



Appeal number FTC/71/2012

CORPORATION TAX – deemed charge under section 419(1) ICTA 1988 on loans to participators – whether company made loan to employees under employee share scheme - yes – whether company made an advance to employees under scheme - no – whether employees incurred a debt under scheme – yes – whether debt has any value before occurrence of contingent event – yes - appeal dismissed

**UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER**

ASPECT CAPITAL LIMITED

Appellant

- and -

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

Respondents

**Tribunal: Mr Justice Warren, Chamber President
Judge Greg Sinfield**

Sitting in public in London on 13 and 14 November 2013

**Malcolm Gammie QC, instructed by King & Wood Mallesons SJ Berwin, for the
Appellant**

**Richard Vallat, counsel, instructed by the General Counsel and Solicitor to HM
Revenue and Customs, for the Respondents**

DECISION

Introduction

1. Aspect Capital Limited (“the Company”) appeals against a decision of the First-tier Tribunal (“the FTT”) released on 29 June 2012, [2012] UKFTT 430 (TC), (“the Decision”). The Company had appealed to the FTT against a decision by the Respondents (“HMRC”) that the Company was liable to a charge to tax under section 419 of the Income and Corporation Taxes Act 1988 (“ICTA”).

Legislation

2. During the period in issue, section 419 ICTA provided:

10 “(1) Subject to the following provisions of this section and section 420, where a close company, otherwise than in the ordinary course of a business carried on by it which includes the lending of money, makes any loan or advances any money to an individual who is a participator in the company or an associate of a participator, there shall be due from the company, as if it were an amount of corporation tax chargeable on the company for the accounting period in which the loan or advance is made, an amount equal to 25 per cent of the amount of the loan or advance.

15 (2) For the purposes of this section the cases in which a close company is to be regarded as making a loan to any person include a case where -

20 (a) that person incurs a debt to the close company; or

(b) a debt due from that person to a third party is assigned to the close company;

25 and then the close company shall be regarded as making a loan of an amount equal to the debt.”

3. Section 419(3) ICTA provided that any tax due under the section was payable nine months and one day after the end of the accounting period in which the loan or advance was made. Section 419(4) provided that a company that had incurred a charge to tax in relation to a loan or advance may claim relief from the tax where the loan or advance was repaid or the company had released or written off the debt. Before the FTT, HMRC relied on section 419(5). The FTT decided that the conditions in section 419(5) were not met and HMRC did not seek to challenge that conclusion before us. Section 419(5) and (6) are not relevant to this appeal.

Facts

35 4. The facts, which were not disputed and are set out by the FTT at [8] – [40] and [48] – [77] of the Decision, may be stated quite briefly for the purposes of this decision. The Company is an investment manager based in London. At the time of the appeal, 77% of the Company’s shares were held by the Company’s directors or associated trusts and 20% were held by the Company’s employees and the trustee of
40 the Aspect Capital Limited Employee Benefit Trust Number 2 (“the Trust”). The

Trust had acquired its shares from the founders of the Company and departing employees who had held shares.

5. In May 2006, the Company established an employee share scheme called the Aspect Capital Equity Participation Scheme (“the EPS”) to enable certain employees to buy shares in the Company. HMRC accepted that the EPS was a commercially motivated share incentive scheme and did not allege that its purpose was to avoid tax.

6. An employee who wished to buy shares under the EPS entered into a Share Acquisition Agreement and a Facility Agreement (“the EPS Agreements”) with the Company. The FTT found that the EPS Agreements were entered into simultaneously and were all part of a single contract. The relevant clauses of the EPS Agreements are set out below.

7. In summary, the Share Acquisition Agreement provided that the employee would pay the subscription price to the Company, the Trust or such other person as the Company directed within three business days. In return, the Company undertook that it would either issue new fully paid shares to the employee or procure the transfer of shares from the Trust or another person to the employee. In fact, the Company never issued new fully paid shares. In every case but one, the Company arranged for the Trust to transfer shares to the employees. In the only other case, the shares were transferred from an employee who was leaving the Company to an employee who wished to buy shares under the EPS.

8. The introduction to the Share Acquisition Agreement was as follows:

“INTRODUCTION

(A) In order to incentivise and retain selected key employees who are not directors of the Company, the board of directors of the Company has resolved to allow certain employees, including the Employee, the opportunity to acquire a certain number of ordinary shares in the capital of the Company under the Aspect Capital Equity Participation Scheme.

(B) The arrangement for the acquisition of the ordinary shares pursuant to this Agreement is an employee share scheme (within the meaning given in Section 743 of the Companies Act).

(C) The Employee wishes to acquire ordinary shares in the Company and the Company wishes to facilitate such acquisition by the Employee by issue or transfer of the Shares upon and subject to the terms and conditions of this Agreement..”

9. The relevant clauses of the Share Acquisition Agreement were as follows:

“2.1 The Employee:

(a) applies for the acquisition of Shares and at the Subscription Price..

(b) undertakes to pay to the Company (the [Trust] or such person as the Company directs where the shares are transferred to the

Employee) ... in cleared funds an amount equal to the Subscription Price for the Shares in payment in full of such Shares, such payment to be received into the Bank Account within three Business Days following the execution of this Agreement;

5 2.2 The Company undertakes to the Employee that, within a reasonable time following the receipt by the Company, the [Trust] or such person as the Company directs of the Subscription Price ... the Company shall:

(a) ...

10 (b) either allot and issue as fully paid up that number of Shares as are due to the Employee pursuant to this Agreement, or procure the transfer of such Shares from the [Trust] or from any other person ...”

10. The “Bank Account” was defined as:

15 “the current account of the Company (in the case of a subscription for Shares) or (in the case of a transfer of Shares) the current account of the [Trust] or such other person as notified by the Company to the Employee, in each case as set out more fully in Schedule 1;”

11. The introduction to the Facility Agreement was as follows:

20 “INTRODUCTION

(A) At the request of the Employee the Company has agreed to provide a facility to the Employee for the acquisition of ordinary shares in the Company under the Aspect Capital Equity Participation Scheme on and subject to the terms and conditions of this Facility Agreement.

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(D) It is the intention of the Parties that a debtor-creditor relationship will be established between the Parties in respect of the Facility only on the occurrence of certain events specified in this Facility Agreement and not prior thereto.

30 ...”

12. The Facility Agreement provided that the Company granted a facility to the employee under which the Company provided funds (“the Facility Amount”) up to an amount equal to the purchase price of the shares plus any stamp duty to be used solely for the purpose of acquiring shares in the Company under the EPS. The Company agreed to pay the Facility Amount to the employee or transfer it, on the employee’s behalf, to the transferor of the shares. In return, the employee undertook to repay the Facility Amount to the Company on the occurrence of one of several defined events. The Company’s accounts for 2007 and 2008 showed the outstanding Facility Amounts as “interest free loans”. The accounts for 2009 onwards described the outstanding amounts as “facilities”.

13. The relevant clauses in the Facility Agreement state:

“2. The Facility

2.1 Upon and subject to the provisions of this Facility Agreement, the Company agrees to provide the Facility up to the Facility Amount available to the Employee.

5 2.2 The Company undertakes that within a reasonable time following the execution of this Facility Agreement by the Parties, the Company shall provide the Facility Amount to the Employee (or shall transfer the Facility Amount on the Employee's behalf directly to the transferor of the Shares) in cleared funds PROVIDED THAT:

10 (a) the Employee applies the entire Facility Amount only for the acquisition of the Shares (and Stamp Duty if applicable) or acknowledges the payment on his behalf of the Facility Amount by the Company to the transferor of the Shares, in either case pursuant to the Equity Participation Scheme and in accordance with the terms of the relevant Share Acquisition Agreement ...; and

15 (b) the Employee undertakes to repay the Facility Amount to the Company following the Facility converting into a Debt on the occurrence of any of the Contingent Events specified in clause 3.5.

20 2.4 The Company shall not have any right of enforcing the repayment of the Facility from the Employee until and unless the Facility converts into a Debt on the occurrence of any of the Contingent Events specified in clause 3.5.

3 Repayment of the Facility Amount

25 3.1 The Employee may, at his own volition, at any time during the Facility Period, declare that the Facility Amount is a Debt that he owes to the Company and repay the Company the Debt in full provided that Employee may make such repayment of the Debt so declared only once a year on the last Business Day in the month of April or such other date or period that the Company may appoint and notify to the Employee provided that the declaration of the Debt and the repayment thereof are both made in the same Accounting Period.

...

35 3.3 The Employee may, at his own volition, at any time during the Facility Period, declare that the Facility Amount is a Debt that he owes to the Company and instruct the Company to set-off the entire Debt against any dividend or distribution declared in respect of the Shares, net of tax at the relevant rate, up to the outstanding balance of the Facility Amount, provided that the declaration of the Debt and such set-off against the dividend are both made in the same Accounting Period and on condition always that any such dividend or distribution shall on a net basis be at least equal to the Facility Amount.

40 3.4 The Employee may, during the Facility Period, declare that the Facility Amount is a Debt and may instruct the Company to set-off the entire Debt so declared out of any bonus payments (net of income tax and employee's national insurance contributions) received by the Employee or that the Employee is entitled to receive from the Company or any of the trustees of the EBTs, provided that the declaration of the Debt and such set-off against the bonus payments are both made in the same Accounting Period and on condition always that

any such bonus payment shall on a net basis be at least equal to the Facility Amount.

3.5 Notwithstanding anything contained in this Facility Agreement but subject to clause 3.6, the Employee shall not be under any obligation to repay the Company in respect of the outstanding balance of the Facility Amount until the Facility Amount automatically converts into a Debt on the occurrence of any of the following events (each a “Contingent Event”):

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(a) the cessation of the Employee’s employment with the Group for any reason whatsoever (excluding death);

(b) the conclusion of a Trade Sale;

(c) on the directors in their discretion providing written notification to the Employee that there is a reasonable likelihood of a successful IPO and confirming that such notification constitutes a Contingent Event or failing such prior notification, then automatically on the date the Company’s shares are initially traded on any exchange unless otherwise provided in writing by the directors of the Company;

(d) a Change of Ownership;

(e) prior to the day on which the Employee is appointed as a director of the Company or any member of the Group;

(f) the date on which the directors notify the Employee after having become aware that the Employee is in breach of the terms of the Share Acquisition Agreement;

(g) on the day on which the Employee completes a sale or disposal of any of the Shares; and

(h) on the directors in their discretion determining the Facility Amount to be a Debt provided that the directors shall only exercise such discretion in the event that the Net Profits of the Company for the preceding Accounting Period of the Company are greater than the sum of £100.

3.6 On the occurrence of any of the Contingent Events specified in clause 3.5, or any declaration of a Debt by the Employee in accordance with clauses 3.1, 3.3 and 3.4, a “creditor-debtor” relationship will be established between the Company and the Employee, but not prior thereto.

3.7 The outstanding balance of the Debt shall not be repayable by the Employee on the occurrence of any of the following events:

(a) death;

(b) Insolvent Liquidation of the Company; or

(c) the waiver of Debt by the Company at its sole discretion which discretion the Company may exercise only in exceptional circumstances.”

The FTT recorded at [31] of the Decision that, in practice, the only Contingent Event which occurred during the years of assessment was the cessation of the employees' employment with the Company.

5 14. Clause 4 of the Facility Agreement provided that the employee's liability to repay the Company was limited to the amount of the sale proceeds of his shares, unpaid dividends on them, termination payments and bonus payments from the Company.

15. "Debt" was defined in the Facility Agreement as:

10 "the conversion of the Facility Amount into an indebtedness of the Employee to the Company in accordance with the clauses in 3.1 to 3.5 (as applicable), but not prior thereto;"

16. The "Facility Amount" was a specified amount.

15 17. A different facility agreement ("the US Loan Facility Agreement") was offered to participating employees with US passports to ensure that those employees were not at a disadvantage due to the US tax regime. It expressly stated that a debtor-creditor relationship was created. It did not exclude death as a Contingent Event. It was accepted by the Company that the US Loan Facility Agreement created a debtor-creditor relationship between the employee and the Company.

20 18. HMRC took the view that, in granting the facility to employees to enable them to buy shares in the Company, the Company became liable to pay tax under section 419(1) ICTA on the basis that the Company was a close company and the amount that it paid to the Trustees amounted to a loan to participators. HMRC raised assessments and issued closure notices totalling £3,153,915 in respect of years ending 31 December 2006, 2007, 2008 and 2009. The Company appealed against these
25 assessments to the FTT.

19. It was common ground before the FTT (and us) that:

- 30 (1) section 420 ICTA did not apply;
(2) the Company was a close company;
(3) it was not acting in the ordinary course of a business that included lending money; and
(4) the employees were participators in the Company.

20. It follows that the Company was liable to pay tax under section 419 ICTA if, under the EPS Agreements, the Company made any loan (which includes where an employee incurred a debt to the Company) or advanced any money to an employee.

35 21. The FTT (Judge Barbara Mosedale and Tribunal Member Jo Neill ACA) held that, under the Facility Agreement, the Company acted as the employee's agent when the Company, using its money, paid the Trust for the shares acquired by the employee and thereby made a loan to the employee. The FTT also held that the employee incurred a debt to the Company when the Company paid the purchase price for the

5 shares to the Trust. The FTT did not consider that the Company had advanced any money to the employee. The FTT decided that the Company was liable to a tax charge under section 419(1) ICTA on the basis that it made a loan to the employee and/or the employee incurred a debt to the Company and dismissed the Company's appeal.

10 22. The Company appealed, with permission of the FTT, against the Decision to the Upper Tribunal. The Company contended that the FTT erred in law in concluding that the Company made a loan to employees and that employees incurred a debt to the Company under the EPS Agreements. Further, the Company contended that the FTT erred in failing to conclude that, if employees incurred a debt, the debt had no value until the occurrence of a contingent event.

Issues

23. The Company is liable to tax under section 419 ICTA if the answer to any of the following questions is yes:

15 (1) Did the Company make loans to the employees under the EPS Agreements?

(2) Did the Company make an advance of money to the employees under the EPS Agreements?

20 (3) Did the employees incur a debt to the Company under the EPS Agreements?

24. If the employees incurred a debt then an additional issue arises, namely can any value be ascribed to the debt before the occurrence of a contingent event?

Approach to construing the EPS Agreements

25 25. In construing the EPS Agreements, we apply the approach stated by Dillon LJ in *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148 at 160 that:

“... in determining the legal categorisation of an agreement and its legal consequence the court looks at the substance of the transactions and not at the labels which the parties have chosen to put on it.”

30 26. Dillon LJ went on to describe this as trite law and, at 161-163, to conclude in that case, where the question was whether the parties had created a sale of goods or a loan subject to a charge on those goods, that it was necessary to look at the provisions of the agreement as a whole to ascertain the substance of the parties' agreement from the language used. That was, however, in the context of transactions that were very similar so that Dillon LJ observed at 162:

“... the similarity between a loan and a sale ... would make it virtually impossible to decide which the transaction was if it was not permissible to have regard to the words the parties had used in their agreement in describing that transaction on which they had agreed.”

5 It follows that the terms used by the parties to describe their legal relationship may be useful in determining the legal nature of a relationship or agreement in cases where the agreements are capable of different interpretations but the terms used by the parties cannot affect the legal categorisation of what they have agreed in cases where there is no doubt or ambiguity (see *Street v Mountford* [1985] A.C. 809 at 826H - 827B).

Did the Company make loans to the employees?

10 27. Malcolm Gammie QC, who appeared for the Company, submitted that the EPS Agreements were entered into at the same time and should be seen as a single agreement. That was the view of the FTT which held, at [46] of the Decision, that where both agreements were entered into at the same time, the two agreements must be seen as a single contract. We do not agree. In our view, the Share Acquisition Agreement and the Facility Agreement should be regarded as two separate agreements. There is nothing in the EPS Agreements to suggest that the parties
15 intended that they should be regarded as a single contract or that the Facility Agreement should be seen as simply amending the Share Acquisition Agreement. The existence of two versions of the Facility Agreement, one for UK employees and another for US employees, also supports the view that the Share Acquisition Agreement, which was common to all employees, was a separate agreement as that
20 allows the Share Acquisition Agreement to be construed in the same way for both types of employee. Even if we are wrong on this point, we consider that our analysis below would be the same if the Share Acquisition Agreement and the Facility Agreement were regarded as a single agreement.

25 28. Mr Gammie referred to clause 2.1 of the Share Acquisition Agreement which provided that the employee was obliged to pay the Company, or another at its direction, for the shares within three business days but Mr Gammie contended that, in the case of UK employees, this should be read in the context of the Facility Agreement. Any obligation on the employee under the Share Acquisition Agreement to pay for the shares fell away and was replaced by the Facility Agreement. We do
30 not agree that the employee's obligation under the Share Acquisition Agreement to pay for the shares fell away as a result of or was changed by the Facility Agreement. We consider that the Facility Agreement provided the means by which the employee fulfilled the obligation under the Share Acquisition Agreement to pay for the shares.

35 29. Mr Gammie submitted that the issue is whether the Company was making a loan to the employee when it made a payment to the Trust (or the departing employee shareholder). He contended that there was no loan by the Company to the employee in this case. He submitted that the payment was made by the Company to the Trust and so could not be regarded as a loan made to the employee.

40 30. Mr Gammie further submitted that, in the light of clause 2.4 of the Facility Agreement, the employee has no obligation to repay unless and until the employee converts the Facility Amount into an indebtedness under clauses 3.1, 3.3 or 3.4 or such conversion happens automatically on the occurrence of a Contingent Event specified in clause 3.5 (together, a "Conversion Event"). Clause 3.7 refers to the

circumstance when the Debt, as defined, is not repayable but he contended that that only arises after the Facility Amount has already been converted into an indebtedness in accordance with the Facility Agreement.

5 31. Mr Gammie submitted that the Trust was not a party to the Agreement and the employees did not contract with the Trust to purchase its shares. That is undoubtedly correct but, in our view, does not assist the Company as the employees agreed with the Company that they would pay the Trust or any other person if the Company so directed. Mr Gammie contended that the Company's payment to the Trustees satisfied the Company's obligation under these arrangements to pay the Trustees and not any
10 obligation that the employee had to the Trustees but, even if correct, the payment is expressed in clause 2.2 of the Facility Agreement to be made on the employee's behalf and, as we have held, creates an obligation to repay the amount to the Company except on the occurrence of certain events. Our analysis would be the same whether or not the Company was acting as the employee's agent in making the
15 payment to the Trust.

32. Mr Gammie relied on *Potts' Executors v Inland Revenue Commissioners* [1951] AC 443, 32 TC 211 to support the proposition that a payment by the Company to the Trust could not be the making of any loan "to an individual" within section 419(1) ICTA because, although it was made at the request of the employee, the Company
20 made the payment to the Trust and not to the employee. *Potts' Executors* concerned a charge to surtax which arose under section 40(1) of the Finance Act 1938 on "any capital sum paid directly or indirectly ... by the trustees of a settlement ... to the settlor". Section 40(3) of the Act provided that "a capital sum paid to the settlor ... by any body corporate connected with the settlement ... shall be treated as having been
25 paid by the trustees of the settlement ...". Section 40(5) of the Act provided that "capital sum" meant, among other things, any sum paid by way of loan. We observe that section 40 applied to capital sums, which included amounts paid by way of loan, paid, directly or indirectly, to a person whereas section 419 does not refer to amounts paid to any person.

30 33. Mr Potts had sold all the shares, save one, in a company which he owned to a trust of which he was the settlor. For many years before the sale of the shares, Mr Potts had an account with the company to which amounts due to him as director were credited and from which payments were made on his behalf and at his request. The payments often resulted in the account being overdrawn in large amounts. After Mr
35 Potts died, his executors were assessed to surtax on the basis that the trustees had paid capital sums directly or indirectly to Mr Potts, the settlor of the trust. The executors appealed and the Special Commissioners found that the amounts were paid by way of loan and confirmed the assessments. The executors appealed again and the High Court reversed the Special Commissioners' decision, holding that the payments were
40 not capital sums. The Inland Revenue appealed to the Court of Appeal which reversed the High Court and held that the phrase "paid to the settlor" in section 40(3), which did not include the phrase "directly or indirectly", included payments to the settlor both directly and indirectly. The Court also held that the amounts in question had been paid by way of loan directly or indirectly to Mr Potts. The executors
45 appealed to the House of Lords.

34. The House of Lords, by a majority, reversed the Court of Appeal's decision and allowed the appeal. Mr Gammie relied on passages from the speeches of the majority in *Potts' Executors* (in particular Lord Simonds and Lord Normand who concluded that the payments by the company were not to be regarded as a loan to Mr Potts). Mr Gammie also relied on the fact that none of the Law Lords in *Potts' Executors* considered that the amount paid by the company had been paid directly to Mr Potts and four of their Lordships held that the payments had not been made indirectly to Mr Potts.

35. Mr Richard Vallat, who appeared for HMRC, submitted that *Potts' Executors* is not binding authority for the proposition that a payment by A to B at the request and on behalf of C could not be regarded as a loan by A to C. Mr Vallat also submitted that *Potts' Executors* need not be followed as there was no consistency among the majority on the issue of whether a payment to a third party could create a loan or a debt. Mr Vallat pointed out that *Potts' Executors* concerned a different statute with different words and that the approach to construction of the words of the statute was deliberately formalistic and could not be regarded as correct following *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] STC 1 ("BMBF").

36. We accept that although the majority in *Potts' Executors* concluded that the trustees did not make a payment by way of loan directly or indirectly to Mr Potts, they reached that conclusion for different reasons. In particular, there seem to have been divergent views on the question of whether the payments by the trustees to third parties constituted loans to Mr Potts. On that subject, Lord Simonds said at 454 - 455:

"I do not doubt that in certain contexts money paid at A's request to B may be properly described as "paid to A": see eg *Parsons v Equitable Investment Co Ltd* per Lord Cozens-Hardy MR. The explanation of this is to be found in the judgment of Shearman J in *Stott v Shaw & Lee Ltd*: '... if the legal or business or commercial effect of the transaction can be taken to be the same as that described in the bill of sale, then the courts will hold the consideration to be truly stated.'

But this is not the way in which a taxing statute is to be read. I am not, in the construction of such a statute, entitled to say that, because the legal or business result is the same whether on the one hand I borrow money from the company and with it make certain payments, or on the other hand the company at my request makes certain payments on my implied promise to repay, therefore, it is immaterial what words are in the statute if that result is attained."

37. Lord Simonds concluded that, adopting a strict construction of the taxing statute, the payments by the trustees to third parties could not be regarded as payments by way of loan to Mr Potts. Lord Simonds did not rule out, however, that such payments could be so regarded in certain contexts. The example of *Parsons v Equitable Investment Co Ltd* [1916] 2 Ch 527 given by Lord Simonds concerned a bill of sale used to borrow money. The lender paid part of the loan to one of the borrower's creditors and retained part to repay an earlier loan to the borrower which

was outstanding but had not yet become due. Lord Cozens-Hardy MR in *Parsons* stated (emphasis supplied):

5 “Now the following propositions seem to me to be established by the authorities. In the first place, a sum of money paid by the bill of sale holder at the grantor’s request to a creditor *or another person* is properly described as a payment to her.”

10 38. It appears that Lord Simonds based his conclusion in *Potts’ Executors* on the fact that he was construing a taxing statute and must apply the words of that statute without regard to the result or effect of the transactions. We do not consider that such an approach to construction of a taxing statute can be maintained following *BMBF*. Lord Nicholls of Birkenhead giving the opinion of the Committee in *BMBF* observed at [28] and [29]:

15 “[28] As Lord Steyn explained in *IRC v McGuckian* [1997] STC 908 at 915, [1997] 1 WLR 991 at 999, the modern approach to statutory construction is to have regard to the purpose of a particular provision and interpret its language, so far as possible, in a way which best gives effect to that purpose. Until [*W T Ramsay v IRC* [1981] STC 174, [1982] AC 300], however, revenue statutes were ‘remarkably resistant to the new non-formalist methods of interpretation’. The particular vice of formalism in this area of the law was the insistence of the courts on treating every transaction which had an individual legal identity (such as a payment of money, transfer of property, creation of a debt, etc) as having its own separate tax consequences, whatever might be the terms of the statute. As Lord Steyn said, it was-

20 ‘... those two features - literal interpretation of tax statutes and the formalistic insistence on examining steps in a composite scheme separately - [which] allowed tax avoidance schemes to flourish ...’

25 [29] The *Ramsay* case liberated the construction of revenue statutes from being both literal and blinkered.”

30 39. The approach introduced in *Ramsay* and endorsed in *BMBF* was not confined to cases of tax avoidance as Lord Nicholls made clear at [33] when he said that:

35 “... the *Ramsay* case did not introduce a new doctrine operating within the special field of revenue statutes. On the contrary, as Lord Steyn observed in *McGuckian* [1997] STC 908 at 915, [1997] 1 WLR 991 at 999 it rescued tax law from being ‘some island of literal interpretation’ and brought it within generally applicable principles.”

40 40. Lord Normand in *Potts’ Executors* said at 456 - 457:

45 “The Crown submitted that the payments made by request were capital sums paid indirectly to the settlor as loans. I shall refer presently to the authorities by which the submission was supported. But first I shall consider the meaning of the relevant words apart from authority. In my view they are apt to cover payments made as loans to third parties through whom the payment reaches the settlor himself, but they are not apt to cover payments made to third parties who are not accountable to the settlor and are entitled to retain the sums as their own moneys.

This is a taxing Act and its terms are not to be enlarged by reasoning that the same final result is achieved as by a loan made to the settlor followed by a payment made by him to the third party.”

41. Our comments on the correct approach to the construction of section 419 ICTA and its application to the facts of the case following *BMBF* in relation to Lord Simonds’ speech apply equally to Lord Normand’s comments in the final sentence of the passage quoted above.

42. It is, further, clear that Lord Normand’s comments on whether payments to third parties could be loans were obiter dicta as he said at 458 – 459:

10 “I therefore hold that the payments made by the settlor’s request to
third parties were not payments made directly or indirectly to the
settlor. It is not necessary to consider whether they were payments
made by way of loans. But since the question was argued I will state
my opinion. There is a real distinction between a loan to A to enable
15 him to pay his creditors and a payment to A’s creditors made for the
purpose of discharging his debts. It is a distinction recognized and
taken advantage of both by commercial men and by others. But there
are exceptions, for example in banking law payments to third parties
are customers’ loans if the account is overdrawn ... I therefore think
20 that the payments in question were not payments by way of loans as
that word is understood in common parlance and as it is used in section
40.”

43. Lord Normand was referring to a very different situation from that in this case. He was considering payments made by the trustees to third parties who were not
25 accountable to Mr Potts but were entitled to retain the amounts paid because they
satisfied an obligation of Mr Potts to pay an amount (eg an amount of tax) or fulfilled
a wish expressed by Mr Potts to pay an amount (eg a donation to a charity). In this
case, the Trust was obliged, under its arrangement with the Company and as a result
of the payment, to transfer shares to the employee, ie the employee received the value
30 of the Facility Amount in shares.

44. Lord Oaksey also concluded that there was no loan but he approached the question differently. He said at 460:

35 “The object of the Act, in my opinion, was to tax a settlor who
obtained payment of capital sums from the trustees of his settlement or
from companies connected with the settlement for which he had not
given full consideration in money or money’s worth; it cannot have
been the object of the Act to tax him in respect of payments for which
he had given full consideration. ...

40 For my own part, I should also be prepared to decide the case upon the
ground that the true construction [of section 40(5)(a)(i)] is that it refers
only to sums paid by way of loan which are not paid for full
consideration in money or money’s worth and that in the present case
the accommodation offered to the appellant was given for full
consideration in money or money’s worth.”

It is not necessary for us to comment on Lord Oaksey's approach save to observe that it has no application to the legislation or facts under consideration in this case.

5 45. Lord Morton of Henryton did not agree with the majority and held, by analogy with a bank, that the amounts paid by the company to third parties at the request of Mr Potts were loans to him. Lord Morton said at 462 - 463:

10 "My lords, I think that the sums so paid out cannot accurately be described as anything other than loans to the settlor. ... That transaction can, I think, be accurately stated as follows: - The settlor said: 'Please pay my surtax; if you do pay it I promise to repay the sum on demand.' When the money was paid to the Inland Revenue, it seems to me that it was lent to the settlor just as much as if the company had been a bank and had granted him an overdraft of that amount."

15 46. Lord MacDermott also took a different approach in relation to the question of whether there was a loan. Lord MacDermott accepted that when A makes a payment to B on behalf of and at the request of C, there may be a loan by A to C but the relationship between A and C created by the payment depended on the circumstances and there would not necessarily be a loan in every case. Lord MacDermott did not reach any firm conclusion on the point because he did not need to as he had concluded
20 that the payments were not made, directly or indirectly, to Mr Potts. In reaching that conclusion, Lord MacDermott assumed that the payments by the company were loans. Lord MacDermott said at 465:

25 "Now I entertain little doubt that in certain circumstances it may properly be said that, if A out of his own moneys pays a sum to B for and at the request of C, A has paid the sum by way of loan, and by way of loan to C in the sense, and only in the sense, that he has thereby created the relation of lender and borrower between himself and C. But this is not to say that all transactions of that kind are loans. They may be but incidents in some wider relationship, other than that of
30 lender and borrower, and take, as it were, their colour from it. ... On the other hand, the kind of wider relationship to which I am referring may provide opportunity for transactions within it which are exceptional and beyond the normal scope of the relationship and which may properly be describable as loans and as nothing else.

35 The true view must depend on the circumstances. ... because, on the view I take of the rest of the case, it becomes unnecessary to do so, I do not propose to express any concluded opinion on this branch of the matter. I therefore proceed to the second question assuming, for the purpose, an affirmative answer to the first [ie that the payments were
40 loans]."

47. On the question of whether the payments were made, directly or indirectly, to Mr Potts, Lord MacDermott said at 466:

45 "I think the natural meaning of the words 'paid ... to the settlor' signifies a payment that goes to the settlor, not one that goes away from him ...

5 It was said for the Crown that it was no straining of language, where A paid a sum to B at C's request and for C's benefit, to say that A had paid C. I cannot agree; the person paid is B and no one else, and the consideration that the payment is advantageous to C seems to me to be beside the point so far as concerns the construction of the material words."

10 48. Lord Simonds and Lord Normand were clearly of the view that a payment by A to C at the request and on behalf of B was not a loan by A to B. Lord Simonds appears to have reached this conclusion based on an analysis that it was not generally possible to regard such an arrangement as a payment to B. He did state, however, that in certain contexts, eg banking transactions, money paid to a person at the request of another may properly be described as paid to the other. Lord Normand, although his remarks were obiter, considered that there was a conceptual distinction between a loan to a person, who uses it to pay his debts, and a payment to a creditor to discharge a person's debts. Lord Normand also accepted that there were exceptions, such as banking transactions. Lord Oaksey took a very different approach and his speech does not provide any guidance on whether the transaction in this case can be regarded as a loan. Lord Morton clearly regarded the arrangements in *Potts' Executors* as giving rise to a loan. Lord MacDermott held that such arrangements could give rise to loans depending on the wider circumstances but reached no concluded view in that case because it was not necessary for him to do so.

25 49. In our opinion, *Potts' Executors* does not assist us to determine whether or not there is a loan in this case. In *Potts' Executors*, the House of Lords was considering different legislation which primarily concerned whether a payment by way of loan had been made, directly or indirectly, to a person. Only Lord Simonds decided that the payment could not be regarded as a loan to Mr Potts. The others in the majority made comments that were obiter or did not decide that point. Lord Simonds reached his conclusion by adopting a literal approach to construction of the legislation because he considered that was the correct approach to use when construing a taxing statute. As discussed above, such an approach has been subsequently rejected by the House of Lords in *BMBF*. Following *BMBF*, we construe section 419 ICTA and apply it to the EPS Agreements in the same way as we would approach any other statute, ie purposively and by reference to the facts viewed realistically.

35 50. We do not regard *Potts' Executors* as authority for the proposition that, with the exception of banking transactions, where A, at the request and on behalf of B, pays an amount to C that transaction cannot be regarded as a loan by A to B. There is no clear ratio to be derived from *Potts' Executors*. We agree that a payment to a person by way of loan to enable him to discharge a debt and a payment to the person's creditor to discharge that debt are not the same thing. However, as Lord MacDermott observed, and Lords Simonds and Normand accepted to a limited extent, it all depends on the circumstances.

45 51. Mr Gammie also pointed out that Section 75 Finance Act 1965 (the precursor of section 419(1) ICTA) was amended by paragraph 2 of Schedule 14 to the Finance Act 1969 to address the point (derived from *Potts' Executors*) that section 419(1) did not encompass payments made to third parties and not direct to the individual

participator. Section 75 introduced what is now section 419(2) ICTA which is discussed further below. In our view, although the amendment to section 75 is consistent with Mr Gammie's submission, such an amendment could have been made for the avoidance of doubt or out of an abundance of caution and does not mean that
5 'loan' in section 419(1) cannot include a payment made to a third party at the request and on behalf of another.

52. Both parties agreed that, in order for a payment to be considered to be a loan, the payee (borrower) must have an obligation to repay the payer (lender). Mr Gammie contended that the parties' agreement that no debt is created expressly
10 negated any obligation to repay at the outset. Mr Gammie submitted that there was no such obligation in this case unless and until the occurrence of a Conversion Event in clauses 3.1 to 3.5 of the Facility Agreement, which might never happen. Accordingly, there could be no loan (or advance or indebtedness) until that time.

53. Mr Vallat contended that the Facility Agreement created an immediate
15 obligation to repay the Facility Amount, albeit that the time of payment was deferred until the occurrence of a Conversion Event, most probably a Contingent Event, and, in certain limited circumstances, the obligation to repay would fall away. He submitted that the definition of "Debt" as the conversion of the Facility Amount into an indebtedness of the employee to the Company on the occurrence of a Conversion
20 Event was merely a re-labelling and at all times the Facility Amount was a debt owed by the employee to the Company. The Conversion Events and consequences described in clause 3.1 to 3.7 were no more than the mechanics of the repayment obligation. Mr Vallat submitted that a Contingent Event, which included the termination of employment otherwise than on death and the sale of the Company, was
25 very likely to occur in practice. Mr Vallat also submitted that the amount which the Employee was obliged to repay was certain as the non-recourse provision in Clause 4 of the Facility Agreement, which protected the employee from the effect of any fall in the value in shares, only applied after the Facility Amount had become a Debt. It followed that the non-recourse provision was simply a reduction in or waiver of part
30 of the amount owed and did not mean that the amount of the debt was uncertain.

54. We note that, although "Debt" is defined in the Facility Agreement as an event, namely the conversion of the Facility Amount into an indebtedness on the occurrence of a Conversion Event, Debt is also used to mean the amount that is repayable by the employee. Under clauses 3.1, 3.3 and 3.4 of the Facility Agreement, the employee
35 may elect to convert the Facility Amount into a Debt. Clause 3.1 states that the employee may "repay the Company the debt in full" and refers to "repayment of the Debt". Clauses 3.3 and 3.4 refer to set-off of the entire Debt. Clause 3.7 sets out circumstances where "the outstanding balance of the Debt shall not be repayable by the Employee".

40 55. The employee undertakes to repay the Facility Amount to the Company on the occurrence of a Contingent Event. Clause 3.5 of the Facility Agreement provides that the employee is not under any obligation to repay the Facility Amount until it automatically converts into a Debt, as defined, on the occurrence of a Contingent Event. We do not accept that clause 3.5 means that there is no loan. There can, in our

view, be a loan of monies where there is a present obligation to repay those monies in the future upon the happening of defined events, that is to say a Contingent Event occurs. This is so notwithstanding that there are circumstances in which a lesser sum will be repayable or, indeed, nothing will be repayable at all. Clauses 3.1, 3.3, 3.4 and 3.5 are, in our view, not concerned with creation of an obligation to repay the Facility Amount or Debt but when that obligation becomes operative, ie the timing of the repayment. The fact that clause 3.6 of the Facility Agreement states that a creditor-debtor relationship is only created on the occurrence of a Conversion Event under clauses 3.1, 3.3, 3.4 or 3.5 does not mean that there is no obligation to repay at some point determined by reference to a future event if that is the true effect of the EPS Agreements – see *Street v Mountford*. Clause 3.7 removes the obligation to repay only if certain events occur after the parties have entered into the Facility Agreement and the Facility Amount has been provided. Between the time when the Company paid the Facility Amount to the Trust (or departing employee) and repayment or the occurrence of an event specified in clause 3.7, the employee has an obligation to repay contingent on the occurrence of a Conversion Event. Further, the non-recourse provision in clause 4 of the Facility Agreement does not mean that the employee was not liable to repay the Facility Amount, only that the amount actually repayable on the occurrence of a Conversion Event might be less than the Facility Amount.

56. In summary, we consider that the employee incurred an obligation under the Share Acquisition Agreement to pay, within three days, the Company, or the Trust or such other person as the Company directed, for the shares that the employee had applied to acquire. That obligation was fulfilled by the employee requesting and the Company agreeing to provide funds (the Facility Amount), up to a specified amount, to the employee which the employee used to buy the shares. The Company agreed, in clause 2.2, to pay the Facility Amount in cleared funds to the employee or to pay the Trust (or departing employee shareholder) on the employee's behalf. The Company transferred funds to the Trust pursuant to the Facility Agreement and the Trust transferred the shares to the employee. The employee was obliged by clause 2.2(b) to repay the Facility Amount on the occurrence of a Conversion Event. Viewed realistically, a Conversion Event would always be possible and would probably always occur, eg when the employee ceases to be employed other than on death. In certain circumstances, the employee would not be required to repay all or part of the Facility Amount but the amount repayable would only be determined after the occurrence of the Conversion Event. It follows that under the Facility Agreement, the employee had an obligation to repay the Facility Amount although the date of repayment was uncertain, because it was linked to the occurrence of a Conversion Event, as was the amount of the repayment, because it was linked to the value of the shares and any other items specified in clause 4 of the Facility Agreement. Those uncertainties as to date and amount of repayment do not prevent the Facility Amount from being a loan (see *Grant v Watton (Inspector of Taxes)* [1999] STC 330 discussed at [68] below). We conclude that, in the context of the EPS Agreements, the payments by the Company to the Trust at the request and on behalf of the employees were the making of loans to the employees.

Did the Company advance money to employees?

57. The FTT held, at [124] that the Facility Amount was not an advance of money. The FTT, referring to *Bronester Ltd v Priddle* [1961] 1 WLR 1294, held that

5 “... the natural meaning of “advance” is that it is the bringing forward of something: in the context of money it is the bringing forward of a payment that would be made at some point in the future.”

58. In *Bronester*, Holroyd Pearce LJ, at page 1301, quoted with approval the definition of ‘advance’ given by the judge at first instance which was as follows:

10 “It seems to me that ‘advance’ means: ‘I will pay now what I may have to pay in the future. I am paying before due time. If, after the advance, some event in the future upon which payment becomes due does not occur, you (*sic*) can recover it back.’ ... When someone says: ‘I am going to make you an advance,’ I think they are saying: ‘We will let you have it as a loan or on an implied understanding that if
15 the event does not occur which makes it legally payable, we must have it back.’”

59. Mr Gammie’s primary submission was that the Company did not “advance any money to an individual who is a participator” within the meaning of section 419(1) ICTA 1988 for the same reasons as those given in relation to the making of a loan.
20 He further submitted, relying on *Bronester*, that advance means a payment of an amount that will or may become payable by the Company to the employee and it was not an appropriate term for an amount that may (on certain contingencies) become due from the employee to the Company.

60. Mr Vallat contended that the FTT was incorrect to take a narrow approach and consider that the Facility Agreement could not be an advance because it was not an
25 early payment of a sum to which the employee might later be entitled. He submitted that the term ‘advance of money’ also includes a payment of money advanced against an obligation to make a payment to the advancer in the future. The employee received the benefit of the Facility Amount in return for agreeing to make a future
30 payment on the happening of a Contingent Event and that, Mr Vallat submitted, was an advance of money.

61. We do not accept Mr Vallat’s submission on this point. We agree with the FTT’s view of the meaning of advance of money in the context of section 419(1). It
35 seems to us that Mr Vallat’s broader definition of advance would make it unnecessary for section 419(1) to use the term ‘loan’ because, on his interpretation, a loan would always be an advance. *Bronester* shows that an advance always includes a loan but that does not mean that a loan necessarily includes an advance. If money paid by way of loan is not money that the payee may be absolutely entitled to in the future then there is no element of advance in the loan. We conclude, as the FTT did and for the
40 same reasons, that the provision of the Facility Amount was not an advance of money.

Did employees incur a debt to the Company?

62. The ordinary meaning of ‘loan’ is extended by section 419(2) ICTA to include cases where an employee incurs a debt to the company. We have already concluded that there was a loan by the Company to the employees. That is sufficient to dispose
5 of the appeal. In case we are wrong in concluding that there was a loan with an obligation to repay, we consider whether the employees incurred a debt to the Company within section 419(2) ICTA.

63. On the question of whether the employees incurred a debt to the Company, Mr Gammie referred us to *O’Driscoll v Manchester Insurance Committee* [1915] 2 KB 499 (“*O’Driscoll v MIC*”) and *Grant v Watton (Inspector of Taxes)* [1999] STC 330.
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64. In *O’Driscoll v MIC*, the issue was whether an insurance committee owed a debt to a doctor on its panel of doctors in circumstances where the exact amount payable to the doctor was unascertained. Swinfen Eady LJ said at 511-512:

15 “The Insurance Committee received from time to time payments of large sums on account from the Insurance Commissioners, and when they received all the funds for the year they would be in a position to determine the amount payable to each doctor.

20 In those circumstances I am of the opinion that ... there was a debt owing or accruing from the Insurance Committee to the panel doctors. It was not presently payable, the amount not being ascertained, but it was a debt to which the doctors were absolutely and not contingently entitled. The only question was as to the amount of the debt, the debt not being payable until the amount had been ascertained.”

65. Swinfen Eady LJ also said at 512-513:

25 “It is contended, however, that there cannot be a ‘debt’ until the amount has been ascertained, and in support of this contention cases have been cited to us where it was attempted to attach unliquidated damages. But in such cases there is no debt at all until the verdict of the jury is pronounced assessing the damages and judgment is given.
30 Here there is a debt, uncertain in amount, which will become certain when the accounts are finally dealt with by the Insurance Committee. Therefore there was a ‘debt’ at the material date, though it was not presently payable and the amount was not ascertained. It is not like a case where there is a mere probability of a debt, as, for instance, where
35 a person has to serve for a fixed period before being entitled to any salary, and he has served part of that period at the time the garnishee order nisi is served. In such a case there is no ‘debt’ until he has served the whole period.”

66. In the present case, in return for the Company paying the Facility Amount to the Trust on behalf of the employee, the employee undertakes to repay that amount on the
40 occurrence of a Conversion Event. That is a contingent obligation to repay. The Facility Amount is a specified amount, although the amount actually repaid might be reduced by the non-recourse provision in clause 4 at or after the time it becomes payable. The Facility Amount is repayable unless and until the obligation to repay is

extinguished by the occurrence of an event specified in clause 3.7 of the Facility Agreement. In our view, this case falls within the description of debt discussed by Swinfen Eady LJ in *O'Driscoll v MIC*. There was a debt, repayable at a future time determined by the occurrence of an event. It was, however, a debt incurred by the employee on entering into the Facility Agreement.

67. In *Grant v Watton*, Pumfrey J considered whether, among other issues, particular transactions gave rise to a debt, and therefore a loan, between a close company and a director for the purposes of section 419 ICTA. Mr Grant was an estate agent who had established a service company to provide certain services to this estate agency business. Mr Grant was a director and controlling shareholder of the service company and a partner in the estate agency. The service company charged an annual fee and charged the estate agency from time to time. Pumfrey J found that Mr Grant incurred a debt to the service company, which was a close company, and thus a charge arose under section 419(2) ICTA. Pumfrey J held that:

“In my judgment the word ‘incurred’ is apt to describe the point in time at which the debtor became legally committed to some future expenditure albeit unascertained. If the debtor knows in respect of a service which he has received that he will have to pay for that service on some date in the future, if he has not already done so, I believe that in the ordinary sense of the words he has incurred a debt, albeit that the debt will not be due until that future date and although its quantum may not be capable of ascertainment because of the possibility of discharge or partial discharge between the date on which it is incurred and the date on which it becomes due and payable.”

He also quoted and endorsed Swinfen Eady LJ's remarks in *O'Driscoll v MIC* at 512-513 and held that there was a debt. Pumfrey J's remarks and his quote were referred to with approval by the Court of Appeal in *Nejad v City Index Ltd* [2000] CCLR 7.

68. As in *Grant v Watton*, the employees knew that they were obliged to repay the Facility Amount at some future date when a Conversion Event occurred, typically when they ceased employment with the Company, although the amount repayable was uncertain because it depended on the value of the shares and the operation of the non-recourse provisions and the obligation could be discharged by death or one of the other events in clause 3.7. We consider that, as in *Grant v Watton*, the employees incurred a debt to the Company albeit the date and amount of repayment were not ascertainable until some later time.

69. Both parties made submissions on *Marren (Inspector of Taxes) v Ingles* [1980] STC 500, in which the House of Lords considered whether a payment of deferred consideration was a receipt of a capital sum derived from disposal of an asset, namely a chose in action. Their Lordships also considered whether the liability to pay the deferred consideration, being an unidentifiable sum payable at an unascertainable date, was a ‘debt’ within Schedule 7 to the Finance Act 1965. Lord Wilberforce at 503 held as follows:

“First, was there a debt in September 1970? In my opinion there was not. No case was cited, and I should be surprised if one could be

found, in which a contingent right (which might never be realised) to receive an unascertainable amount of money at an unknown date has been considered to be a debt and no meaning however untechnical of that word could, to my satisfaction, include such a right. The legislation does, of course, make provision for debts not immediately payable; it does so by the draconian method of charging them, when a charge arises, without any allowance for deferral (Schedule 6, paragraph 14(5)); and I would, for the purpose of argument, be prepared to agree that a contingent debt might come within the paragraph. In *Mortimore v IRC* (1864) 2 H. & c. 838 - a case concerned with stamp duty - Martin B so held. But from this it would be a large step to hold to be included an unascertainable sum payable, if a contingency happens, at an unascertainable date, a step which I am unable to take.”

70. Lord Fraser held at 506:

“The meaning of the word ‘debt’ depends very much on its context. It is capable of including a contingent debt which may never become payable, *Mortimore v. Inland Revenue Commissioners*, 2 H. & C. 838. It is also capable of including a sum of which the amount is not ascertained: *O’Driscoll v. Manchester Insurance Committee* [1915] 3 K.B. 499. But I agree with Slade J and with Templeman LJ, both of whom held that that the word ‘debt’ in paragraph 11 does not apply to the obligation of the purchaser under this agreement, which was described by Templeman LJ [1979] STC 637 at 639, [1979] 1 WLR 1131 at 1147 as ‘a possible liability to pay an *unidentifiable* sum at an *unascertainable* date’. The words to which I have added emphasis bring out the three factors of this obligation which cumulatively prevent its being a debt in the sense of paragraph 11. Further, the reference to a person who ‘incurs’ a debt ‘whether in sterling or in some other currency’ points, in my opinion, to the debt being definite, or at least ascertainable, in amount.”

71. *Marren v Ingles* concerned a right to receive an amount calculated by reference to the value of shares after the flotation of a company, which might never occur, at an unascertained future date. At the time that the right was created, it was possible that there might never be a flotation and thus no liability to pay an amount would ever arise. Further, even if there were a flotation, the amount of any payment could not be known because it was based on the value of the shares after the flotation. That was a very different situation to the one in this case. In clause 2.2(b) of the Facility Agreement, the employee agrees to repay the Facility Amount to the Company on the occurrence of a Conversion Event. As discussed above, a Conversion Event will occur at some, unascertainable, point in the future save only if the employee dies in service. The amount repayable may be reduced or waived after the Conversion Event has occurred. It follows that, unlike *Marren v Ingles*, there is, at the time the Facility Amount is paid, a liability owed by the employee to the Company to pay an ascertained amount at an unascertained future date, although the obligation to repay may be extinguished if one of the events specified in clause 3.7 occurs subsequently. That comes within Lord Fraser’s description of a contingent debt and is a debt for the purposes of section 419(2) ICTA.

72. Mr Gammie referred us to two cases (*Whittaker v Kershaw* (1890) 45 Ch D 320; *Re Russian Spratts Ltd* (1898) 2 Ch 149) which concerned whether there was a debt when a company issued partly paid shares. The cases showed that no debt exists until the call requiring a shareholder to pay any unpaid amount is made. Mr Gammie sought to draw a parallel with the terms on which the shares were acquired by the employees under the EPS Agreements when no amount was payable until a Conversion Event occurred. In our view, the two situations are not the same. The call by a company which has issued partly paid shares creates the obligation to pay the unpaid amount. Until that point, there is no obligation. As we have found, the employee is obliged to pay the Facility Amount to the Company from the time that the Company paid it to the Trust. Unlike in the case of the unpaid shares, there is an obligation to pay from the beginning although the date of the repayment is unascertained and the obligation to repay may be extinguished.

73. For the reasons discussed above, we conclude that the employees incurred a debt to the Company within section 419(2) ICTA.

Can any value be ascribed to the debt before the occurrence of a contingent event?

74. Mr Gammie submitted that even if, which he did not accept, the employees had incurred a debt to the Company, it had no value until a Conversion Event occurred. Accordingly, no charge to corporation tax arose under section 419 ICTA. Section 419(4) showed that the section is predicated on the basis that the loan can be repaid and that the debt that the loan represents can be released or written off. He contended that, at the time the shares were acquired, any amount repayable was uncertain and could only be known when the Contingent Event occurred. Mr Vallat submitted that the amount of the debt incurred at the time that the EPS Agreements were entered into was equal to the Facility Amount and could not be nil.

75. As discussed above, we have concluded that the employee is obliged to pay the Facility Amount to the Company from the time that the Company paid it to the Trust. The Conversion Event determines when the repayment is made not whether it is made although the amount repayable is uncertain because of the possibility that the non-recourse provisions may apply. The possibility that, at the time that repayment is due, the employee may not be required to repay the Facility Amount in full does not reduce the amount of the debt owed by the employee at the time when the debt is created, that is to say when funds are made available pursuant to the Facility Agreement. Under section 419 ICTA, tax is charged, in the case of a straightforward loan, on the amount of the loan. In the case of a debt within section 419, the company is regarded as having made a loan to the person incurring the debt. Tax, in such a case, is charged on the amount of the debt since that, in our view, must be the measure of the amount which is regarded as the amount of the deemed loan. In the present case, the amount of the debt is, we consider, the full amount of the Facility Amount which was in fact made available to the employee.

Conclusions

76. For the reasons set out above, we conclude that:

- 5 (1) the payments by the Company to the Trust at the request and on behalf of the employees were the making of loans to the employees within section 419(1) ICTA;
- (2) the provision of the Facility Amount was not an advance of money by the Company within section 419(1) ICTA;
- (3) the employees incurred a debt to the Company within section 419(2) ICTA; and
- 10 (4) the debt is of an amount equal to the Facility Amount.

Disposition

77. For the reasons set out above, the Company's appeal against the FTT's decision is dismissed.

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Mr Justice Warren
Chamber President

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Greg Sinfield
Judge of the Upper Tribunal

Release date: 19 February 2014

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