TC03150

Appeal number: TC/2009/16579, TC/2010/02257, TC/2010/02266 & TC/2010/02264

Income tax and NI – cheap loans - employee benefit trust – discount agreement – was interest or discount paid – was re financing payment – was interest paid for relevant years of assessment – held – payments under discount agreement interest for tax purposes – refinancing did not amount to payment –no interest paid for relevant years – appeals dismissed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

LEEDS DESIGN INNOVATION CENTRE LTD **Appellants**

ROBERT NOBLE

RICHARD WATKISS
&
PETER CONNOLLY

- and -

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

TRIBUNAL: JUDGE RACHEL SHORT
NIGEL COLLARD

Sitting in public at 45 Bedford Square, London on 9 October 2013

Mr Andrew Thornhill QC and Edward Waldegrave for the Appellant

Mr James Rivett instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This appeal concerns the income tax treatment of certain arrangements made under an employee benefit trust for the benefit of Mr Noble, Mr Connolly and Mr Watkiss, all of whom were either directors or employees of Leeds Design Innovation Centre Limited (the Company), and the Company's Class 1A national insurance obligations in respect of those arrangements. In each case the years of assessment are the years from 1999 – 2000 to 2004 -5, excluding in each case the 2003 – 4 year of assessment. An appeal against HMRC's decision to charge income tax on each of the employees was made on 24 November 2009. An appeal against HMRC's decision to charge Class IA national insurance to the Company was made on 25 November 2009.

2. The point at issue between the parties is whether the loans made available to each of the employees under agreements described as the Discount Loan Agreements (the "Discount Agreements") entered into by each of them in March and July 1998 fell to be taxed as a "cheap loan" or "beneficial loan" by reason of no interest being paid on that loan agreement for the years in question, or whether the fact that a sum described as a payment of discount was due at the end of the term of the loan, took the arrangements outside a charge to tax for either the employees or the Company.

3. It was agreed before the Tribunal that the point at issue was the same as respects each of the employees' income tax position and the Company's Class 1A national insurance obligations and that the provisions of the Discount Agreements were the same for each of the employees.

Agreed Facts.

4. The Company is a UK resident company in which all the shares are owned by Mr Noble and Mr Connolly who are its two directors. Mr Watkiss is an employee of the Company. The Leeds Design Innovation Centre Pre-Retirement Employee Benefit Trust ("EBT") was established on 9 March 1998 by the Company. The Trustee of the EBT is a Guernsey resident entity, Louvre Trustees Limited. The EBT lent funds to a British Virgin Islands entity, A E Limited ("AE"), which made loans to Mr Watkiss, Mr Noble and Mr Connolly. The loans were made on the basis of the Discount Agreements and the loans made under those agreements which are the subject of this appeal are set out below. The Discount Agreements allowed for more than one loan to be advanced and several loans were in fact made under one Discount Agreement. There was no dispute between the parties that the rates of "discount" which were charged under the agreements were commercial rates.

Name	Date of Discount Agreement	Date of Appendix	Amount of Loan £
Mr Noble	12 March 1998	n/a	51,000
	18 March 1999	n/a	90,000

	18 March 1999	12 October 2000	55,000
	18 March 1999	27 March 2002	20,000
	18 March 1999	26 March 2003	93,600
	18 March 1999	18 December 2003	25,000
Mr Connolly	12 March 1998	n/a	66,000
	1 March 1999	n/a	90,000
	1 March 1999	16 October 2000	64,600
	1 March 1999	27 March 2002	20,000
	1 March 1999	26 March 2003	86,400
	1 March 1999	18 December 2003	25,000
Mr Watkiss	31 July 1998	n/a	7,000

5. The Discount Agreements obliged each of the individuals to repay their loan on the tenth anniversary of the entering into of the Discount Agreement. The repayment terms included an obligation on the borrower to make a payment of a sum described as “discount”. This element was calculated by reference to LIBOR plus 2% on a compounding basis, on the amount of the loan for every complete year of the loan. The Tribunal were provided with copies of the Discount Agreements entered into with Mr Noble, Mr Connolly and Mr Watkiss.

6. The loans all became due to be re-paid during 2008 and 2009, but were not, in fact, repaid then. Mr Watkiss paid off his loan on 25 April 2012. Mr Noble and Mr Connolly did not pay off their loans, but refinanced them under finance agreements with AE on 27 October 2010 (“the Refinancing Agreements”). The Tribunal was provided with copies of these Refinancing Agreements, which were also described as “discount agreements”. We were also shown the schedules calculating the outstanding amounts due, which referred to an interest rate and the number of days for which the relevant loan had been outstanding. Mr Noble’s refinancing agreement was for a total of £721,880.69, being the amount of the original loan, plus compound interest on the amount outstanding. Mr Connolly’s re- financing agreement amounted to £783,844.12, being the amount of the outstanding loan plus compound interest. Both Refinancing Agreements also took account of the payments due for the period from 2008 and 2009 to 2010 when the loans had been left outstanding despite that fact that they had come to the end of their term. The Refinancing Agreements were due to be re -paid on 27 October 2020. Correspondence sent to Mr Noble and Mr Connolly

in February 2011 referred to these agreements as *"renewing and consolidating the loans made to you"*.

Relevant Law.

7. The relevant legislation which imposes a charge to tax on loans made to employees is s 160 Income Taxes Act 1988 ("Taxes Act 1988"), for periods to April 2003, and s 175 Income Tax (Earnings and Pensions Act) 2003 ("ITEPA 2003"), for periods from April 2004. It was agreed between the parties that, while the drafting of the two sets of provisions were different, they applied to give the same result.

8. S 160 applies to "beneficial loan arrangements" and states that:

> S 160(1) *Where in the case of a person employed in employment to which this Chapter applies there is outstanding for the whole or part of a year a loan (whether to the employee himself or a relative of his) of which the benefit is obtained by reason of the employment and –*
>
> *(a) no interest is paid on the loan for that year; or*
>
> *(b) the amount of interest paid on it for the year is less than interest at the official rate,*
>
> *An amount equal to whatever is the cash equivalent of the benefit of the loan for that year shall, subject to the provisions of this Chapter, be treated as emoluments of the employment, and accordingly chargeable to tax under Schedule E; and where that amount is so treated the employee is to be treated as having paid interest on the loan in that year of the same amount.*

The cash equivalent of the benefit of the loan is determined by Schedule 7, paragraph 3 of the Taxes Act 1988.

> *Paragraph 3(1) The cash equivalent for any year of the benefit obtained from a loan is-*
>
> *(a) the amount of interest …..which would have been payable for that year had interest at the official rate been payable on the loan, less*
>
> *(b) the amount of interest actually paid on the loan for that year*
>
> *And, in a case where there are two or more loans, the aggregate of the cash equivalents (if any) of the benefit of each of those loans shall be treated for the purposes of section 160 as the cash equivalent of the benefit of all of them.*

Additional provision is made in s 160(4A) to deal with situations where interest is paid in a later year after it has been assessed:

> S 160(4A) *Where an assessment for any year in respect of a loan has been made or determined on the footing that the whole or part of the interest payable on the loan for that year was not in fact paid, but it is subsequently paid, then,*

on a claim in that behalf, the cash equivalent for that year shall be recalculated so as to take that payment into account and the assessment shall be adjusted accordingly.

The relevant legislation for years after 5 April 2003 is at s 175 ITEPA 2003. S 175 is headed "Benefit of taxable cheap loan treated as earnings" and states that:

> (1) *The cash equivalent of the benefit of an employment-related loan is to be treated as earnings from the employee's employment for a tax year if the loan is a taxable cheap loan in relation to that year.*
>
> *(2) For the purposes of this Chapter an employment-related loan is a "taxable cheap loan" in relation to a particular tax year if –*
>
>> *(a) there is a period consisting of the whole or part of that year during which the loan is outstanding and the employee holds the employment,*
>>
>> *(b) no interest is paid on it for that year, or the amount of interest paid on it for that year is less than the interest that would have been payable at the official rate, and*
>>
>> *(c) none of the exceptions in s 176 to 179 apply.*
>
> *(3) The cash equivalent of the benefit of an employment-related loan for a tax year is the difference between –*
>
>> (a) *the amount of interest that would have been payable on the loan for that year at the official rate, and*
>>
>> *(b) the amount of interest (if any) actually paid on the loan for that year.*
>
> *(4) If there are two or more employment -related loans, this section applies to each separately.*

S 170 contains similar provisions to deal with interest paid outside the relevant year of assessment, s 191 ITEPA applies to claims for relief to take account of certain events after assessment:

> (1) *Any claim for relief may be made in the following cases.*
>
> *(2) The first case is where –*
>
>> *(a) The tax payable by an employee for a tax year in respect of a loan has been decided on the basis that for the purposes of section 175 (benefit of taxable cheap loan treated as earnings), the whole or part of the interest on the loan for that year was not paid, and*
>>
>> *(b) It is subsequently paid.*

(4) Where a claim is made under this section the tax payable is to be adjusted accordingly.

There is no dispute under either the old or the new legislation that the loans were obtained by reason of Mr Noble, Mr Connolly and Mr Watkiss' employment.

The legislation which charges the Company to Class 1A national insurance contributions as a result of the making of these loans is at s10 of the Social Security Contributions and Benefits Act 1992:

S 10(1) gives rise to a Class 1A contribution where

(a) *for any tax year an earner is chargeable to income tax under ITEPA 2003 on an amount of general earnings received by him from any employment ("the relevant employment"),*

(b) the relevant employment is both-

(i) employed earner's employment, and

(ii) an employment, other than an excluded employment, within the meaning of the benefits code……,

(c) the whole or part of the general earnings falls, for the purposes of Class 1 contributions, to be left out of account in the computation of the earnings paid to or for the benefit of the earner,

a Class 1A contribution shall be payable for that tax year, in accordance with this section, in respect of that earner and so much of the general earnings as falls to be so left out of account".

The Evidence

9. The Tribunal was provided with copies of the Discount Agreements entered into by Mr Noble, Mr Connolly and Mr Watkiss in 2008 and the Refinancing Agreements entered into by Mr Noble and Mr Connolly in 2010. Mr Noble and Mr Connolly provided witness statements and gave oral evidence before the Tribunal.

10. When asked why the Discount Agreements had been structured to provide for a payment of discount at the end of their term rather than interest during the life, neither Mr Noble nor Mr Connolly were clear why this had been done. Neither had questioned the arrangement, although both stated that it suited them not to have to make payments until the end of the life of the loans. Mr Noble explained that the reason why the original loans were not paid off at the end of the original term was due to the credit crunch in 2008 and 2009. Mr Noble, who was responsible for the Company's financial affairs, did say that he had asked questions to ensure that AE and the trustees of the EBT were not "men of straw" and that the EBT was acting

properly in making loans to AE. In respect of the Refinancing Agreements, Mr Noble was clear that these covered the amount of the original loan and all interest payments which were outstanding. Both Mr Noble and Mr Connolly described the payments on the original loan and the refinancing as interest.

The Taxpayers' Arguments

11. The Appellants' starting point was that the overall intention of the beneficial loan legislation was only to bring into charge to tax loans in respect of which employees had obtained a benefit, by reason of no, or a low rate of, interest being paid on the loans; this intention was evidenced by the head note to both relevant pieces of legislation. This was not the case for the loans made to Mr Noble, Mr Connolly and Mr Watkiss because of the large "discount" payment which was due at the end of the ten year term of the loans.

12. Mr Thornhill argued that the obligations under the Discount Agreements, although described as discount payments, were in fact payments of interest; they were calculated by reference to LIBOR and that calculation was made on a daily, accruing basis, fulfilling the definition of interest in *Bennett v Ogston* ([1930] 15 TC 374). No interest was payable under the loan agreement and the overriding presumption should therefore be that this payment was legally and commercially interest and not discount.

13. While the term discount was used in a variety of commercial contexts in a "loose sense", the true meaning of discount, which was the relevant meaning for the purposes of the taxes act, was a much narrower definition which applied only in a small category of cases to certain types of instrument, such as discounted bills of exchange and treasury bills of the type referred to in *Lomax v Dixon.* (*Lomax v Peter Dixon & Sons Ltd* [1943]1 KB 671) That case indicated that discount was fundamentally different from interest, including an element of capital risk and not just representing a payment by time for the use of money. That was not applicable to the discount paid under these Discount Agreements, which was a proxy for interest. The manner in which the discount was calculated at the time of the refinancing of the loans to Mr Noble and Mr Connolly in 2010 supported this approach, referring as it did to an interest rate and the number of days for which the loan had been outstanding.

14. The Appellants could not provide a reason why these loan agreements had been drafted as discount agreements, referring only to the adviser who had constructed the agreements, Mr Baxendale's "fertile imagination". Mr Thornhill accepted that had the purpose been to avoid a UK withholding tax charge which would have applied to interest payable to AE in the BVI, the agreements would have been ineffective if it was correct that the payments made under them did amount to interest.

15. The Appellants argued that as far as Mr Watkiss was concerned it was clear that his "discount" has been paid in April 2012 when he paid off his loan. For Mr Noble

and Mr Connolly, the re financing agreements entered into in October 2010 should be treated as “in satisfaction” of the original debts, including the outstanding discount element. Mr Thornhill relied on the statement of the House of Lords in *McNiven v Westmoreland Investments Limited* ([2001] STC 237) to confirm that the payment could be treated as made even though the funds to make payment were provided from the creditor as an extension to the original loan from AE.

16. The Appellants suggested that both s 160 Taxes Act 1988 and s 175 ITEPA 2003 had not been drafted to take account of circumstances such as this where interest was paid at the end of the term of a loan rather than in equal parts during its term. It was absurd to suggest that late, or early, payment of interest meant that a charge could arise under these sections despite the fact that payment in full had actually been made. This was a lacuna in the drafting which gave rise to an absurd result which cannot have been the intention of the draftsman. Mr Thornhill particularly stressed the absurdity which would arise were interest to be paid up front in year one.

HMRC’s Arguments.

17. Mr Rivett said that the Appellants’ attempt to apply a purposive interpretation to the beneficial loan legislation was ineffective since the legislation itself provided a very specific definition of what amounted to a “beneficial” or “cheap” loan. If a loan fell within those definitions it was caught by the legislation, and there was no room for any purposive interpretation.

18. HMRC’s interpretation of the Discount Agreement differed fundamentally from Mr Thornhill’s. HMRC argued that payments were in fact discount because on the drafting of the Discount Agreements the Repayment Amount included the full amount of the discount due, even if the loan was re-paid early. In particular clause 3 of the Discount Agreements –Repayment, obliged the borrower to repay the “Gross Obligation” on the repayment date and if the loan was re paid early the borrower was obliged to repay “any part of the Loan and the Discount”. Discount was defined as

> “*the sum of the annual compounded products of the Discount Rate and the Loan and that number shall be equal to the number of complete calendar years comprised in the Finance Term”*.

Therefore even if the loan was repaid before the end of the Finance Term, the full amount of Discount was payable. The payment could not be characterised as a payment by time for the use of money; the “discount” was not accruing on a daily basis as interest would have.

19. Mr Rivett pointed out the differences between the 1998 Discount Agreements and the 2010 Refinancing Agreements in this regard. The 2010 Refinancing Agreements were drafted to take account of an early termination date in determining what level of discount was payable.

20. HMRC argued that even if the payments could be treated as interest, they could not be treated as interest paid “for” the relevant years in question. Income tax is an annual tax and therefore it is logical to expect that assessments should be made on an

annual basis by reference to what has happened in a particular year. Any harshness which this imposed was mitigated by s 160(4A) Taxes Act 1988 and s 191 ITEPA, which gave a taxpayer the opportunity to reopen years within a four year window if interest was in fact paid "for" a particular year at a later time. Concerning the "absurd" result which could arise from a pre-payment of interest, Mr Rivett said that it would be perfectly possible to allocate pre-payments to specific future years, if the pre-payment was in satisfaction of the obligation to pay future regular amounts of interest.

21. In HMRC's view, if any interest was paid in respect of these arrangements, it was not until the refinancing agreements were entered into in 2010 (for Mr Connolly and Mr Noble) and when the debt was fully repaid in 2012 (for Mr Watkiss). By that date it was too late to disturb the assessments for any of the years, the four year window for making a claim under s 160(4A) Taxes Act 1988 and s 191 ITEPA having passed by then. HMRC suggested that the re-financing agreements in 2010 were an attempt by the taxpayers to demonstrate, after they were aware of HMRC's arguments that the interest had not been paid, that payment in some form had occurred.

22. From Mr Rivett's perspective, the refinancing agreements entered into in 2010 could not be treated as the "payment" of interest for these purposes. They were akin to the book entry payments considered in *Minsham Properties* (*Minsham Properties Ltd v Price* [1990] STC 718) and, unlike in *McNiven v Westmoreland*, there were no other legal or commercial consequences of these payments being made (including no levying of withholding tax).

Discussion.

What was the character of the payment under the Discount Agreements?

23. Discount is a difficult concept to pin down. Interest is a well known and easily recognisable commercial concept with a handy judicial definition in *Bennett v Ogston*. Discount is defined only in case authorities which are difficult to apply to modern commercial dealings. Nevertheless, it is clear that the tax legislation did, at least until 2005, consider the two types of commercial return to be different things which were taxed differently. Therefore our starting point is that for a payment to be treated as discount it must have some features which differ from an interest payment.

24. Mr Thornhill attempted to provide a description of what the essence of discount was, or what clearly distinguished it from interest. He accepted that discount could include an element of "time value of money" and be calculated at least in part by reference to LIBOR, so that a LIBOR based calculation was not fatal to the attempt to characterise something as discount, but in his view discount also had to have what he referred to (on the basis of *Lomax v Dixon*) as a "capital element". He also suggested that an agreement which contained an interest rate and a discount element was more likely to be respected as including what he termed "true" discount, than an agreement, such as the Discount Agreements, which provided for no interest return and whose only return was paid by way of discount.

25. We accept that in terms of both the tax legislation (until the changes made by the Finance Act 2005) and for commercial purposes discount is a concept which is distinct from interest and must therefore exhibit some different characteristics. Exactly what those different characteristics are we are less certain of. The discounted instruments discussed in *Lomax v Dixon* differed from the agreements under consideration here because they included a discount element, an interest rate and a redemption premium. The only types of instrument which were clearly accepted by the court in that case to carry discount were short term bills of exchange and treasury bills carrying no right to interest in respect of which the discount was applied not as between the original issuer and the borrower but by a third party purchaser of the notes.

26. Nevertheless, we take from *Lomax v Dixon* that not everything which is described in the commercial world as discount is to be taxed as discount: the tax definition is a narrower definition than the commercial one. In respect of the interaction between an interest return and a discount return; if an instrument carries a commercial rate of interest and a return described as discount, the discount element must relate to "capital risk", however, if the parties choose, that capital risk can be subsumed within the interest rate charged, which will then all be taxable as interest. Conversely, if a debt instrument does not include a return described as interest the starting assumption is that any other return payable is in fact an interest return. The relevant factors to determine whether a payment can be treated for tax purposes as a payment of discount are; the term of the loan (the longer the term, the more likely there is to be a capital risk), the rate of interest charged and the extent to which the parties took account of capital risk in setting the return.

27. On this basis and following the approach of Mr Thornhill, the taxes acts have preserved a legal definition of discount which is no longer aligned with its common commercial meaning. While not specifically relevant here, it remains an open question whether the meaning of discount should now be treated as extending beyond the narrow definition offered by *Lomax v Dixon*, which as is pointed out in that case, was first introduced in the early nineteenth century. There are discounted notes in the market whose discount is calculated only on the basis of LIBOR but nobody would suggest that their return should be treated as interest, as least as far as imposing a withholding tax obligation is concerned.

28. In a recent UTT decision in the context of relevant discounted securities (under Schedule 13 of Finance Act 1996), the court concluded in slightly different terms that discount was characterised by being, or including, a risk-based rather than a purely time-based return (*Nicholas Pike v HMRC* [2013] UKUT 0225 (TCC)). In considering whether the payment made under loan notes was interest or discount the Tribunal considered a number of relevant factors; The manner in which a payment was calculated; in that case the payment was calculated on a daily accruing basis by reference to a stipulated rate, suggesting that it was an interest return. The components of the return were also relevant; in order to be discount a payment should include a "risk-based" component. The time when payment of the return was made (at the end rather than during the life of the loan) was a neutral factor. Finally, the overall

commercial context of the lending should be considered. The Tribunal concluded that how a payment was labelled could not be determinative of its legal character.

29. Turning to these Discount Agreements and applying the criteria set out above; (i) the return on the Discount Agreements is a LIBOR based return only (ii) The discount is paid at the end of the life of the loan and, according to HMRC's interpretation, does not accrue on a daily basis (iii) The payment is described as a payment of discount. Therefore it is only the fact that the payment is not accruing on a daily basis which suggests that payments under the Discount Agreements might be something other than interest.

30. HMRC relied on the drafting of the Discount Agreements and the fact that a repayment sum would have included the full amount of discount on an early termination as evidence that the Discount did not accrue on a daily basis (Clause 3.3 obliged the borrower to re pay the Loan and the Discount on early repayment). Our view of this is that this is as likely to have arisen from poor drafting as from a real intention that the full amount of Discount would become payable on an early repayment, which we suspect the beneficiaries would have found to be rather a surprising result. Although no early termination calculations were made, at the time when the refinancing was done in 2010 the discount was calculated by reference to LIBOR applied on a daily accruing basis. We do not accept that this drafting deserves the weight which HMRC give to it in determining the correct characterisation of the payment.

31. We are not convinced that there is such a clear distinction as Mr Thornhill suggested between "*true discount*" and "loosely defined" discount. Nevertheless, we agree, on the basis of *Lomax v Dixon*, that a payment which contains no element other than a LIBOR based return, which is differentiated from interest only because it is paid at the end, rather than during the term, of the loan, cannot properly be said to be anything other than interest. As regards the relevance of any "capital risk", the commercial context of these Discount Agreements (essentially inter group lending for the benefit of employees) is not one in which capital risk is likely to have been a relevant consideration and indeed there is no evidence that it was taken account of.

32. Our conclusion is that the return on those loans contained no element other than a LIBOR based return and the fact that the return was labelled as discount and payable only at the end of the term of the loan is not sufficient to differentiate it from being a payment of interest. Despite their description, the "discount" payable under these Discount Agreements should be treated for tax purposes as interest and not discount. Both Mr Noble and Mr Connolly referred in their evidence to the payments due under the Discount Agreements as interest, reflecting their commercial understanding of what they were obliged to pay and our analysis of the true character of these payments.

If the Agreements did provide for the payment of Interest – when was the interest paid?

33. Dealing first with Mr Watkiss, there is no argument that his payment was made when he paid off the loan in April 2012. For Mr Noble and Mr Connolly, we agree with HMRC that the 2010 re-financing should not, on these facts, be treated as amounting to a payment of the interest by the taxpayers. We have concluded this for a number of reasons including the fact that the Refinancing Agreements make no specific reference to the fact that they are in consideration of the extinguishing of the original debt, including the interest or discount element. In each case the October 2010 Refinancing Agreements refer in their recital to an amount of loan finance, with no reference to the source of that sum or the previous Discount Agreements. The accompanying correspondence refers to a "*loan agreement renewing and consolidating the loans made to you as per the enclosed loan calculation schedule*".

34. We have concluded from this evidence that the taxpayers did not suffer any actual cost as a result of the re-financing, which from their perspective was very similar to a "book entry" as their debts were rolled over into the new re financing agreement. Taking HMRC's reference to *Minsham Properties*, we agree that in these circumstances Mr Noble and Mr Connolly cannot be treated as having paid the interest since it has not actually, from their perspective, been discharged. We take from *Minsham Properties* that if interest is added to existing outstanding indebtedness, that will not generally be treated as a payment. Here the interest payments were not "placed at the disposal of any other person" but actually remained outstanding and due, although under the terms of a new agreement.

35. In approaching the question of when interest should be treated as paid, the courts have tended to avoid an over legalistic approach and preferred to ask whether by reference to ordinary language and taking account of commercial common sense and practice, a payment should be treated as having been made. For example in *Paton (as Fenton's Trustee) v Commissioners of Inland Revenue* (1935) 21 TC 626 Lord Atkin observed that to treat capitalised interest as having been paid would be " *a travesty of the actual facts….the interest is not capitalised because it has been paid, but because in fact it has not been paid".* Equally here, while there might have been a notional settlement of the interest or discount as a result of it being rolled up into the new loans, in no sense has there been any reduction in the liabilities of the payers, the debt obligation (the discount payment) has merely changed in form.

36. We do not think that *McNiven,* to which Mr Thornhill referred, answers this point and we agree with HMRC that other than the new loan agreements being signed, the re-financing had no other commercial or legal consequences for the taxpayers. In *McNiven,* it was accepted that the interest payments had been discharged for the purposes of s 338 Taxes Act 1988 (the trustees had received a cash payment and withholding tax had been paid on that payment). The court was asking not whether the payment should be treated as having been discharged, but whether the fact that the cash to make those payments had been provided as part of a circular flow of cash with the intention to create tax losses coloured the tax treatment of the payment. In fact the court stressed that the question of whether payment had been made was a question of fact, and one which had to be determined by reference to commercial concepts.

37. For these reasons we have concluded that the re-financing agreements entered into by Mr Noble and Mr Connolly in October 2010 should not be treated as "payment" of the discount due under the original Discount Agreements.

If the interest or discount could be treated as paid in 2010, can it be taken account of for the purpose of s 160 and s 175?

38. Notwithstanding our conclusions above that, as regards Mr Noble and Mr Connolly, the discount due on the Discount Agreements should not be treated as paid in 2010, and taking account of Mr Watkiss' actual repayment in 2012, we have considered whether, if we are wrong as regards the 2010 repayments, there is any basis on which the later transactions could be taken account of for s 160 Taxes Act 1988 and s 175 ITEPA.

39. Mr Rivett referred us to the decision in *Morley-Clarke v Jones* (59 TC 567) as authority for the proposition that, ignoring the right to make retrospective claims under s 160(4A) or s 191, there is no other basis on which an annual charge to tax can be disturbed by later events and we agree with this reasoning. As stated in that case "when one is examining the fiscal consequences of what has actually been done one cannot, even by order of the court, retrospectively overturn reality".

40. As HMRC pointed out, it would have been open to the taxpayers to make a claim under s 160(4A) Taxes Act 1988 or s 191 ITEPA, that these late payments were actually "for" earlier periods, and if a claim was going to be made, that should have been done in 2010 at the latest in order to benefit from the four year window for making retrospective claims under s 43 Taxes Management Act 1970. We do not think it is fatal to a claim for exclusion from s 160 Taxes Act 1988 or s 175 ITEPA that a cash payment is not made in, or during the year in question, and it is clearly possible to allocate payments to earlier or later years, as long as a taxpayer is within the necessary time limit for doing so. We therefore do not agree with Mr Thornhill that these rules provide such an absurd result that they should be ignored or overridden with some purposive interpretation. Therefore we do not think there is any basis beyond the rules in s 160(4A) Taxes Act 1988 and s 191 ITEPA on which these payments can be treated as made for the years in question.

41. For these reasons these appeals in respect of the employees' income tax charge and the Company's Class 1A national insurance contributions are DISMISSED.

42. 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.

RACHEL SHORT
TRIBUNAL JUDGE

RELEASE DATE: 20 December 2013