ITEAP, or any amount treated as earnings under s7(5).

125. "Earnings" are defined in s62 ITEPA (the only section in Chapter 1 of Part 3). Section 62 provides, so far as relevant:

> "62 Earnings
>
> (1) This section explains what is meant by "earnings" in the employment income Parts.
>
> (2) In those Parts "earnings", in relation to an employment, means—
>
> (a) any salary, wages or fee,
>
> (b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or
>
> (c) anything else that constitutes an emolument of the employment.
>
> (3)For the purposes of subsection (2) "money's worth" means something that is—
>
> (a) of direct monetary value to the employee, or
>
> (b) capable of being converted into money or something of direct monetary value to the employee..."

126. Section 9 ITEPA provides that the amount of general earnings charged to tax is the "net taxable earnings" from an employment in the year. That amount is calculated under section 11 ITEPA by reference to any taxable earnings from the employment in the year. Section 10 then provides that taxable earnings are determined under Chapters 4 and 5 of Part 1 ITEPA (which in turn set out the provisions identifying that all general earnings received by a UK resident in a tax year are taxable earnings).

127. Section 11 provides that:

> "the "net taxable earnings" from an employment in a tax year are given by
>
> the formula:
>
> TE - DE
>
> Where:
>
> TE means the total amount of any taxable earnings from the employment in the tax year, and
>
> DE means the total amount of any deductions allowed from those earnings under provisions listed in section 327(3) to (5) (deductions from earnings: general)."

128. The result is that the code sets out that a person is taxed on their net taxable earnings and in making that calculation the only deductions are the amounts allowed under the ITEPA provisions.

129. The context and approach to be adopted in considering the earnings provisions was set out by Lord Hodge in the Supreme Court in *RFC 2012plc (in liquidation) (formerly The Rangers Football* [2017] I WLR.

130. *Club plc) vAdvocate General for Scotland*where he stated that:

> "Income tax on emoluments or earnings is, principally but not exclusively, a tax on the payment of money by an employer to an employee as a reward for his or her work as an employee." (para 35)

131. Lord Hodge further identified that the legislation applies to remuneration paid in money or money's worth (para 59). He noted (at para 59) that:

> "The relevant provisions for the taxation of emoluments or earnings were and are drafted in deliberately wide terms to bring within the tax charge money paid as a reward for an employee's work…. "

132. The Court of Appeal in *Murphy v HMRC* [2022] EWCA Civ 1112 confirmed the interpretation and restriction of these provisions (at para 22):

> "Thus the statutory scheme contemplates that all earnings from a person's employment are taxable, subject only to the allowable deductions provided for by the provisions listed in s.327 (all of which are in Part 5 of ITEPA). The question whether a payment amounts to "taxable earnings" from the taxpayer's employment is therefore entirely separate from the question whether a deduction is to be allowed against taxable income. Whilst it is only the "net taxable earnings" from a person's employment which are chargeable to income tax by virtue of s.9(2), the expression "net taxable earnings" is a defined expression which takes into account those types of expenditure which Parliament has expressly stipulated may be deducted."

133. Notably, the Court of Appeal specifically reaffirmed the limitation of "earnings" to amounts "from" a person's employment (at para 24) confirming the approach of *Hochstrasser* and, in particular, the judgement of Viscount Simonds (at p388):

> "not every payment made by an employer to an employee is necessarily made to him as a profit arising from his employment. Indeed, in my judgment, the authorities show that to be a profit arising from the employment the payment must be made in reference to the services the employee renders by virtue of his office, and it must be something in the nature of a reward for services."

134. The analysis of other authorities on this issue provided by the Upper Tribunal in the case of *Charman v HMRC* gives further guidance:

> [85] In *Kuehne & Nagel* the issue was whether a payment found as a fact to be made for two reasons which were not dissociable was an emolument 'from' employment. In the Upper Tribunal ([2010] UKUT 457 (TCC), [2011] STC 576) it was recorded as 'clear from the authorities (and also common ground between the parties) that, in determining whether a payment was "from" an employment, the fact that an employee would not have received a payment but for his employment is not necessarily decisive': [34]. The Court of Appeal, upholding the FTT and Upper Tribunal, determined that it was possible for a payment to be 'from' more than one source, and that if the fact-finding tribunal determined that there were two non-dissociable sources, one of which was employment, it was entitled to find that the payment was an emolument.
>
> Mummery LJ stated as follows (at [32] and [33]):
>
> '[32] When considering the cause of, or the reason for, an event or an act in a particular case, the courts steer clear of involvement in general theories of causation. Instead they apply a mix of general principle, legal policy and good-sense pragmatism to determine whether legal liability in accordance

> with the conditions set by the relevant rules has been established on the particular facts of the case …
>
> [33] All I need say at this point is that the use of "from" in the idea expressed in the statutory expression "earnings from an employment" and "earnings derived from an employment" in a fiscal context indicates, as matter of plain English usage, that there must, in actual fact, be a relevant connection or a link between the payments to the employees and their employment.'
>
> [86] Mummery LJ also referred at [34] to the fact that appeals are confined to questions of law:
>
> '[34] … it was for the judge in the FTT, entrusted by statute with the judicial function of finding the facts, to consider all the relevant documents and oral evidence and to make findings of primary fact and proper inferences of fact, to which he then had to apply the tax legislation, as interpreted by the courts. It follows that it is not the task of the UT, or of this court, to re-decide or second guess the primary facts, their proper function being limited to questions of law, such as whether the FTT misinterpreted the law, or misapplied it to the facts, or made perverse findings of fact unsupported by any evidence, or reached a conclusion that was plainly wrong.'
>
> [87] Patten LJ referred (at [50]) to the need for 'a sufficient causal link to be established between the payment and the employment'. Having reviewed the chief authorities, he then stated as follows (at [52] and [53]):
>
> '[52] It must follow from this that, in order to satisfy the s 9 test, one must be able to say that the payment is from employment rather than from a non-employment source. This has certainly been the approach of the courts in most of the decided cases, examples of which are:
>
> (i) Viscount Simonds in *Hochstrasser v Mayes* at (1959) 38 TC 673 at 706, [1960] AC 376 at 389: "often difficult to draw the line and say on which side of it a particular case falls";
>
> (ii) Lord Wilberforce in *Brumby v Milner* at [1976] STC 534 at 536, [1976] 1 WLR 1096 at 1099: "not an easy question to answer";
>
> (iii) Lord Diplock in *Tyrer v Smart (Inspector of Taxes)* [1979] STC 34 at 36, [1979] 1 WLR 113 at 115: "determination of what constitutes his dominant purpose"; and
>
> (iv) Carnwath J in *Wilcock (Inspector of Taxes) v Eve* [1995] STC 18 at 25, 67 TC 223 at 232: where there is more than one operative cause "there is an element of value judgment in deciding on which side of the statutory line the payment falls".
>
> [53] This process of evaluation requires the fact-finding judge to make findings of primary fact based on the evidence as to the reasons and background to the payment and then to apply a judgment as to whether the payment was from the employment rather than from something else
>
> …'

135. If a payment is from employment then in making the required calculations, even in the context of the word "profit", the full amount of the earnings are taken into account, not some amount after taking into account deductions (see *Murphy* at para 23):

> "It is designed to capture the taxpayer's entire earnings from his employment from which permissible deductions can then be made. Seen from this perspective, it would make no sense if the word "profit" in s.62(2)(b) were to

> be given a meaning that involved making a deduction from the payment received by the taxpayer, all the more so if that deduction would not be permitted under Part 5 of ITEPA."

DISCUSSION

136. In its purest form a share scheme is used to reward and incentivise employees. It can reward past service while at the same time providing a clear economic link between the company's performance and the value of the asset (the shares) held by the employee. If the business does well the employee will expect to profit directly by virtue of the shareholding. If the company does badly the value of the employee's previous reward can be reduced so the employee also suffers an economic loss. However, in this case those links were broken. Everyone appears to have assumed (despite the obvious flaw in doing so) that the value of the shares would only increase and when they fell in value the employee's connection to that loss by virtue of their shareholding was overridden.

137. In the 2014 transactions instead of the First Cooke Loan being released (which would have clearly triggered a charge under s188 ITEPA), the gift was made so that the loan could be repaid. As we have noted, HMRC have agreed not to pursue s188 in this case and we therefore say no more about it save to comment that clearly there is some scope to consider that the cash payment under the Deed of Gift, which was paid directly to INBV, was in effect a release of the Loan such that s188 might be expected to be applicable. What is important for our purposes though is that, as a matter of law, the potential application of s188 does not exclude the application of the earnings code contained in ITEPA. Section 189 ITEPA provides that section 188 does not apply if by virtue of any other provision of the Income Tax Act, the amount released or written off is employment income of the employee (unless that is as a result of the application of the provisions dealing with payments and benefits on termination of employment).

138. Turning to consider the application of the general earnings rules, the issue recognised by both parties to be key to the dispute is whether the 2014 gift was a gratuity or other profit or incidental benefit from Mr Cooke's employment. We start by addressing whether the gift was "from" his employment.

139. Mr Stone submitted that it was just necessary for the Appellant to show that the payment was not from employment; it was not necessary to identify what it was from. However, the authorities we have described earlier in this decision make clear that it is incumbent on us to identify from what if anything else the gift could be said to have been made and where there are two operative causes to identify on which side of the statutory line the gift fell.

140. It is self-evident, and as Mr Cooke recognised at the hearing, he was only in the position of holding shares in CIL and CIGL because he had been an employee of City Index. In addition, the 2011 Call Option Agreement caused Mr Cooke to be better off, because, in effect, he no longer had a liability to repay a loan of more than £3million without funds to do so. That result was due to the relationship between his employer, and more particularly his boss, Mr Spencer, and Mr Cooke. Moreover we were told by Mr Cooke that this arrangement recognised his service and efforts for CIL over seven years.

141. The fact that the share awards were in recognition of service and to tie Mr Cooke into the company, and that the 2011 Call Option Agreement was at least in part recognising his service with the company, does not in itself determine whether the 2014 gift was "from" Mr Cooke's employment. To decide that we have considered the explanations given to us by the Appellant and Mr Cooke for the gift.

142. At the start of the hearing the Appellant's case focussed on asserting that the gifts were payment for release of the indemnity by CIL (as reported in the individuals' tax returns) but we have explained in our findings of fact why this is not the correct interpretation of the documents and transactions.

143. We explored with both counsel whether in fact the gifts were derived from what may be described as a termination package contained in the Call Option Agreement. HMRC have confirmed that they are not relying upon the termination payment provisions contained in s401 ITEPA in this case and say that the amounts are earnings under general principles. Section 401(3) ITEPA states that the provisions in s401 only apply where a payment is not otherwise taxable to income tax. It therefore does not narrow the scope of s62 and we are back to the fundamental question of whether that section applies.

144. The witnesses broadly confirmed the reason for the transactions in 2014 was the sale of CIHL to Gain Capital Inc, but we see that as a trigger for the actions. In particular, the sale was not the source for the gift to Mr Cooke for the reasons we now explain.

145. The sale of CIHL by CIGL had raised the problem of the indemnity given by CIL to Mr Cooke, but Mr Cooke's shares in CIGL did not otherwise impact on the sale of CIHL as CIGL was CIHL's parent (and vendor).

146. Ms Kilmister-Blue draws a comparison in her Witness Statement to the position of another minority shareholder, Francisco Partners, saying that a payment made to that shareholder is equivalent to the gift to Mr Cooke because in both cases the payments enabled the sale to take place. As we have said, we have reduced the weight given to Ms Kilmister-Blue's evidence. Mr Rodszstain told us that there was no concern about Francisco Partners but we recognise he may not have been aware of background discussions between City Index and that shareholder.. However, even if City Index made a payment to Francisco Partners in order to get the sale through, that does not mean that the payments made to Mr Cooke and Mr Hambury should be viewed as equivalent. The circumstances are entirely different. Francisco Partners was a US private equity investor who held shares in CIGL and whom Ms Kilmister-Blue says may have caused problems on the sale because they would not receive much return as minority shareholders. Quite how they would have been able to block the sale as minority shareholders is not explained, but, at most, Francisco Partners received a payment to get them to agree to the deal.

147. In contrast, Mr Cooke and Mr Hambury were not seeking to make the sale to Gain Capital difficult. There is no evidence that they needed to be paid a sum to agree to the sale. The difficulty was the aversion of Gain to the CIL indemnity and the ongoing relationship between CIL and them as ex-employees resulting therefrom. But as we have already explained the gift was not paid to remove those issues.

148. There was little evidence to explain why the parties entered into the 2014 transactions rather than simply use the 2011 Call Option Agreement to unwind the position save for the limited evidence of Ms Kilmister-Blue. In her Witness Statement she says that the option price that INCAP Gaming would have needed to pay under the Call Option Agreement was significantly greater than the market value of the shares. She says that in any normal situation no company would exercise an option that was so out of the money.

149. However, the very act of selling CIHL and CIL meant that CIGL had sold its business and no prospect has been identified for CIGL to increase its value. There was therefore no prospect of the value of the CIGL shares coming back to the original subscription price. The out-of-the-money pricing of the Call Option was now built in.

150. The simplest route out of the problems caused by the reduced share value would have been the exercise of the Call Option. The tax indemnity could be dealt with (as it was) by provision of another indemnity by an INCAP group entity. Ms Kilmister-Blue's evidence is that the reason neither this nor a simple release of the First Cooke Loan occurred was that the 2014 transactions were considered to be more tax efficient.

151. As we have explained, the gift was not a pure act of generosity or largesse; it was not paid for agreeing not to enforce CIL's indemnity or to agree to the sale of CIHL to Gain.

152. In this case identifying whether the gift was a payment from employment requires us to take into account its background, not least because of the limited evidence otherwise about the payments. Mr Stone submitted that the status of Mr Cooke was irrelevant to the 2014 transactions and therefore they could not relate to his services or employment. Indeed, the Call Option Agreement was not from his employment; it was part of the termination package and therefore even if the 2014 gift was linked back to the 2011 package it was still not an emolument.

153. However, we have found that the shares awarded under the deferred share plans were awarded as part of Mr Cooke's reward for services. The evidence from Mr Cooke at the hearing led to our findings that the 2011 Call Option Agreements were put in place to recognise his services and ensure that he was not financially exposed as a result of the loans used for the share plans. Mr Cooke was better off after the 2011 Call Option Agreements than before and that was as a result of his service for City Index although, at that time he received no money or money's worth.

154. The gifts in 2014 were then made in the context of the set of transactions including the Framework Agreement entered into effectively to unwind the Call Option Agreements. At the end of the day, the 2014 transactions were structured to honour the 2011 "deal" that in view of his service to City Index and the understanding of how the share plan would operate Mr Cooke would not suffer financial loss as a result of the share plan and First Cooke Loan.

155. These conclusions reached by us regarding the nature of, and background to, the 2014 transactions mean that despite the fact that Mr Cooke had ceased working for CIL some 5 years earlier, we conclude that the payment of the £3 million was "from" his employment. The 2014 gift gave effect to the "deal" which had been put in place in 2011, nullifying Mr Cooke's potential liability under the First Cooke Loan and delivering that benefit to him.

156. Having concluded that the payment was from employment we now address what amount is taken into account. While Mr Cooke was economically "flat" after the 2014 transactions (when considering simply the fact that the money received by him was used to repay loans), the repayments are not allowable deductions in calculating the net taxable income. The Court of Appeal has made clear in *Murphy* that in identifying "profit" in s62 ITEPA the full amount received by the employee is taken into account and it is only amounts which fall within specific deductions within the code which are then deducted.

157. Therefore the full amount of the gift of £3,187,500 is taxable as earnings with no deduction for the amounts paid as loan repayments.

158. As stated above, both parties accept that the treatment of the gift to Mr Hambury follows our decision as to the treatment of the gift to Mr Cooke.

CONCLUSION

159. The appeal is dismissed. The Determination is confirmed. The gift of £2,458,201 to Mr Hambury and £3,187,500 to Mr Cooke is taxable in each case as earnings to which PAYE should have been applied by the Appellant.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

160. 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.

TRACEY BOWLER
TRIBUNAL JUDGE

Release date: 19th JANAURY 2022