TC00618

Appeal number: SC/3020/2008

TRANSACTIONS IN SECURITIES – company with distributable reserves acquiring company with negative reserves having loan stock acquired by the shareholder of the parent company – loans by the parent company to the subsidiary which repaid the loan stock – whether caught by Circumstance D – yes; hive-down of trade of parent to subsidiary – whether repayment of loan stock out of subsequent profits of the subsidiary caught – no; whether the reference in Circumstance C(2) to assets representing a return of capital which under the law of the country of incorporation is available for distribution limited to foreign-incorporated companies – no

FIRST-TIER TRIBUNAL

TAX

MARCUS BAMBERG **Appellant**

- and -

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

TRIBUNAL: JOHN F AVERY JONES CBE (TRIBUNAL JUDGE)
SANDI O'NEILL

Sitting in public at 45 Bedford Square, London WC1 on 8 and 9 June 2010

Andrew Thornhill QC, counsel, instructed by Charterhouse (Accountants) LLP, for the Appellant

Raymond Hill, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This is an appeal by Mr Marcus Bamberg against assessments made under s 703 of the Taxes Act 1988 for the years 2000-01 (£87,499.92), 2001-02 (£87,499.92), 2002-03 (£149,999.77) and 2003-04 (£262,749.85). The Appellant was represented by Mr Andrew Thornhill QC, and the Respondents ("HMRC") by Mr Raymond Hill.

2. Briefly, The Trade Exchange Limited ("TTEL") is a company owned by the Appellant with distributable reserves of around £2m, and White Clover Limited ("WCL") is a Guernsey incorporated, UK resident, company with negative distributable reserves of about £15m, no assets and a liability to repay loan stock of £15m. The Appellant purchased the loan stock of WCL for £237,000 and the shares for a nominal amount and sold them to TTEL. TTEL made loans to WCL which were used to repay part of WCL's loan stock to the Appellant. Later, on 1 February 2002 the trade of TTEL was hived-down to WCL which continued the trade and further repayments of its loan stock were made to the Appellant. The issue is whether s 703 applies in these circumstances.

3. There was an agreed statement of facts as follows:

(1) On 14 February 1997 WCL, then a wholly-owned subsidiary of Capital Housing Company Limited ("CHCL") borrowed £15 million by way of unsecured loan notes repayable on 31 December 2010. On the same date WCL guaranteed the liability of CHCL in respect of £30million of loan notes issued by CHCL and purchased by Union Bank of Switzerland ("UBS"). Under this arrangement WCL was required to deposit £15 million with UBS. WCL subsequently suffered a forfeiture of this sum.

(2) On 4 May 2000 the Appellant purchased the issued share capital of WCL fopr £2 and purchased all the loan notes issued by WCL on 14 February 1997 for £237,000. On the same day the Appellant sold the issued share capital of WCL to TTEL for £2. At all material times the Appellant owned 100 per cent of the shares in TTEL and was a director of WCL and TTEL.

(3) From time to time TTEL made loans to WCL. The following loans were made at the following times:

(a)	5 May 2000	£250,000
(b)	29 August 2000	£100,000
(c)	13 November 2000	£200,000
(d)	3 January 2001	£150,000
(e)	14 January 2002	£150,000

£50,000 of the loan at (b), the whole loan at (c) except for £1,000, £100,000 of the loan at (d) and the whole of the loan at (e) were used to repay the loan notes held by the Appellant.

(4) On 1 February 2002 TTEL transferred its trade and all its trading assets to WCL in consideration of the market value at the transfer date of the assets

transferred. The trade consisted of buying and selling of second-hand goods, making loans and cashing of cheques.

(5) Further loans were by TTEL to WCL as follows:

(f) 1 March 2002 £200,000

(6) £100,000 was repaid by WCL to Payday Loan Company Limited on 5 July 2002.

(7) The following sums were paid by WCL to the Appellant by way of repaying the loan notes on the following dates:

(a) 5 July 2002 £500,000 (the £100,000 repaid at (6) above was included in this sum)

(b) 6 February 2003 £100,000

(c) 1 May 2003 £500,000

(d) 30 June 2003 £201,000

(e) 30 July 2003 £100,000

(f) 23 September 2003 £100,000

(g) 5 January 2004 £150,000

4. We had a bundle of documents and heard evidence from Mr Javed Siddiqui, partner in Charterhouse (Accountants) LLP. We find the following further facts:

(1) The Appellant was the sole director of TTEL until 19 August 2002 when Mr T Cane was appointed director and company secretary. Following the acquisition of WCL the Appellant was sole director and Mr T Cane was appointed a director on 24 October 2002.

(2) The hive-down was at book value, no value being attributed to goodwill. Following the hive-down TTEL ceased to trade. As is clear from the transactions, until the hive-down every time there was a repayment of loan stock by WCL, TTEL lent a corresponding amount to WCL immediately before.

(3) On 27 December 2000 the Appellant waived the interest on the loan notes whether accruing before or after that date until such time as he should notify WCL that the waiver should cease.

(4) Assets representing profits made by DCL after the hive-down are not available for distribution because of its negative reserves (see paragraph 5 below) on the basis that in the absence of evidence to the contrary Guernsey law is to be assumed to be same as UK company law.

5. The distributable reserves for each company shown in their accounts were:

	TTEL	WCL
30 September 2000	1,422,837	(15,011,654)
31 January 2002	2,032,931	(15,501,000)

31 January 2003	2,032,931	(14,796,434)
31 January 2004	2,035,944	(14,683,081)
31 January 2005	1,754,115	(14,176,540)

The reason for the diminution of TTEL's reserves in the year to 31 January 2005, which had remained almost constant since the hive-down on 1 February 2002 is that there was a loss of £281,829 in that year caused principally by a payment of corporation tax of £285,000 relating to events before the hive-down.

6. Sections 703 and following provide:

"*703 Cancellation of tax advantage*

(1) Where—

(*a*) in any such circumstances as are mentioned in section 704, and

(*b*) in consequence of a transaction in securities or of the combined effect of two or more such transactions,

a person is in a position to obtain, or has obtained, a tax advantage, then unless he shows that the transaction or transactions were carried out either for bona fide commercial reasons or in the ordinary course of making or managing investments, and that none of them had as their main object, or one of their main objects, to enable tax advantages to be obtained, this section shall apply to him in respect of that transaction or those transactions.

(2) For the purposes of this Chapter a tax advantage obtained or obtainable by a person shall be deemed to be obtained or obtainable by him in consequence of a transaction in securities or of the combined effect of two or more such transactions, if it is obtained or obtainable in consequence of the combined effect of the transaction or transactions and the liquidation of a company….

704 The prescribed circumstances

The circumstances mentioned in section 703(1) are—

…

C—(1) That the person in question receives, in consequence of a transaction whereby any other person—

(*a*) subsequently receives, or has received, an abnormal amount by way of dividend; or

(*b*) subsequently becomes entitled, or has become entitled, to a deduction as mentioned in paragraph B(1) above,

a consideration which either—

(i) is, or represents the value of, assets which are (or apart from anything done by the company in question would have been) available for distribution by way of dividend, or

(ii) is received in respect of future receipts of the company, or

(iii) is, or represents the value of, trading stock of the company,

and the person in question so receives the consideration that he does not pay or bear tax on it as income.

(2) The assets mentioned in sub-paragraph (1) above do not include assets which (while of a description which under the law of the country in which the company is incorporated is available for distribution by way of dividend) are shown to represent a return of sums paid by subscribers on the issue of securities.

OR

D—(1) That in connection with the distribution of profits of a company to which this paragraph applies, the person in question so receives as is mentioned in paragraph C(1) above such a consideration as is therein mentioned.

(2) The companies to which this paragraph applies are—

(*a*) any company under the control of not more than five persons, and

(*b*) any other company which does not satisfy the conditions that its shares or stocks or some class thereof (disregarding debenture stock, preferred shares or preferred stock), are listed in the Official List of the Stock Exchange, and are dealt in on the Stock Exchange regularly or from time to time,

so, however, that this paragraph does not apply to a company under the control of one or more companies to which this paragraph does not apply.

(3) Subsections (2) to (6) of section 416 shall apply for the purposes of this paragraph.

709 Meaning of "tax advantage" and other expressions

(1) In this Chapter "tax advantage" means a relief or increased relief from, or repayment or increased repayment of, tax, or the avoidance or reduction of a charge to tax or an assessment to tax or the avoidance of a possible assessment thereto, whether the avoidance or reduction is effected by receipts accruing in such a way that the recipient does not pay or bear tax on them, or by a deduction in computing profits or gains.

(2) In this Chapter—

"company" includes any body corporate;

"securities"—

(*a*) includes shares and stock, and

(*b*) in relation to a company not limited by shares (whether or not it has a share capital) includes also a reference to the interest of a member of the company as such, whatever the form of that interest;

"trading stock" has the same meaning as in section 100(1);

"transaction in securities" includes transactions, of whatever description, relating to securities, and in particular—

(i) the purchase, sale or exchange of securities;

(ii) the issuing or securing the issue of, or applying or subscribing for, new securities;

(iii) the altering, or securing the alteration of, the rights attached to securities;

and references to dividends include references to other qualifying distributions and to interest.

(3) In section 704—

(*a*) references to profits include references to income, reserves or other assets;

(*b*) references to distribution include references to transfer or realisation (including application in discharge of liabilities); and

(*c*) references to the receipt of consideration include references to the receipt of any money or money's worth."

7. Incorporating the cross-references and definitions into Circumstance D results in:

> In connection with the distribution, [transfer or realisation (including application in discharge of liabilities)] of profits, [income, reserves or other assets] of a company to which this paragraph applies, the person in question so receives [that he does not pay or bear tax on it as income] consideration [in money or money's worth] that either [(i) is, or represents the value of, assets which are (or apart from anything done by the company in question would have been) available for distribution by way of dividend, or (ii) is received in respect of future receipts of the company, or (iii) is, or represents the value of, trading stock of the company.]

8. HMRC contends that Circumstance D applies because the distributable reserves of TTEL are represented by the value of assets available for distribution by way of dividend; that the loans by TTEL to WCL and the subsequent hive-down are transfers of those assets; and in connection with such transfers the Appellant received those assets in a form that he does not bear tax on them as income, namely repayment of WCL's loan stock. It is not in dispute that there has been a transaction in securities or that TTEL is a D company. Nor is the escape clause in issue.

9. Mr Thornhill, for the Appellant, takes issue with three points:

(1) The exclusion in C(2) applies to the redemption of the loan stock as it represent a return of sums paid by subscribers on the issue of securities. If C(2) is limited to companies governed by foreign law which can pay dividends out of share capital there is otherwise no let out (apart from the escape clause in s 703(1)) for the repayment of loans in circumstances in which a dividend could have been paid. The point was not fully argued in *Hague v IRC* 44 TC 619, 631, *IRC v Addy* [1975] STC 601, 613, or *IRC v Brown* 47 TC 217, 234.

(2) The loans made by TTEL to WCL before the hive-down are genuine loans and are not the distribution of profits because TTEL's distributable reserves are not diminished. The loans in *Williams* are different because they were equivalent to outright payments and the issue was whether the loans constituted a tax advantage. Although the reserves were not diminished in *Cleary* the buying company parted with cash to the shareholders in the same way as if a dividend had been paid.

(3) After the hive-down the profits made by WCL are its own profits and these are not available for distribution because of the large negative reserves of that company. HMRC's argument that the hive-down is something done by the company in question apart from which the profits would have been made by TTEL and would have been available for distribution by way of dividend, goes too far in looking to future profits that were never made by TTEL.

(4) He replies to Mr Hill's argument that the section should be given a wide meaning; the statements relied on date from the time when the section was originally thought to be restricted to preventing dividend stripping. When the taxpayer tried to resurrect the argument in *IRC v Laird Group plc* (2003) 75 TC 399 Lord Millett said at [25] "With all due respect, that horse has been dead for nearly 30 years.

10. Mr Hill, for HMRC, contends:

(1) The exclusion in C(2) is restricted to companies governed by foreign law so that even though foreign law enabled distribution of share capital by way of dividend a company was not disadvantaged compared to a UK company. The words in brackets specifically refer to foreign law. The decision to this effect in *IRC v Addy* is part of the ratio.

(2) There is no need for there to be an outright distribution of profits at each stage of the series of transactions, given the definitions that distribution of profits includes transfer of assets. The loans are transactions between companies controlled by the Appellant.

(3) The section should be read broadly giving wide meanings to general phrases: see, for example Viscount Dilhorne in *IRC v Parker* [1966] 1 All ER 399 at 404, and Lord Wilberforce at 413-4; Lord Reid in *Greenberg v IRC* [1971] 3 All ER 136, 149g-j, and Lord Simon at 160d. The relevant transactions should be looked at as a whole.

11. As a preliminary we do not consider it necessary to deal in detail with the arguments about whether the section should be given a wide interpretation. We agree with Mr Thornhill's point that the statements to that effect date from the time when it was originally thought that the section was aimed at dividend stripping and was subsequently being used for other purposes. We note that in the most recent case of *IRC v Laird Group plc* the House of Lords approached the interpretation of the section as a matter of the ordinary meaning of language. We therefore give the section its ordinary meaning in so far as such a section has an ordinary meaning. It is common ground that we must view the transactions as a whole.

12. On the first issue, C(2) states that the assets in question "do not include assets which (while of a description which under the law of the country in which the company is incorporated is available for distribution by way of dividend) are shown to represent a return of sums paid by subscribers on the issue of securities." The courts have certainly assumed that the words in brackets refer solely to foreign law so that even if foreign law permits dividends out of share capital (or share premium account, as permitted for a Cayman Islands company in *First Nationwide v HMRC* [2010] SFTD 408) that is to be ignored with the effect that foreign companies are treated no worse than UK incorporated companies.

13. In *Hague* Cross J said

> "Those words were apparently directed to the case where the law of the country in which the company was incorporated provides that the capital of the company can be distributed as income."

The point was clearly not fully argued, and it was accepted that the repayment of the original capital of the company was not taxable, the issue being how one calculated the proportion when the amount distributed exceeded the amount available for distribution by way of dividend, on which the Court of Appeal disagreed with Cross J. In *IRC v Brown* 47 TC 217, 234 Megarry J said:

> "For brevity, I may call this the 'foreign law clause.' These words make it plain that, whatever may be said by the law governing a foreign company, assets which represent a return of capital are not to be included in 'assets' for the purposes of the subsection."

The context was that this lent support for the interpretation that "available" meant legally available rather than available on sound commercial practice, which was in issue in that case. In *IRC v Addy* [1975] STC 601, 613 Goff J said:

> "In my judgment, however, the passage in the section relied on has no application because it relates solely to foreign companies: see per Cross J in *Hague's* case [1968] 1 All ER at 1103, [1969] 1 Ch at 405, 44 Tax Cas at 631 and per Megarry J in *Inland Revenue Comrs v Brown* [1971] 2 All ER 33 at 47, [1971] 1 WLR 11 at 26, 47 Tax Cas 217 at 234—and his reasoning, it will be remembered, was adopted by Russell LJ [1971] 3 All ER 502 at 510, [1971] 1 WLR 1495 at 1499, 47 Tax Cas 217 at 236. Where the company is an English one, assets representing share capital are excluded, but not because of this provision. It is because they are manifestly not available for distribution as dividend. In such circumstances, however, no problem arises unless, as in *Hague's* case [1968] 1 All ER at 1103, [1969] 1 Ch at 405, 44 Tax Cas at 631, but not the instant case, the amount distributed exceeds the reserves, whether of a revenue or a capital nature, which are available for distribution as dividend. In my judgment, therefore, the commissioners reached the right conclusion on this question, not precisely for the reasons which they state but for the reasons which I have just given."

The context was that there was an issue of quantum as shown by the last part of the quotation. The taxpayer was effectively arguing that the return of capital came out

first but Goff J decided that as the reserves exceeded the amount distributed the whole was taxable. Therefore the ambit of C(2) made no difference to the decision.

14. In none of these cases did the possible application of C(2) to a UK company affect the decision since in all of them it was accepted that the capital of the particular UK companies was not available for distribution by way of dividend. In *Addy* Goff J said that for an English company assets representing share capital were manifestly not available for distribution as dividend. However, if the company had been an UK unlimited company there would be nothing to prevent distribution of share capital as dividend. If the point had been put to him we are sure he would not have considered that the provision was restricted to foreign companies. While therefore there are clear statements that C(2) is restricted to foreign incorporated companies we consider that we are not bound by them as they are obiter. We see no reason why C(2) should not apply to a UK incorporated unlimited company. There may also be circumstances in which a purchase of own shares brings it into effect but this was not fully argued and the position is complicated by the fact that sometimes such a purchase is taxable as income.

15. Having decided that C(2) can be applicable to a UK company, we do not consider that this assists Mr Thornhill's case. The effect of C(2) is that assets representing a return of sums paid by subscribers on the issue of securities are not available for distribution by way of dividend; it is not that the return of assets subscribed is never caught by Circumstance D. Suppose that WCL's loan stock had been TTEL's and that the Appellant had bought it at the same discount from the original subscriber, we do not consider that this would prevent Circumstance D from applying to the repayment of the loan stock in circumstances where there were distributable reserves. C(2) determines the maximum that can be paid as dividend as the amount of distributable reserves (not including a return of share capital if that is otherwise distributable). Even if the Appellant had received a repayment of the amount subscribed for the loan stock that would not prevent its being said that this was consideration in tax-free form that represented TTEL's distributable reserves. While this may look like overkill it is no different in principle from the sale of the shares of a D company for cash being potentially within Circumstance D. In both cases the Circumstance potentially applies and the taxpayer has to rely on the escape clause.

16. The second issue is whether it makes any difference that the loan stock is WCL's and the assets in question go into WCL as loans before the hive-down, and as the transfer of assets in consideration of a debt on the hive-down. Mr Thornhill contends that the position is unlike that in *IRC v Williams* 44 TC 257 where the loans to the taxpayers were tantamount to outright payments. Mr Hill contends that there is nothing to stop the tracing of the consideration representing assets available for distribution by way of dividend through loans. He relies on *Emery* in which the taxpayer (Mr Emery) sold his company (Mersey) to Tishmear (owned by Messrs Bradman and Faber, the promoters of the avoidance scheme) in consideration of a debt, which debt the taxpayer sold to Kopley (also owned by Bradman and Faber) for cash that was funded by a loan from Mersey; on the following day Mersey paid a dividend to Tishmear which lent it to Kopley which repaid to Mersey the loan made to acquire the debt. Nourse J said:

> "…the Crown's primary argument on this point, is to this effect: that in connection with the distribution of the profits of a company to which this paragraph applies (Mersey), the person in question (Mr Emery) received a consideration (£233,409) which represented the value of assets which, apart from anything done by the company in question (Mersey), would have been available for distribution by way of dividend; and that the said person (Mr Emery) so received the consideration that he did not pay or bear tax on it as income. As before, there is a comparable area of common ground and a comparable area of dispute. The dispute is whether Mr Emery received the £233,409 'in connection with' the admitted distribution of Mersey's profits.
>
> In my judgment there can be no doubt that circumstance D is satisfied in the present case. The same facts and a similar process of reasoning lead inevitably to the conclusion that Mr Emery received his money 'in connection with' the distribution of Mersey's profits."

17. We agree with Mr Hill. While in *Williams* the taxpayers did receive their consideration in the form of loans from a company that ended up as a subsidiary of a company that they owned, we do not consider that the consideration representing the value of assets which are available for distribution by way of dividend cannot be traced through genuine loans. In *Emery* the consideration received by the taxpayer was derived through Mersey lending funds to Kopley to enable Kopley to buy from the taxpayer the debt due from Tishmear. That debt was a genuine short-term debt that was then repaid the next day out of the dividend from Mersey to Tishmear which was lent on to Kopley. All that is necessary is that the consideration received by the taxpayer ultimately represents assets that are (or apart from anything done by the company in question would have been) available for distribution by way of dividend ("available assets" for short). Since distribution of profits includes application of assets in discharge of liabilities, why should it not include lending the assets in the first place?

18. Here the Appellant has received in the form of repayment of WCL's loan stock tax-free consideration that represents assets that were available to TTEL for payment of dividend having been lent by TTEL to WCL (or transferred to WCL in exchange for a debt in the hive-down). Before the hive-down loans were made that exactly corresponded to the repayments of WCL's loan stock to the Appellant. After the hive-down the assets were already in WCL and available for repaying the loan stock. It might be argued that in the hive-down TTEL has done something to those assets apart from which they would have been available assets, but we do not consider that this is correct because the assets have merely been replaced by a debt due to TTEL of the same amount that is still an available asset, as can be seen from the fact that the same amount of distributable reserves are still in TTEL after the hive-down. In our view these facts are sufficient to bring the circumstance D into effect.

19. The third issue concerns the repayment of WCL's loan stock out of assets representing profits accruing to WCL after the hive-down. Mr Hill contends that the hive-down is a distribution of profits being a transfer of assets and such assets are, or represents the value of, assets which are (or apart from anything done by the company in question would have been) available assets, in that if the hive-down had not

occurred the profits would have been made by TTEL and in that company those assets would have been available assets. Mr Thornhill contends that the profits were actually made by WCL and in that company were not available for distribution by way of dividend because of the negative distributable reserves.

20. We agree with Mr Thornhill on this issue. We consider that the effect of the words in brackets in C(1)(i)—"assets which are (or apart from anything done by the company in question would have been) available [assets]"—is that they apply if one starts with actually available assets, to which the company has done something to prevent them from being available, the obvious example being capitalising them. On the hive-down there was a transfer of assets that represents the value of available assets of TTEL corresponding to its distributable reserves up to the date of the hive-down, which we have decided in the second issue remain available assets. But this issue concerns WCL's profits after the hive-down. If one starts by assuming that WCL is the company referred to in the passage in brackets, the assets representing those profits are not available assets because of the negative distributable reserves in WCL. WCL cannot logically have done anything to them apart from which they would have been available assets. It may have paid them away in repayment of loan stock but that has not made them any the less available.

21. If one considers TTEL to be the company referred to in the passage in brackets, for Mr Hill to succeed on this issue he has to show that the assets representing WCL's profits after the hive-down also represent TTEL's assets which apart from the hive-down (and presumably the repayment of the loan stock by WCL) would have been available assets of TTEL. For this to be satisfied TTEL would have to be able to look into the future to know that it would have made the same profits as WCL did. While we accept that the same directors were directing both companies and can be assumed to have made the same business decisions whichever company was carrying on the trading, the question of whether assets are available assets depends on the situation of the company carrying on the trading. Suppose that the Appellant notified WCL of the ceasing of the waiver of interest on the loan stock, which would not be "anything done" by TTEL, the interest would, we assume, have exceeded the trading profits so that there would be no available assets in WCL simply because there were no profits.. We consider that Mr Hill's argument takes the hypothesis one stage too far. The hypothesis extends to a company's action in making its available assets into non-available assets; it does not extend to making one company's non-available assets into a different company's available assets by saying that the assets would have accrued to the latter company but for the hive-down. The fact is that the profits after the hive-down did not accrue to TTEL and they never were available assets to TTEL to which that company has done something to make into non-available assets.

22. Whichever basis one reads the words in brackets, the condition is not satisfied.

23. In summary our decision is that:

(1) C(2) potentially applies to UK incorporated companies but this does not prevent the repayment of the amount originally subscribed for WCL's loan stock from being within Circumstance D;

(2) The fact that assets have been lent by TTEL to WCL or transferred on the hive down in consideration of a debt does not prevent those assets from continuing to represent assets available for distribution by TTEL by way of dividend;

(3) Assets representing profits made by WCL after the hive-down are not assets that would have been available to TTEL for distribution by way of dividend on the basis that apart from the hive-down those profits would have been made by TTEL.

Accordingly our decision in principle is that the appeal is dismissed up to the amount of distributable reserves of TTEL until the hive-down but allowed in respect of any further profits made by WCL after the hive-down. We adjourn for the figures to be agreed or determined by us if they cannot be agreed.

24. 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.

JOHN F AVERY JONES

TRIBUNAL JUDGE
RELEASE DATE: 14 July 2010