Appeal number: TC/2010/03538
TC/2010/04081
TC/2010/07791

INCOME TAX – loss relief – whether appellants carrying on a trade – no – whether any trade carried on on a commercial basis with a view to profit – no – whether loss calculated in accordance with generally accepted accounting practice – no – whether appellants liable to penalties – yes – whether penalties correctly calculated – no – Mr Mungavin's and Mr Worsfold's penalties reduced

FIRST-TIER TRIBUNAL
TAX CHAMBER

ERNEST THOMSON
TERENCE WORSFOLD
RICHARD MUNGAVIN — **Appellants**

- and -

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

TRIBUNAL: JUDGE JONATHAN RICHARDS
ELIZABETH BRIDGE

Sitting in public at the Royal Courts of Justice, Strand, London on 20-30 March 2017; at the Rolls Building, London on 4 December 2017 and at Taylor House, Rosebery Avenue, London on 9 May 2018.

Alison Graham-Wells, instructed by Montpelier Tax Consultants Limited for the Appellants

Sadiya Choudhury, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

1. These are the joined appeals of three appellants, Mr Thomson, Mr Worsfold and Mr Mungavin which have been heard together as they raise similar issues. All three appellants entered into a financial contract that has been described as a contract for differences ("CFD") with Pendulum Investment Corporation, a company incorporated in the Seychelles (a "Pendulum CFD"). All three appellants contend that they entered into their Pendulum CFD in the course of a trade of dealing in derivatives and that the CFD resulted in them making a loss that could be set against their other taxable income. HMRC have refused the claims for loss relief as they deny that the appellants were carrying on a trade on a commercial basis with a view to profit. HMRC have also charged the appellants penalties for what they consider to be negligent completion of their tax returns for the tax years in question.

Evidence and procedural history

The evidence on which the appellants relied

2. The appellants all gave evidence themselves. Watkin Gittins, chairman of the Montpelier group of financial and tax advisers also gave evidence for the appellants. The appellants relied on expert evidence as to accounting matters from Guy Wiltcher. All of the appellants' witnesses were cross-examined.

3. The appellants were all giving evidence as to matters that took place some time ago and we have made due allowance for that when assessing the reliability and credibility of their evidence. In many respects, we found the appellants' evidence to be reliable and credible. We have, however, concluded that all three appellants' evidence deliberately understated the extent to which they were motivated by tax considerations when deciding whether to enter into the Pendulum CFD and surrounding arrangements. We will deal with this issue in our findings of fact below, and at this stage will only note that this aspect of the appellants' evidence has affected our assessment of the overall reliability and credibility of their evidence.

4. We found Mr Gittins to be a generally reliable witness. However, he too sought to gloss over what we regarded as the clear fact that the Pendulum arrangements formed part of a tax avoidance scheme and our impression of his evidence suffered as a result.

5. We set out our overall impression of the expert evidence in Part Seven below.

The evidence on which HMRC relied

6. HMRC relied on evidence of Mark Bradley, an officer of HMRC, and on expert evidence from Stephen Harrap. The appellants applied to postpone the hearing listed on 6 to 7 December 2017 for cross-examination of Officer Bradley and Mr Harrap because their counsel, Ms Graham-Wells, was unwell. However, we considered that by then the Tribunal had already made a number of accommodations for Ms Graham-Wells's conditions, including postponing a previous hearing and making case management directions designed to make it as easy as possible for the appellants to

instruct alternative counsel if necessary to cross-examine HMRC's witnesses. We therefore refused the application to postpone (and have given separate full reasons for that decision). That case management decision is the subject of a separate appeal to the Upper Tribunal.

7. The appellants did not attend the hearing on 6 December 2017. In those circumstances, Ms Choudhury, in accordance with her professional duties, conducted a cross-examination of Officer Bradley and Mr Harrap. The appellants clearly feel that they have been materially prejudiced by the fact that their chosen counsel did not cross-examine HMRC's witnesses. Therefore, after setting out our conclusions on relevant issues, from [283] onwards, we will explain why we consider there has not been any such prejudice.

The parties' closing submissions

8. Following the hearing on 6 December 2017, we directed the parties to make closing submissions in writing by 31 January 2018 to be supplemented by an oral hearing at which the Tribunal could ask questions and the parties could emphasise particular points and respond to each other's arguments. HMRC filed their written closing submissions within applicable time limits, but the appellants did not. Nevertheless, the appellants' late filing of their written submissions caused no delay to the overall timetable and we imposed no sanction. By the end of March 2018, all parties had filed their written closing submissions. The oral closing hearing was listed for 9-10 May 2018.

9. On 2 February 2018, the appellants applied to the First-tier Tribunal for permission to appeal against our refusal to postpone the hearing of 6-7 December 2017. They also applied for a direction that the appeal be stayed until that application, and any appeal to the Upper Tribunal resulting from it, was determined.

10. On or around 16 February 2018, Judge Richards released a decision refusing permission to appeal and refusing to stay the appeal. He gave reasons for both decisions. The appellants renewed their application for permission to appeal against the postponement refusal to the Upper Tribunal who granted permission to appeal. The appellants did not, however, seek permission to appeal against Judge Richards' refusal of the stay.

11. Having been granted permission to appeal by the Upper Tribunal, the appellants renewed their application to the First-tier Tribunal for a stay of proceedings. Specifically, they requested that the hearing on 9-10 May 2018 should be cancelled. On 23 April 2018, Judge Richards refused this application and gave reasons but stated that he would hear submissions at the hearing as to whether the Tribunal should defer releasing a decision until conclusion of the Upper Tribunal proceedings. The appellants subsequently applied for permission to appeal against the refusal to postpone the hearing.

12. On 8 May 2018, the appellants informed the Tribunal that they regarded the hearing on 9-10 May as unfair and stated that neither they, their representatives nor their counsel would be attending.

13. We regarded that letter as extraordinary. If the appellants objected to the Tribunal's refusal to stay the appeal pending the conclusion of proceedings in the Upper Tribunal, they should have sought permission to appeal against the Tribunal's decision to this effect. Moreover, it is difficult to see how the mere holding of a hearing on 9-10 May to hear oral closing submissions was unfair when the appellants had submitted their written closing submissions without complaint. If the appellants thought that no determination of the appeal could be fair until the Upper Tribunal proceedings were concluded, the proper course would have been to attend the hearing on 9-10 May and make submissions to this effect which the Tribunal had expressly invited.

14. Neither the appellants nor their representatives did attend the hearing. Faced with deliberate non-attendance by parties who had clearly received notice of the hearing, we concluded that it was in the interests of justice to proceed in the absence of the appellants and we duly did so.

15. In directions sent prior to the hearing on 9-10 May, the Tribunal asked both parties to expand on points that had been made in written closing submissions. Some of the questions directed to the appellants arose because the Tribunal considered that they had not set out their case on important points adequately in their written closing submissions. For example, while the appellants' written closing submissions contained a survey of the evidence that had been given and a summary of the law on the "trading question"[1] there was little express application of the law to the evidence, so we were in some doubt as to precisely why it was said that the appellants should succeed on the trading question. Similarly, the appellants' position on the penalties was not articulated in great detail.[2] The appellants did not reply to those questions and, since they did not attend the hearing on 9-10 May did not answer them orally.

16. Therefore, in important respects, the appellants have failed to articulate precisely why, on the available facts, they consider their appeals should be allowed. We have been presented with lengthy documentary evidence and several days of oral evidence. We have done our best to work out from that volume of evidence what facts might support the appellants' case.

The decisions under appeal

17. All appellants are appealing against HMRC's decisions in closure notices issued under s28A of the Taxes Management Act 1970 ("TMA 1970") refusing their claims for loss relief in the tax years under enquiry. They are also appealing against HMRC determinations that penalties are due for the negligent submission of tax returns for those years. The decisions under appeal are summarised in the following table:

[1] We use this as a general shorthand for the questions of whether the appellants were carrying on a trade, on a commercial basis and with a view to the realisation of profit.

[2] Ms Graham-Wells's skeleton argument for the hearing in March 2017 stated that a further skeleton argument relating to penalties would be served prior to the hearing that was due to start on 20 March 2017, but no such document was ever served.

Appellant	Tax year	Date of closure notice	Date of penalty	Penalty amount
Mr Thomson	2005-06	20 April 2010	3 November 2014	£44,617
Mr Worsfold	2004-05	7 January 2009	28 November 2014	£41,929
Mr Mungavin	2004-05	13 January 2009	28 November 2014	£47,412

PART ONE – FINDINGS RELEVANT TO ALL THREE APPELLANTS

18. In this section, we explain features that are common to all three appeals. Later sections will augment these findings by making findings of fact particular to each of the three appellants.

The appellants' relationship with Montpelier and the general nature of their online CFD activities

19. All three appellants had a relationship with the Montpelier group of companies and became aware of the Pendulum CFD and its terms following discussions with companies in the Montpelier group. One company in that group, Montpelier Tax Planning (Isle of Man) Limited (previously known as MTM (Tax Consultants) Ltd) carries on a tax consultancy business which Mr Gittins accepted devised some transactions that amounted to "out and out tax avoidance" (although he did not accept that the Pendulum CFD necessarily amounted to tax avoidance). All three appellants were, therefore, introduced to Pendulum by a company in the Montpelier group that carried on a business that included devising tax avoidance schemes. (We will refer to companies in the Montpelier group as "Montpelier" where it does not matter which specific company is being referred to.)

20. The three appellants all have a business background. However, no appellant's primary area of professional expertise consisted of dealing in derivatives. All three appellants started to buy and sell CFDs on online trading platforms a few months before they entered into their Pendulum CFD. They all assert that they thereby commenced a trade of dealing in derivatives and that they entered into the Pendulum CFD in the ordinary course of that trade. Since their online transactions involving CFDs bore many similarities, in this section, we will set out basic elements of how those online transactions work.

21. The CFDs that the appellants bought and sold online all referenced an underlying financial instrument or index. The value of that CFD would depend on the performance of the underlying instrument or index. For example, a CFD referencing 100 shares in XYZ plc entered into at a time when XYZ plc's share price was £5 would have a value of £500 at that point. A CFD referencing 10 contracts in the FT-SE 100 index ("FT-SE"), at a time when that index stood at 5,000, would have a value of £50,000.

22. The appellants, in their online dealings, all had a choice as to whether to go "short" or "long" on particular shares or indices. An appellant wishing to take a "long" position on a share or index would <u>buy</u> a CFD referencing that share or index, and hope that the share or index increased in value. If that happened, the appellant would "close out" his long position by entering into a contract to <u>sell</u> a CFD contract referencing the same quantity of the share or index. So, for example, an appellant who wished to go "long" XYZ plc might buy a CFD referencing 100 shares in XYZ plc at a time when the share

price was £5 (for a cost of £500). If the share price rose to £5.50, the appellant could sell a contract referencing 100 shares in XYZ plc (for a price of £550). An appellant in this position would make a profit of £50. Of course, if XYZ plc's share price fell to £4.50, the appellant would be due only £450 on sale of a contract referencing 100 shares in XYZ plc and would make a loss of £50.

23. The risks and rewards of the appellants' online CFD transactions were increased by "leverage". The CFD platforms that the appellants used did not require them to pay 100% of the price of a CFD immediately on purchasing it, but rather allowed them to trade "on margin". Some online platforms set the margin as low as 1%, thereby requiring only that an appellant had available funds (standing to the credit of his online account with the provider) equal to 1% of the value of the CFDs held. So, for example, an appellant could deposit £500 with the provider and having done so could go "long" FT-SE by purchasing 10 CFD contracts over FT-SE at a time when FT-SE was standing at 5,000 (having an aggregate value of £50,000) as the appellant would have available funds equal to 1% of the value of that contract. Transacting "on margin" in this way greatly increased both the risk and reward of online CFD trading. For example, in the above situation, if FT-SE rose by just 50 points to 5,050 (an increase of just 1% in the value of FT-SE), an appellant could "close out" his CFD by selling 10 CFD contracts realising a profit of £500 in the process. A 1% increase in FT-SE would have resulted in a 100% return to the investor on the original £500 deposited. By contrast, if FT-SE fell by just 50 points, the appellant would lose the entirety of the £500 deposit and a 1% fall in FT-SE would have produced a 100% loss.

24. It was possible for the appellants to enter into a CFD and close it out on the very same day, within minutes of the CFD being purchased. This practice is known as "day trading" and all the appellants did this, at least on occasions.

25. However, it was equally possible (if more risky) for an appellant to leave a CFD position open at the end of a trading day without closing it out. In that situation, all of the appellants' CFDs would be valued and "marked to market" at the end of the trading day with amounts of profit, or loss, being debited to the appellants' accounts. Continuing with the example set out at [23], if on Day 1 an appellant with available margin of £500, bought 10 CFD contracts over FT-SE when FT-SE stood at 5,000, and FT-SE stood at 5,050 at the end of the day without the CFD being closed out, a profit of £500 would be credited to the appellant's account. That would increase the appellant's available funds and so increase the margin that the appellant could use to make further purchases of CFDs. If, on Day 2, FT-SE fell back to 5,025 (having opened at 5,050), a loss of £250 would be debited to the appellant's account. This process of marking the contracts to market would continue until the contract was closed out. The online platforms would typically charge a "funding cost" on positions kept open for more than one day (reflecting the fact that the effect of the margin arrangement was that an appellant had only paid 1% of the cost of his CFDs with his own money and should be treated as having borrowed the remaining 99% of that cost and charged notional "interest" for that borrowing).

26. It will be seen from the above explanation that the combination of the "margin" arrangements, which made the appellants' online CFDs highly leveraged investments,

and the fact that the underlying share prices or index levels would change every second, meant that short term volatility in financial markets could result in either large percentage profits or large percentage losses. To protect against the risk of large absolute losses, the CFD platforms that the appellants used offered "stop loss" arrangements. For a fee, these entitled appellants to ensure that particular CFD positions would be automatically closed out if they reached a certain pre-determined value, thus limiting the maximum loss that the appellants could suffer on a particular CFD.

27. The platform providing the CFD was also exposed to risk. An appellant's CFD positions could in theory fall in value with the result that the investor no longer had sufficient margin to cover open CFD positions. In theory, losses could even result in an appellant's account with the CFD provider becoming overdrawn (so that he would owe the CFD provider money). To deal with this risk, the CFD platforms' terms and conditions permitted them to close out an appellant's CFD positions if the balance of a customer's account was insufficient to cover the necessary margin.

The contractual arrangements relating to the Pendulum CFDs

The contractual matrix

28. The general structure of the agreements that each appellant entered into in connection with their Pendulum CFD was similar. However, while in a largely standard form, the precise terms of the appellants' Pendulum CFDs were different and, in addition, there was a dispute as to the precise effect of those agreements. By way of broad summary, each appellant's arrangements with Pendulum involved the documents set out at [29] to [40] below.

29. Before entering into a Pendulum CFD, each appellant entered into a "Master Agreement" with Pendulum. The Master Agreement did not amount to a contract relating to a particular CFD, but rather set out template contractual terms that would apply to any CFD documented under the Master Agreement. These template terms and conditions would be applied to specific financial terms agreed following the service of an Offer to Trade and Acceptance Confirmation Note as described at [31] to [33]. Different appellants used different versions of this Master Agreement. Mr Thomson's Pendulum CFDs were documented under "Version 10" of the Master Agreement whereas Mr Mungavin and Mr Worsfold's Pendulum CFDs were documented under "Version 9".

30. Any CFD entered into under the Master Agreement was expressed to be subject to the law of the Seychelles and to be subject to the jurisdiction of the courts in the Seychelles. The Master Agreement provided for the following contractual framework to apply to Pendulum CFDs documented under it:

> (1) The Master Agreement provided for payments to be made by reference to the performance of the "Designated Index" (such as the FT-SE 100 index) specified for the purposes. Payments would be calculated by applying percentages either to the "Designated Issue Value" of a Pendulum CFD or to other figures related to that Designated Issue Value.

(2) The Master Agreement provided that there would be five "phases" to each Pendulum CFD documented under it.

(3) Phase One of a Pendulum CFD commenced on execution of that Pendulum CFD and the Master Agreement envisaged that the parties would agree how long Phase One of a particular Pendulum CFD would last. Each Master Agreement provided that, no later than around 5 business days after a particular Pendulum CFD took effect, Pendulum's counterparty would pay the "Initial Margin" to Pendulum. The Initial Margin was a percentage of the Designated Issue Value of that Pendulum CFD with the precise percentage to be determined in the Offer to Trade and Acceptance Confirmation Note described below.

(4) Payments due under Phase One of a Pendulum CFD depended on how much the Designated Index moved up, or down, over Phase One. The Master Agreement envisaged that the parties would agree on the "Designated Swing Movement" for the purposes of Phase One. If the Designated Index moved up, or down, by an amount greater than the Designated Swing Movement over Phase One, the Pendulum CFD would come to an end on conclusion of Phase One and Pendulum would be obliged to make a payment of "Trade Profit" to its counterparty.

(5) If a Pendulum CFD did not terminate following Phase One, it would move into Phase Two. The Master Agreement provided that, if a Pendulum CFD moved into Phase Two, Pendulum would serve a Notice of Obligation on its counterparty requiring the counterparty to pay Pendulum the "Margin Call Balance" (being the balance of the Designated Issue Value of the CFD less the Initial Margin that had already been paid at the start of Phase One as described at [(3)] above).

(6) The Master Agreement envisaged that Pendulum and its counterparties would agree, in the Offer to Trade and Acceptance Confirmation Note, how long Phase Two was to last[3]. Payments due under Phase Two would depend on whether the Designated Index was greater than or equal to a specified "Index Target Level" (that Pendulum and its counterparty would agree) at the end of Phase Two. If the Designated Index had a value at least equal to the Index Target Level at the end of Phase Two, the Pendulum CFD would come to an end and Pendulum's counterparty would be entitled to receive a payment of "Trade Profit" from Pendulum.

(7) The Master Agreement provided that, if a Pendulum CFD did not end following Phase Two it would move into Phase Three. A counterparty was not required to make any further payment to Pendulum if a CFD moved into Phase Three (or any subsequent phase since), as noted at [(5)] the counterparty would have paid the balance of the Designated Issue Value that was due at the beginning of Phase Two. Phase Three was in substance

[3] Time was reckoned from the "Start Date" set out in an Acceptance Confirmation Note. All appellants' Pendulum CFDs stated that the duration of Phase Two would be 2 years which meant that Phase Two ended two years after the Start Date.

similar to Phase Two: Pendulum and its counterparty would agree how long Phase Three was to last and an Index Target Level applicable to Phase Three. If, at the end of Phase Three, the Designated Index had a value at least equal to the specified Index Target Level, the CFD would come to an end and Pendulum's counterparty would be entitled to receive a payment of "Trade Profit". Otherwise the CFD would move into Phase Four, and potentially Phase Five, both of which provided for payments to become due on a similar basis to that applicable to Phase Three.

(8) Phase Five of all appellants' Pendulum CFDs was expressed to end 25 after the Start Date. This meant that, unless it terminated early (if an appellant achieved success at Phase One to Four), the Pendulum CFD would last for 25 years and an appellant's final chance to achieve success would come 25 years after the Start Date.

31. Agreement on the key contractual terms to which the template set out in the Master Agreement would apply was achieved by a combination of a "CFD Offer to Trade" and an "Acceptance Confirmation Note".

32. Each appellant sent Pendulum a CFD Offer to Trade. This document referred to the Master Agreement with the relevant appellant and provided that the terms of that Master Agreement were incorporated by reference into it. In the CFD Offer to Trade, each appellant made proposals as to the key financial terms that would apply to the CFD proposed. For example, each CFD Offer to Trade contained proposals as to:

(1) the Designated Index;

(2) the Designated Issue Value of the CFD and the percentage of that Designated Issue Value that would be payable by way of Initial Margin;

(3) the Start Date;

(4) the length of Phase One and the Designated Swing Movement that, if achieved, would result in the CFD terminating at the end of Phase One;

(5) the lengths of each of Phase Two to Phase Five and the Index Target Levels for each Phase which, if achieved, would result in the CFD terminating and the appellant receiving a payment;

(6) the Trade Profit (expressed as a percentage of Issue Value) that Pendulum would be obliged to pay to each appellant if that appellant achieved success in any of Phase Two to Phase Five.

33. Having received the appellants' CFD Offers to Trade, Pendulum would send an Acceptance Confirmation Note. The Acceptance Confirmation Note included a statement to the effect that the appellants' offers (contained in the CFD Offers to Trade) had been accepted and set out a list of various key financial terms (including those financial terms on which the appellants had made proposals in their CFD Offers to Trade). In some cases, there were minor differences between the terms that Pendulum purported to "accept" and those that the appellants had offered. Therefore, as a matter of English contract law, to that extent the Acceptance Confirmation Note would have constituted a counter-offer. We had no evidence as to the contract law of the Seychelles

and no submissions as to whether the law of the Seychelles applied to the formalities necessary for entering into a contract or only to the terms of the contract once it had been concluded. However, no party suggested anything turns on this and therefore, for the purposes of these appeals, we will proceed on the basis that a binding contract between Pendulum and the appellants came into existence when Pendulum sent the Acceptance Confirmation Note and the terms of that contract were to be ascertained by reading the Acceptance Confirmation Note (which set out specific financial and other terms) together with the template contractual terms set out in the Master Agreement.

34. The Master Agreement provided that the appellants could freely assign their rights under their Pendulum CFDs.

The calculation of Trade Profit

35. The parties were not agreed on matters as fundamental as how much a party to the Pendulum CFD would obtain if the Pendulum CFD was successful at any phase. This is because the definition of "Trade Profit" was somewhat unclear.

36. We do not think that much turns on the precise answer to this question of contractual interpretation[4]. However, since both parties made some submissions on the true meaning of the contracts, we will record the following conclusions we have reached:

(1) If any appellant's Pendulum CFD terminated after Phase One, the total payment that he would have received from Pendulum was 200% of his Initial Margin. He would not have obtained an additional payment of his Initial Margin. So, for example, if Mr Thomson's Pendulum CFD achieved success at Phase One, Mr Thomson would have received a total payment from Pendulum of £32,500 (200% of his Initial Margin of £16,250).

(2) If any appellant's Pendulum CFD terminated on or after Phase Two, the total payment that he would have received was the relevant percentage figure specified in the Acceptance Confirmation Note multiplied by the Designated Issue Value. He would not have received an additional payment equal to the Designated Issue Value. So, for example, if Mr Thomson's Pendulum CFD achieved success in Phase Two, he would have received a total payment of £422,500 (130% of £325,000).

(3) The contracts were, however, ambiguous. There was room in the documents for an interpretation that, if a Pendulum CFD achieved success at Phase One, an appellant would receive 200% of his Initial Margin <u>plus his Initial Margin</u>. There was also room for an interpretation that, if an appellant achieved success at Phase Two or subsequently, he would receive a payment equal to the Designated Issue Value <u>plus</u> the relevant percentage multiplied by Designated Issue Value. Given the closely articulated nature of the drafting of the contracts, we do not consider this interpretation to be correct, but it is arguable.

[4] It is perhaps more relevant that the contracts were ambiguous but the appellants were not aware of the ambiguity. We explain this point in the "Discussion" section applicable to each appeal.

The loan arrangements with Bayridge

37. Within about 5 days of receiving the Acceptance Confirmation Note, each appellant had to pay his Initial Margin to Pendulum. Pendulum did not put in place any special facility to enable the appellants to fund that sum and all appellants paid their Initial Margin from cash resources available to them.

38. No appellant achieved success in Phase One and therefore all appellants' CFDs moved into Phase Two. That meant that all appellants had to fund the balance of the Designated Issue Value (i.e. the "Margin Call Balance") that was due. All appellants were put in touch with a company, Bayridge Investments LLC ("Bayridge"), that was prepared to offer funding for this purpose. As noted at [47], there were some links between Pendulum, Bayridge and the Montpelier group of companies.

39. All the appellants entered into loan agreements with Bayridge (each a "Bayridge Loan") that had the following terms so far as material:

> (1) Bayridge lent each appellant the amount necessary to fund the balance due to Pendulum. That loan could only be used to fund the Margin Call Balance due to Pendulum.
>
> (2) Bayridge did not charge interest on the loan that it made. Instead, if an appellant achieved success under its CFD at any of Phase Two to Phase Five, that appellant would pay Bayridge a fee equal to a percentage of the profit made on the Pendulum CFD.
>
> (3) The loan became repayable as soon as any fee became due to Bayridge. Since fees would become due only if an appellant achieved success in any of Phase Two to Phase Five, in effect this meant that, if an appellant achieved success at a particular Phase of the Pendulum CFD, the loan would become repayable at that point. However, if a Phase of the Pendulum CFD ended without the appellant in question achieving success, the loan would be rolled over until the end of the next Phase.
>
> (4) Notwithstanding the terms set out at [(3)] above, there was a "long stop" date by which the loan would be repayable even if the relevant appellant had not achieved success under the CFD. That "long stop" date was typically 50 years after the loan agreement was signed. Therefore, if an appellant's Pendulum CFD had not achieved success by the end of Phase Five (which ended 25 years after commencement of the Pendulum CFD), the Bayridge Loan would continue, on interest-free terms, for a further 25 years. Moreover, on repayment, the appellants would be obliged to repay the amount originally advanced, the value of which would have been eroded by 50 years' worth of inflation.
>
> (5) The loan agreement specified that, on the occurrence of a limited number of "events of default" the loan would become immediately repayable. Those events of default included a breach, by the relevant appellant, of the terms of the agreement and certain insolvency related events (for example bankruptcy). However, the loan agreements did not

specify that the death of a borrower would result in a loan becoming repayable.

40. Having entered into a loan agreement with Bayridge on the above terms, each appellant assumed that Bayridge would simply pay Pendulum the principal amount of that loan (since the whole purpose of each loan was to enable the appellants to fund the Margin Call Balance that was due to Pendulum). Therefore, although each appellant received the Notices of Obligation referred to at [30(5)], informing them that they were obliged to pay the Margin Call Balance to Pendulum, they did not make that payment out of their own funds as they relied on Bayridge to do so. We have also concluded that Bayridge did effectively discharge the appellants' obligations to pay the Margin Call Balance by a system of "book entries" as follows:

(1) Bayridge did not pay the principal amount of any Bayridge Loan to the appellants in cash. Instead, it acknowledged to Pendulum that it would, on demand by Pendulum, pay that principal amount to Pendulum. This acknowledgement was recorded by way of "book entry" that recorded an inter-company balance owed by Bayridge to Pendulum.

(2) Having received the acknowledgement from Bayridge referred to at [(1)] above, Pendulum treated the appellants' obligations to pay their Margin Call Balances as discharged.

(3) Since the Bayridge Loan could be used only to fund the Margin Call Balance (as noted at [39(1)] above), Bayridge's agreement to make a payment to Pendulum discharged Bayridge's obligation to advance the principal amount of the loan to the appellants.

41. Ms Choudhury explained during the hearing that HMRC do not accept that all or any appellants entered into loan arrangements with Bayridge and/or that the arrangements were operated in accordance with the system of "book entries" outlined at [40]. However, the evidence that we saw indicated that the parties' actions were consistent with the appellants having entered into loans with Bayridge and the system of book entries having been implemented. Indeed, had the arrangements not taken place as described, Pendulum would not have received any Margin Call Balance and it might be expected that it would contact the appellants to demand payment from them. However, there was no suggestion that Pendulum considered it had not received payments that were due to it. We have therefore concluded first that all appellants entered into loan agreements with Bayridge on terms summarised at [39] and second that the system of "book entries" summarised at [40] was implemented as a means of discharging obligations under the various agreements and contracts.

42. We have concluded that the Bayridge Loans were, on a standalone basis, on completely uncommercial terms which were highly favourable to the appellants who entered into them. First, those loans could, if the Pendulum CFD did not succeed in Phases Two to Five, be outstanding for up to 50 years. It was by no means certain that any appellant would be alive when the Bayridge Loan fell due for repayment (Mr Worsfold, for example, would have been over 100 years old if the Bayridge Loan ran to its full term) and the death of an appellant would not cause it to become due and payable. The loan carried no interest over its term or premium on redemption. Bayridge

would share in any benefit that the appellants achieved if they achieved success in their Pendulum CFDs but Mr Gittins's evidence was that Bayridge attached little significance to this because, as he explained, Pendulum and Bayridge thought that there was little prospect of Pendulum having to pay out under those Pendulum CFDs. The Bayridge Loan was also uncommercial because Bayridge could only expect to receive repayment if and when a Pendulum CFD was successful at Phases Two to Five or, if it was not successful, 50 years after the loan was advanced. However, as part of the system of book entries set out at [40], Bayridge had a corresponding liability to Pendulum that fell to be settled on demand.

43. Ms Choudhury invited us to conclude that there was some arrangement or understanding to the effect that Bayridge would never demand repayment of the Bayridge Loans. We will not make such a finding. As we note below, the Bayridge Loans were certainly intended to enable the appellants to "ramp up" their claims for tax relief on the Pendulum CFD and the appellants' liability under the Bayridge Loans might be small in economic terms if their loans ran for 50 years (because inflation would erode the principal amount of the loan). However, we are not satisfied that Bayridge waived its right to claim repayment of principal at any point and the appellants all had a contractual obligation to repay the principal of the Bayridge Loans.

Pendulum's repurchase offer

44. None of the appellants achieved success under their CFDs at Phase One. Their CFDs therefore entered Phase Two with the result that they all became obliged to pay the Margin Call Balance to Pendulum. All appellants received correspondence from Pendulum offering to repurchase their Pendulum CFDs and quoting a repurchase price as at the last day of the relevant tax year.

45. Mr Gittins said in evidence that, in its offers to repurchase, Pendulum was not providing a "valuation" of the Pendulum CFDs; rather it was making an offer to repurchase and it set the offer price "as low as possible". We accept that evidence. However, we consider that Pendulum's "repurchase offer" was carefully framed so that it might appear like a valuation. For example, Mr Thomson's repurchase offer included the following words:

> …Accordingly, the market value of the CFD (which is the basis of our offer) is determined as at 5 April 2006. The fair market value of the CFD in question is determined by taking into account the level of the market index today, its current volatility, the likely future volatility, the market trend, the risk-free rate of return, the time remaining before completion of Phase 2, the designated Index Target Level, the costs of trade administration and the profit margin for Pendulum.

The above statement is carefully worded: it refers to "fair market value" being the "basis" of the offer and sets out lots of detail about how "fair market value" is determined. We have concluded that Mr Thomson's repurchase offer (and similar offers received by the other appellants) was worded as it was so that it could be read as an objective assessment of market value (which would be relevant to its accounting value and so the amount of any loss arising, as explained in more detail below) without actually being an objective assessment of market value.

The arrangements from the perspective of Montpelier, Pendulum and Bayridge

46. The tax consequences of the Pendulum CFDs for the appellants will depend largely on a combination of their subjective purposes for being party to those transactions together with an analysis of objective features of those transactions. The perspectives of Montpelier, Pendulum and Bayridge are relevant to this analysis. Most fundamentally, Montpelier were experienced tax professionals. If they regarded the arrangements as a tax avoidance scheme, that tends to suggest that, viewed objectively, they were such a scheme. In addition, if Montpelier regarded the arrangements as a tax avoidance scheme, that might have affected the way in which Montpelier presented the transactions to the appellants (who all entered into the transactions following discussions with Montpelier) which, in turn, might cast a light on the appellants' subjective purposes for entering into the Pendulum CFDs. Finally, as we have noted, the Bayridge Loans were on uncommercial terms that were favourable to the appellants as borrowers. Since businesses do not typically enter into uncommercial transactions, the perspectives of Pendulum and Bayridge may explain why they did so in this case which, in turn, sheds a light on the nature of the arrangements as a whole. Therefore, in this section, we will make some findings about Montpelier, Pendulum and Bayridge and how they viewed the arrangements.

The legal relationship between Montpelier, Bayridge and Pendulum

47. At the material times, the Montpelier group of companies was headed by Montpelier Group LLC. Mr Gittins was a controlling shareholder of Montpelier Group LLC and was also an executive director of MTM (Tax Consultants) Limited, Bayridge was a subsidiary of Montpelier Group LLC (and so was a member of the Montpelier group of companies). Initially, the shares in Pendulum were owned by a Mr Michael Darwyne. Mr Darwyne agreed with Mr Gittins that, if Pendulum was successful, he would give Mr Gittins the first chance to buy the shares in Pendulum from him. In September 2005, Mr Gittins bought those shares. Pendulum, therefore, was never a member of the Montpelier group (as it was not a subsidiary of Montpelier Group LLC). However, from September 2005, there was a clear affiliation between Pendulum and the Montpelier group resulting from Mr Gittins's control of both. Even prior to September 2005, because Mr Gittins had an understanding that he could buy the Pendulum shares from Mr Darwyne, from Bayridge's perspective, Pendulum was more analogous to a group company than an independent company.

Montpelier's marketing of the arrangements

48. Montpelier did not devise the contractual framework that underpinned the Pendulum CFDs. That framework was devised by Michael Darwyne (the owner of the Pendulum shares before Mr Gittins acquired them). He had been interested in devising a CFD product that could be "distance sold" to UK residents who qualified as "sophisticated investors" for the purposes of the Financial Services and Markets Act 2000 ("FSMA"). To that end, Mr Darwyne drafted the terms of the contracts (the Master Agreement etc.) and sought advice from UK counsel on the applicable regulatory regime under FSMA. He also sought tax advice from UK tax counsel, Mr Shipwright, on the tax consequences for investors. Mr Shipwright's advice included an analysis of the general law, and HMRC practice on what amounted to the carrying on of a trade on a commercial basis with a view to profit. However, that analysis was

generic: Mr Shipwright was not purporting to advise as to whether any particular taxpayer met this requirement and he noted that the question was ultimately a question of fact that depended on what a taxpayer actually did.

49. In July 2004, a scheme that Montpelier had been promoting (the "charity scheme"), was counteracted by legislation, or proposed legislation. Mr Gittins accepted that this scheme was an "out-and-out avoidance scheme" whose purpose was to produce an income tax loss that would enable individuals to shelter their tax liabilities. Mr Gittins and others within Montpelier set about devising a replacement scheme that would achieve the same or similar result. We saw emails from Montpelier sent to interested parties (such as independent financial advisers) assuring them that a new scheme was in the pipeline.

50. Initially, Mr Gittins's focus was on developing an avoidance scheme that would involve an interest rate swap. He had some consultations with counsel on such a scheme but could not get it to work.

51. On 8 November 2004 Mr David Conlan sent an email to Mr Gittins and others which Mr Gittins accepted related to the Pendulum CFD arrangements. That email referred to an attachment (with which we were not provided) but which evidently explained the Pendulum arrangements and included the following extract:

> The attached, in addition to outlining the relief available, mainly highlights issues and pitfalls. I would expect to "positive it up" when I have seen Counsel's opinion and WG's trading checklist…
>
> To me, one of the main points is the issue of "commercial organisation". And that clients accept that this is planning which needs them to buy in to the idea, not just sign a cheque.
>
> …
>
> Would it help if I were to make an "Am I trading?" presentation at next meeting….
>
> Also, has anyone looked at minicfds.com in any detail. I have registered. There is a 5 week course on cfd trading and, initially, it is possible to trade a single share, yes, ONE share. The lower limit after training is 100 shares.

This email indicates that Montpelier intended the Pendulum arrangements to function as a device to deliver a trading loss to a user of the scheme but that, before such a loss could be delivered, the user first needed to commence a trade of dealing in derivatives.

52. On 29 November 2004, Jane Goodall, the Compliance Manager at Montpelier Group Europe Limited, sent an email to a number of sales managers at Montpelier that includes the following paragraphs:

> I have been speaking with Pendulum this morning, I am expecting the final draft of the contract any day now.
>
> In an effort to plan, we are trying to gauge the number of trades that clients are likely to make between now and Christmas. To that effect,

could you give me an estimate of the quantum of losses that your clients wish to create between the following 2 sets of dates

1-10 December

12-24 December.

5 This email exchange indicates that Jane Goodall and the sales managers at Montpelier viewed the Pendulum arrangements from the perspective of the tax losses that they could generate for Montpelier customers.

53. Montpelier's view of the arrangements was also set out in a slide presentation and speaking notes that Montpelier prepared for a meeting with a particular firm of 10 independent financial advisers known as Gatekeeper. All of the appellants deny ever having seen this slide presentation before they made their decision to start buying and selling CFDs or to acquire their Pendulum CFDs. We accept that evidence. We have also noted that the slide presentation and speaking notes were dated 10 May 2006 which was after the date on which the appellants entered into their Pendulum CFDs. However, 15 given the background to the development of the Pendulum arrangements, which we have noted, we have concluded that Montpelier's view of the arrangements would not have changed fundamentally and that the view of the arrangements as set out in the slide show dated 10 May 2006 would have been their view at material times prior to that date as well.

20 54. The slides explain a transaction that will generate tax losses for individuals. It is explained that there are:

Two parts to the planning

1- establishing a self-employed trade

2- creating a trading loss

25 55. The slides explain that this can be achieved via a derivative having the following broad terms:

Phase	**Year**	**Index Target Level**	**Trade Profit**
Two	2	8,770	130% of Issue Value
Three	7	11,350	210% of Issue Value
Four	15	24,400	450% of Issue Value
Five	25	63,150	1200% of Issue Value

These figures were, with some small differences, the figures that Mr Thomson specified in the Offer to Trade that he sent Pendulum in March 2006.

56. The speaking notes to this slide explain that the "first phase of the contract" may be 30 "based on a movement of FT-SE over a 7-day period" and expanded on this as follows:

If at the end of 7 days the FTSE has moved over a hundred points up or down you will have won the contract and the Seychelles company will pay you the initial margin of £7,000 back plus an additional £7,000 in profit and the contract is terminated. This has happened on several 35 occasions, this is a real contract, and taxes would have to be paid on any profits made.

> However, the most likely event is that … the contract will move into phase 2 of the contract and there will be a margin call for the difference.

57. We accept that Mr Gittins did not prepare the slide show or speaking notes. He characterised the presentation as "naïve" and suggested in his evidence that it may not even have been referring to the Pendulum arrangements. He noted that the presentation stated that the arrangement it referred to had been "in the market for 2 years" (whereas Montpelier had been marketing the Pendulum arrangements only since November 2004, some 17 months before the date of the presentation). He also noted that the slides indicated that "rebates from 1st year already been received" (suggesting that HMRC were already making payments to users of the arrangements), but that this could not have been true of the Pendulum arrangements. However, it is clear to us that, viewed as a whole, the slide show was describing the Pendulum arrangements and we have concluded that, no doubt as a sales pitch, the presentation exaggerated the longevity of the arrangements and the success that Montpelier had had from them.

58. In judicial review proceedings which Mr Gittins initiated in connection with HMRC's decision to execute search warrants at Montpelier's premises, Officer Rawbone, an HMRC officer had described four tax planning products that Montpelier promoted including a "contract for differences tax plan". In responding to Officer Rawbone's witness statement, Mr Gittins said in his own witness statement:

> At all material times Montpelier, which was engaged in the business of tax consultancy and in particular the creation of tax avoidance arrangements <u>including the four specific arrangements referred to by Mr Rawbone</u> [emphasis added] …

Mr Gittins accepted that, in this statement, he was referring to the Pendulum CFD arrangements. At the hearing, he sought to retreat somewhat from the characterisation of them as "tax avoidance arrangements" saying only that they had "tax avoidance potential" (as there would be no "tax avoidance" if a particular contract came to an end after Phase 1). However, he accepted that what he termed a "GAAP anomaly" might mean that the arrangements might be regarded as having some tax avoidance <u>potential</u> when viewed from the perspective of individual investors. We do not accept that nuanced view of the arrangements (and at [65] below describe how the avoidance scheme was intended to operate). We have concluded from the evidence that Montpelier's sales team regarded the Pendulum arrangements as a device to enable individuals to generate tax losses without realising actual economic losses. In order for those arrangements to succeed, Montpelier's sales team considered that users would first need to establish a trade of dealing in derivatives. Since Montpelier held that view of the arrangements, we have concluded that they would have communicated it to their clients, including the appellants, when suggesting the arrangements to them.

The views of Pendulum and Bayridge

59. Officer Bradley gave evidence that HMRC were aware of 222 instances of taxpayers entering into Pendulum CFDs similar to these entered into by the appellants. He said that only 23 of those contracts resulted in a taxpayer achieving success at Phase One and in all 23 of those cases, the taxpayer concerned, instead of "walking away" with the proceeds of his or her success immediately reinvested their winnings in a

further Pendulum CFD. The appellants did not, through their chosen counsel, cross-examine Officer Bradley on this evidence for reasons we have given. However, the evidence was put to Mr Gittins who did not dispute Officer Bradley's figures, though he did suggest that HMRC might have overlooked one taxpayer who achieved success at Phase One of his Pendulum CFDs. We have concluded that Officer Bradley's evidence was broadly correct and, in particular, have concluded that only around 10% of Pendulum CFDs achieved success at Phase One and that most, if not all, of investors in Pendulum CFDs who achieved success at Phase One reinvested their winnings in a further Pendulum CFD.

60. Mr Gittins said that Pendulum considered the arrangements to be attractive as they involved individual investors taking out CFDs on which investors would "win" (and Pendulum would lose) only if particular indices increased in value over the period of those CFDs. He said that Pendulum had a "bearish" view of the markets and thought that they would not increase as much as investors thought they would. In effect his evidence was that Pendulum and investors simply had different views of the market: investors thought they were entering into a sensible transaction because they thought the indices would rise significantly over time; Pendulum thought that the CFDs were sensible because it did not expect the markets to rise by as much as investors thought they would. Moreover, Mr Gittins explained that Pendulum was so confident of its view of the markets that it did not see any reason to hedge its exposure under the Pendulum CFDs on inception of those CFDs. Rather, its strategy was to keep monitoring market developments, and to accept that there might be circumstances in which it might need to hedge exposure under particular CFDs.

61. Mr Gittins confirmed in cross-examination that Pendulum never actually hedged any of its exposure under a Pendulum CFD. On one occasion, an unhedged position that Pendulum had with a particular counterparty had come close to yielding a profit for the counterparty (and so a loss for Pendulum) at Phase Two or Three. However, that was in the context of a counterparty who had chosen to go "short" the FT-SE index (and so was taking a position that it would not rise as much as the market anticipated). If this particular contract had produced a profit for the counterparty Pendulum would have had an exposure in excess of £1.1m but in the event this did not happen. We have concluded from Mr Gittins's evidence that:

> (1) No investor in a Pendulum CFD has actually achieved success at any of Phases Two to Five (recognising that some of those Phases will not yet have come to an end).
>
> (2) Pendulum has not hedged its exposure under Pendulum CFDs for investors (such as the appellants) who chose to go "long" the FT-SE index demonstrating that Pendulum considered, both when those Pendulum CFDs were entered into and, throughout their life up to the date of the hearing, that it was highly unlikely that those contracts would, in the aggregate, achieve success.

62. Mr Gittins was pressed in cross-examination as to the benefit of the transactions from Bayridge's perspective. He accepted that Bayridge was lending money on interest-free terms. He also accepted that Bayridge attached little significance to the prospect of

earning fees by sharing in investors' profits if they were successful with their Pendulum CFDs. However, he said that the commercial benefit for Bayridge was that it was "building up a loan book": it considered that over the long term inflationary pressures were low and therefore, while the loans might not be repayable for up to 50 years, there was still significant value in those loans (as Bayridge did not expect their value to be eroded by inflation). Moreover, Bayridge thought that there might be some prospect of selling the loan book to a third party although not for a few years (as it might not be possible to sell a loan book such as this until the loans had less than 20 years to run).

63. We accept Mr Gittins's evidence that Pendulum had its own commercial reasons for entering into the Pendulum CFDs. Put simply, Pendulum was prepared to enter into those CFDs because it thought they were highly unlikely to yield a profit for investors (and so a loss for Pendulum).

64. We have not accepted Mr Gittins's explanation of the commercial rationale for the Bayridge Loans, however. We are prepared to accept that Bayridge thought long-term inflationary pressures were low. However, the Bayridge Loans were on manifestly uncommercial terms that were disadvantageous to Bayridge viewed on a standalone basis. We have concluded that Bayridge was prepared to enter into the Bayridge Loans largely because it had a separate economic relationship with Pendulum and Pendulum was obtaining a commercial benefit from the Pendulum CFDs[5]. Moreover, as noted below, the rationale for the Bayridge Loans was to "ramp up" the amount of the trading loss that users of the Pendulum scheme could claim while at the same time ensuring that loss was not an economic loss. That rationale was not commercial.

Overall conclusions on the nature of the arrangements.

65. We have drawn the following conclusions from our findings, and the evidence, summarised at [46] to [64] above together with the nature of the Pendulum arrangements:

> (1) Montpelier presented the Pendulum CFD and surrounding arrangements to its customers as a tax avoidance scheme that, provided it went into Phase Two, would deliver trading losses. Montpelier told users of the scheme that they would first need to "establish a financial trade" before they purchased the Pendulum CFD which was the instrument by which the tax loss would be delivered.
>
> (2) The tax avoidance result could be achieved only if a Pendulum CFD entered Phase Two (or subsequent Phases). In that case, it was important that a user of the tax avoidance arrangements should appear to pay a high Designated Issue Value for rights under the Pendulum CFD but that, shortly after entering Phase Two, a Pendulum CFD could be said to have a low value for accounting purposes. So, for example, in Mr Worsfold's case, the

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[5] Bayridge and Pendulum were affiliated companies from September 2005 as noted at [47]. However, even before then, Mr Gittins had a right of first refusal over the Pendulum shares. The close economic relationship between Pendulum and Bayridge arising from Mr Gittins's control, or right to control, both companies explains why Bayridge was prepared to enter into transactions that served to benefit Pendulum.

Designated Issue Value of the Pendulum CFD was £300,000 but just 5 or 6 days after it moved into Phase Two, the Pendulum CFD was said to have a value of just £4,653 for accounting purposes. The difference between the high Designated Issue Value and the low accounting value would be the tax loss that would be generated. That was the "GAAP anomaly" to which Mr Gittins referred in his evidence summarised at [58]. Indeed it is precisely the basis on which all appellants are claiming the loss that is in dispute.

(3) To achieve the result set out at [(2)], the Index Target Levels applicable to Phases Two to Five (and the lengths of Phases Two to Five) in the Pendulum CFD needed to be set at values that meant that, when Pendulum came to make its repurchase offer described at [44] above, it could justifiably offer a low price. Pendulum was not purporting to "value" the Pendulum CFD. However, it was hoped that a low repurchase value offered by a counterparty who was, at least ostensibly, transacting at arm's length, would justify a low value for accounting purposes. Without such pricing of the Pendulum CFD, the "GAAP anomaly" that Mr Gittins identified could not be achieved, and the desired tax loss could not be generated[6].

(4) If the appellants had had to pay the full Designated Issue Value of the Pendulum CFDs out of their own pockets the steps set out above would have achieved little. For example, Mr Worsfold would have paid £300,000 for a CFD that, a few days later, was, at least according to Pendulum, worth only £4,653. He would have made an economic loss of £295,347 and even if he obtained a tax loss as a result, that would only compensate him for part of his economic loss.

(5) For the arrangements to function as a tax avoidance scheme, the arrangements had to produce a tax loss without an economic loss. That was achieved by the Bayridge Loan which meant that the appellants were not themselves funding the entire Designated Issue Value of the Pendulum CFDs out of their own resources. Under the Bayridge Loan, Bayridge funded 95% of the Issue Value of the Pendulum CFD on highly advantageous terms. The Bayridge Loan therefore operated to "ramp up" the amount that the appellants could claim they invested in the Pendulum CFD even though they had not in any economically real sense invested the full Designated Issue Value[7].

[6] Our findings at [61] also suggest that the Pendulum CFDs were not worth their full Designated Issue Value on issue.

[7] So, for example, Mr Worsfold could claim to have paid £300,000 to acquire his Pendulum CFD (after it moved into Phase 2). However, £285,000 of that was provided by Bayridge who Mr Worsfold did not need to pay until either (i) the Pendulum CFD achieved success in Phases Two to Five (in which case his "winnings" on the Pendulum CFD would provide him with the funds to repay Bayridge) or, which was much more likely, (ii) the Pendulum CFD failed to achieve success in which case the Bayridge Loan did not need to be repaid for 50 years which was sufficiently far in the future not to be a concern, particularly since 50 years of inflation would have eroded the principal of that loan.

(6) Phase One of the Pendulum CFD had two functions. Its first was to act as a smokescreen by enabling the appellants to argue that the Pendulum CFD was not inevitably going to produce a loss[8]. That is why the presentation referred to at [56] speaks in slightly apologetic terms about the possibility that there might be a profit at Phase One. It also explains why Mr Gittins attached significance, when giving his evidence referred to at [58] to the effect that the Pendulum CFD might not produce a tax loss. Since counterparties had to fund the Initial Margin at Phase One out of their own resources, the second function of Phase One was to ensure that Pendulum would receive the Initial Margin from counterparties which was in the nature of a "fee" payable to Pendulum for the tax avoidance scheme that was offered.

PART TWO: PRIMARY FACTS RELEVANT TO MR THOMSON'S APPEAL

Mr Thomson's background

66. Mr Thomson qualified as an accountant in 1976. In 1979 he set up in practice with another partner. Mr Thomson's practice included accounts preparation, audit, tax compliance and tax planning. In due course the practice started offering financial services advice and suitable qualified independent financial advisers (IFAs) were taken on to build up that aspect of the practice.

67. From around June 2003, Mr Thomson was contemplating his eventual retirement from professional practice and that provided the stimulus for a decision to sell the partnership's practices if an interested buyer could be found. Between 2004 and 2005 both the financial services practice and the accounting practice were sold to the Montpelier group (and both practices were carried on by Montpelier Professional Limited). Mr Thomson knew the Montpelier Group (and Mr Gittins) well as his accounting practice had been recommending tax planning products that the Montpelier group offered since the 1990s.

68. Following Montpelier's acquisition of the practice, Mr Thomson stayed on in a managerial position. He remained involved in the audit side of the practice and assisted clients with tax planning.

The meeting with Montpelier in 2004 and Mr Thomson's decision to start buying and selling CFDs

69. Mr Thomson has always had an interest in financial markets. When he was 18 and working as a junior accountant in Manchester, he joined an "investment club" that involved him investing a good proportion of his then monthly salary in stocks and shares. In the 1990s he invested in personal equity plans (PEPs) and made a large number of share acquisitions and disposals during what he described as the "tech bubble" of the late 1990s. In the 1999-2000 tax year, he disposed of shares worth some

[8] There was, therefore, a meaningful likelihood that a Pendulum CFD would provide the appellants with a profit at Phase One. However, as noted in the sales presentation at [36], this was not "the most likely event" and, as noted at [59] only around 10% of Pendulum CFDs achieved success at Phase One.

£189,000 which had been purchased for some £158,000. In the 2000-01 tax year, he disposed of shares worth £66,815 which had been purchased for £87,962. This activity of purchasing and selling shares continued in all tax years up to 2004-05 (except for 2002-03) in which Mr Thomson made no purchases or sales of shares. Mr Thomson treated his profits and losses arising on these transactions in his tax returns as gains on investment transactions which were subject to capital gains tax (and not profits on trading transactions subject to income tax).

70. In November 2004, Mr Thomson attended a meeting with Jane Goodall, who was the compliance officer for Montpelier Group (Europe) Limited and Andy Smith (who was a financial adviser employed by Mr Thomson's professional practice). Mr Thomson attended that meeting because he believed that he had a professional obligation to consider tax planning opportunities that might be available to his clients and failure to draw those to his clients' attention could lead to an action in negligence. Mr Thomson prepared a manuscript note of the meeting that included the following:

> CFD from Seychelles…
>
> Client establish a trade as a derivative trader …
>
> Client has paid 6k for a contract face value 100k for a loss of 98k…
>
> Establish the trade and get trading

71. Even though Mr Thomson attended the meeting to survey possible tax planning opportunities for his clients, we have concluded that this meeting provided the impetus for him to use the arrangements himself. To do so, he first needed to establish a trade of dealing in derivatives and, to that end, he took the steps set out at [72] to [76]. Therefore, Mr Thomson's sudden interest in buying and selling CFDs online (which we discuss below) was not motivated by a desire to earn a profit from that activity. Rather, we have concluded that Mr Thomson was overwhelmingly motivated by a desire to obtain a tax loss from the Pendulum CFD and "establishing a trade" of dealing in CFDs online was simply a stepping stone towards that desired end result. It follows that we have rejected Mr Thomson's evidence that he was motivated by genuine commercial considerations when he decided to start transacting in CFDs (whether online or with Pendulum).

Mr Thomson's transactions involving CFDs prior to the Pendulum CFD

72. Mr Thomson had not bought or sold CFDs prior to 2005. Having decided to start buying and selling CFDs, he undertook some research both on the nature of CFDs and how to buy and sell them over online platforms. He downloaded guides that explained how CFDs worked from the internet. On 2 February 2005 he opened an online account with IFX Markets Limited who traded as "Finspreads" and offered its customers the opportunity to trade relatively small quantities of CFDs (which it referred to as "miniCFDs") over an online platform. The miniCFDs that Finspreads offered provided investors with exposure to returns on shares issued by particular companies (as opposed to offering exposure to all shares comprised within a particular financial index such as FT-SE).

73. Opening this account with Finspreads resulted in Mr Thomson being "enrolled onto the miniCFDs Training Academy" for a period of five weeks. This did not involve Mr Thomson attending any physical lectures or meetings, but he did receive, by email, five weekly instalments of course notes that contained a large amount of information on how CFDs worked, the process for placing trades over the Finspreads platform and tips for a successful strategy of buying and selling CFDs. During those five weeks, as David Conlan had noted in his email referred to at [51], Mr Thomson was able to make an investment on the Finspreads platform of as little as a single share. After five weeks, the minimum order would be for a CFD referencing the performance of 100 shares. Mr Thomson made his first transaction involving a miniCFD on 9 February 2005. Between then and 5 April 2005 he engaged in small scale purchases and sales of miniCFDs. The general pattern in this period is that Mr Thomson would enter into CFDs referencing a small number of shares (fewer than 10 shares while he was in the "miniCFDs Training Academy" and so able to do so) and 100 or 200 shares thereafter. He would typically hold the position that he acquired for a short period of time (one or two days) before selling it. This activity resulted in him making profits and losses on individual transactions that could often be measured in pence and with no profit exceeding £1.25 and no loss exceeding £4.62. Between February 2005 and April 2005, Mr Thomson made gross profits on his miniCFDs of £1.65 and aggregate losses of £6.34.

74. Mr Thomson continued to purchase and sell miniCFDs until October 2005 (although he entered into few transactions between April and June 2005 when he was preoccupied with the sale of his professional practice to Montpelier). The miniCFD transactions were larger in size in this period than they had been up to April 2005, with Mr Thomson buying and selling CFDs referencing between 100 and 400 shares at a time. However, his basic strategy remained to enter into a CFD and terminate his position within a short space of time (typically a day or two). This strategy meant that although he might spend upwards of £1000 in purchasing a particular CFD position, since that position was in existence for a relatively short period, he made little by way of absolute profit or loss on each transaction. Therefore, many transactions produced profits or losses in single figures of pounds. Between April 2005 and October 2005, Mr Thomson made aggregate profits of £51.75 and aggregate losses of £25 on his miniCFDs.

75. In December 2005, Mr Thomson opened an online CFD dealing account with IG Index. Between December 2005 and June 2006 he paid some £2,085 into that account. Mr Thomson's transactions over CFDs with IG Index continued to involve him taking positions on shares issued by particular companies (rather than positions in a financial index as a whole). However, his transactions with IG Index were both larger in scale and somewhat different in nature from the miniCFDs in which he had transacted with Finspreads. In particular:

(1) He acquired and disposed of CFDs referencing, in many cases, thousands of shares (rather than tens or hundreds of shares as was the case with his miniCFDs)

(2) The positions that he took with IG Index were, in many cases, in existence for more than a few days with the result that each position had a greater potential to generate a profit or a loss.

(3) Because Mr Thomson was dealing in greater quantities of CFDs, and holding them for longer periods, he had a greater opportunity for profit (or loss). As a consequence, individual transactions tended to generate profits or losses running to several hundreds of pounds (rather than profits or losses of single figures of pounds, or even pence, that his transactions with Finspreads had generated). To give an example, the greatest profit that Mr Thomson made in this period on his IG Index transactions was £3,700. He made that contract by acquiring a CFD referencing 10,000 shares in Regal Petroleum on 3 February 2006 when the share price was 35 pence and disposing of it on 3 March 2006. The greatest loss that he made in this period was of £1,100 and involved the acquisition of a CFD referencing 20,000 shares in a company called Osmetech on 27 February 2006 when its share price was 26.5 pence and the disposal of that CFD on 22 March 2006 when the share price was 21 pence.

(4) Mr Thomson purchased "stop loss" policies in relation to most, if not all, of the transactions that he effected with IG Index.

76. Between December 2005 and June 2006 Mr Thomson effected around 60 transactions with IG Index (counting a purchase of a CFD and a "closing out" of a CFD as two separate transactions). He realised around £10,710 gross profit from his profitable transactions and made losses totalling £5,970.50 from his loss-making transactions. He also incurred interest charges of £278.83, paid commission on sales and purchases totalling £460 and £362.05 and paid premia on stop loss policies of £734.39. As a result, having paid £2,085 into his IG Index account over that time, the balance of that account was £4,704.43 in June 2006.

77. Mr Thomson's transactions over CFDs with both IG Index and Finspreads typically involved him taking "long" positions which meant that he would profit if the share price increased. He undertook some research to help him to identify companies whose share price was expected to increase. He had a particular interest in companies in the oil and gas sector and he read the financial press and specialist internet bulletin boards to identify companies that had made, or were thought about to make, oil discoveries. He made his successful investment in Regal Petroleum referred to at [75(3)] having performed some research on issues related to its licences in the Ukraine and its then chief executive. He undertook analogous research relating to companies in other sectors and accepted in cross-examination that his trading strategy was "to have feel for something after a little research". He made profits on CFDs over company called "EBT Mobile" following what he described as a "penny share tip".

Mr Thomson's transactions relating to the Pendulum CFD

78. Montpelier put Mr Thomson in touch with Pendulum and in or around March 2006, he wrote a letter to Pendulum that included the following paragraph:

> I have been referred to you by Montpelier Group (Europe) Ltd who are Investment Professionals and who are aware that I conduct derivatives

> trading on a commercial basis with a view to profit. They indicated that I might be interested in CFDs which they understand you currently offer.

We have concluded that Mr Thomson included the legalistic wording regarding "trading on a commercial basis with a view to profit" because, following his discussion with Montpelier, he realised that this was an essential requirement if he was to set the loss that he expected from his Pendulum CFD off against other income and he wanted correspondence he generated at that time to emphasise that the necessary requirements were satisfied.

79. Mr Thomson subsequently entered into CFD arrangements with Pendulum and Appendix I of this decision contains details of the transactions that Mr Thomson entered into with Pendulum and Bayridge.

80. Mr Thomson was not clear in his evidence whether he, or Pendulum, came up with the Index Target Levels set out in his Offer to Trade with Pendulum. As we have noted at [55], Mr Thomson used figures that were almost identical to those used in a presentation that described the Pendulum arrangements in terms of their ability to generate tax losses. We regard it as unlikely that Mr Thomson alighted, by coincidence, on figures that were almost identical to those that appeared in slides that Montpelier was using to promote tax avoidance arrangements. Therefore, we have concluded both that (i) the Index Target Levels set out in Mr Thomson's Offer to Trade were provided either by Pendulum or Montpelier, but were not generated by Mr Thomson himself and (ii) those Index Target Levels must have been communicated to Mr Thomson somehow and, given the way that Montpelier was marketing the arrangements, any communication as to what were appropriate index target levels would have measured "appropriateness" in terms of whether they were likely to achieve the intended tax loss.

81. Mr Thomson performed little, if any, evaluation of his own as to the likelihood of the Pendulum CFD producing a profit beyond looking at the level of FT-SE at the relevant time.

82. Mr Thomson did not read the terms and conditions of the Pendulum CFD in any great detail because he was not aware of the ambiguity surrounding the definition of "Trade Profit". He believed that, if his Pendulum CFD terminated at Phase Two or a subsequent Phase, he would receive a payment equal to the percentage figure set out in his Offer to Trade plus a return of his Issue Value[9], but could not explain any basis for that belief and did not discuss the matter with Pendulum. It follows that he had no clear understanding as to how much he would receive under the Pendulum CFD if it terminated at Phase Two to Five.

83. Mr Thomson was late paying his Initial Margin to Pendulum but, since Mr Gittins knew Mr Thomson well, Pendulum did not exercise its right to terminate Mr Thomson's Pendulum CFD.

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[9] As noted at [36], this understanding was flawed, and in fact he was entitled only to a payment equal to the percentage specified in his Offer to Trade multiplied by the Designated Issue Value of the Pendulum CFD.

The value of Mr Thomson's Pendulum CFD as at 5 April 2006

84. On 10 May 2006, Pendulum sent Mr Thomson a memorandum confirming that, as at 5 April 2006, the "appropriate buy back market value" of Mr Thomson's Pendulum CFD was £6,500 (as compared with a Designated Issue Value of £325,000). Mr Thomson was stoical on receiving this valuation, even though it indicated that his Pendulum CFD was worth much less than he apparently paid for it. He did not challenge the price that Pendulum offered and accepted that he lacked the expertise to propose an alternative valuation. We have inferred that Mr Thomson was stoical precisely because he expected Pendulum to ascribe a low value to the contract as that was how he would obtain his desired trading loss.

Mr Thomson's approach to his tax returns and HMRC's enquiries

85. Mr Thomson took no independent advice on the tax treatment of the Pendulum CFD. Mr Thomson is an accountant with some tax experience. He would have had the expertise to consider the law on the boundary between "trading" and "investment" for tax purposes. However, beyond performing some "minor research" he did not do so although we accept that he formed the genuine belief that he was engaged in a trade for tax purposes because he was buying and selling CFDs on a regular basis, was making profits and suffering losses. Nor did Mr Thomson take independent advice as to how the various instruments should be treated as a matter of generally accepted accounting practice. However, as a partner in a firm of chartered accountants, he felt that he had sufficient expertise in this area himself.

86. Before completing his tax return for 2005-06, Mr Thomson contacted Pendulum to ask about the value of his Pendulum CFD. On 15 January 2007, Pendulum sent him an email to the effect that the value of his CFD as at 5 April 2006 was £6,500[10]. Mr Thomson used that figure when calculating his trading loss in his tax return. He therefore concluded that he had made a loss for tax purposes on the Pendulum CFD of £318,500 (the amount he had "paid" to acquire it of £325,000 less £6,500).

87. On 31 January 2007, Mr Thomson submitted his tax return for 2005-06. He filled in the self-employment pages of that tax return in relation to a business that he described as "derivative trading". In that tax return he claimed a total trading loss of £314,677.50[11]. He claimed to set £58,205 "sideways" against his other taxable income for the 2005-06 tax year and to carry forward the balance of £256,472.50. Mr Thomson's tax return contained no indication that there might be doubt as to whether he was carrying on a derivative trade and, in particular, he did not make any disclosure in the "white space" of his tax return on this issue.

88. In November 2007, HMRC opened an enquiry into Mr Thomson's return for 2005-06. During their enquiries, they asked Mr Thomson to provide a large amount of documents and information. Officer Bradley said in his witness statement that Mr

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[10] This was expressed to be a "valuation" and not an "offer to repurchase" by contrast with the document referred to at [84].

[11] This differs from the loss on the Pendulum CFD because of the presence of other profits and losses from his online CFD activity.

Thomson provided most of the documents requested but his compliance with information requests was "incomplete" (though he did not say in what respect precisely it was incomplete). Officer Bradley was not cross-examined for reasons I have given. Mr Thomson's written closing submissions did not address the penalties at all or point the Tribunal to specific documents that demonstrated the quality or otherwise of Mr Thomson's provision of information. Our own impression is that, during the enquiry, HMRC asked for large volumes of material and information and that Mr Thomson, or Montpelier on his behalf, provided most of what was requested. Occasionally Mr Thomson's response was delayed, and HMRC issued formal notices to produce documents on at least one occasion. However, we saw little correspondence from HMRC complaining about an inadequate response to questions that they asked. Overall, we have concluded that Mr Thomson complied well with HMRC's requests for information during their enquiry, though we have accepted Officer Bradley's evidence that he refused to meet with HMRC at this stage.

89. On 29 January 2008, Mr Thomson claimed to amend his tax return for 2005-06. He continued to set £58,205 of his claimed loss "sideways" against his total income for 2005-06, but instead of carrying forward the balance of £256,472.50, Mr Thomson made the following claims in the following order:

> (1) He claimed to carry £125,485.02 back against profits and income of the 2004-05 tax year under s380 of the Income Tax and Corporation Taxes Act 1988 ("ICTA").
>
> (2) He claimed to carry £69,622.18 back against profits of the 2002-03 tax year under s381 of ICTA.
>
> (3) He claimed to carry £61,365.30 back against profits of the 2003-04 tax year under s381 of ICTA.

90. On 20 April 2010, HMRC closed their enquiry into Mr Thomson's tax return for 2005-06 (as amended above). They issued a closure notice that concluded that no loss relief was available for any of the trading losses claimed.

91. On 27 April 2010, Mr Thomson appealed to HMRC against the closure notice. On 8 June 2010, he requested that HMRC review their decision. On 12 July 2010, HMRC confirmed that a review would be undertaken. On 19 August 2010, HMRC upheld their conclusions following a review (though I was not shown a copy of this letter). There was some confusion as to when precisely Mr Thomson notified his appeal to the Tribunal. He may have submitted a Notice of Appeal form on 6 September 2010 (which would have been in time as it was less than 30 days after HMRC concluded their review). However, the Tribunal acknowledged receipt of a Notice of Appeal form dated 1 October 2010 (which would have been outside the 30-day time limit). We have concluded that the form submitted on 1 October was a resubmission of an in-time appeal notified on 6 September 2010.

92. HMRC also started a civil investigation (under their Code of Practice 9) into the possibility that some users of Pendulum arrangements had committed tax fraud. On 29 April 2013, HMRC started investigations into Mr Thomson under Code of Practice 9. They offered him a "contractual disclosure facility" under which, if he admitted fraud,

HMRC would not take criminal proceedings. Mr Thomson declined the “contractual disclosure facility” because he considered that he had not committed any fraud but he agreed to co-operate with HMRC’s investigation under Code of Practice 9. Mr Thomson’s decision not to admit fraud has been vindicated because HMRC now accept that he did not commit any fraud in connection with his arrangements with Pendulum, although they do consider that he has negligently filed an incorrect tax return.

93. Mr Thomson attended two meetings on 26 November 2013 and 5 September 2014 during HMRC’s Code of Practice 9 investigation and provided HMRC with additional materials. Notes of those meetings were produced as evidence. Mr Thomson evidently did not agree that the notes were in all respects an accurate reflection of what took place at the meetings. Our own impression from the notes of the meetings was that Mr Thomson co-operated with HMRC’s enquiry but that, as in his evidence to the Tribunal, some of his answers to HMRC’s questions at those interviews were misleading because they did not bring out the fact that obtaining loss relief was the true object and purpose of all of his averred derivative trading activity.

94. During HMRC’s Code of Practice 9 investigation, Officer Bradley explained to Mr Thomson that, if he and HMRC reached a negotiated settlement of their dispute on the Pendulum arrangements, HMRC would have more flexibility in the amount of penalty that would be charged. For example, if a negotiated settlement was reached, HMRC could award a 20% reduction in penalty (in addition to any other mitigation that was appropriate) to reflect Mr Thomson’s “disclosure”. However, if Mr Thomson continued to assert that the Pendulum arrangements produced the asserted trading loss, HMRC would not be able to mitigate the penalty at all to reflect “disclosure”.

95. Mr Thomson and HMRC did not reach a settlement. On 10 December 2014, HMRC charged Mr Thomson a penalty under s95 of ICTA in connection with what they considered to be Mr Thomson’s negligence in connection with his tax return for 2005-6. Applying their practice on the abatement of penalties they concluded:

> (1) No discount to the penalty was appropriate to reflect Mr Thomson’s “disclosure” of the inaccuracies in his tax return because, since he continued to maintain that the trading loss was available, there had been no disclosure.
>
> (2) They would abate the penalty by 32.5% (out of a maximum of 40%) to reflect Mr Thomson’s “co-operation”.
>
> (3) They would abate the penalty by a further 25% (out of a maximum of 40%) to reflect the “seriousness” of Mr Thomson’s behaviour.

96. It follows that HMRC agreed to abate the penalty by 57.5%. They calculated the amount of tax and national insurance that they regarded Mr Thomson had under-declared on his return for 2005-06. They multiplied that by 42.5% (the percentage of penalty that remained unabated) and concluded that Mr Thomson owed an aggregate penalty of £44,617.

97. We were not taken to Mr Thomson’s appeal against the penalty. However, HMRC proceeded on the basis that Mr Thomson had made a valid appeal against that penalty which was validly before the Tribunal and we will do the same.

PART THREE: PRIMARY FACTS RELEVANT TO MR WORSFOLD'S APPEALS

Mr Worsfold's background

98. Mr Worsfold qualified as a certified accountant in 1978. Since then he has had an extensive and varied business life. When he was 31, he was the Vice President of Finance in the United States for a medium-sized multinational business in the building sector. In 1987, he had a change of career and started a car rental business (carried on by a company called Sunwheels Limited) with Mr Mungavin who, as well as being a business acquaintance, is also a personal friend. That evolved into a car rental reservations business and Mr Worsfold continued working in that business until his retirement in 2005.

99. Mr Worsfold has always taken an interest in financial markets. From time to time, when he had surplus funds to invest he would invest in the stock market in what he described as a "small way" although he normally chose to invest his surplus funds in his own business. In addition, the company through which Mr Worsfold and Mr Mungavin ran their business would also have surplus funds from time to time and would sometimes invest those in the stock market.

100. By late 2004, the Sunwheels car rental reservations business was performing badly as people were increasingly renting cars for their holidays themselves over the internet and there was a reduction in demand for the services the business offered. At this point, Mr Worsfold was working four days a week for the Sunwheels business. Until 31 December 2004, Mr Worsfold also had an arrangement under which he provided accounting services to a business called Cramm Francis Woolf.

101. By 2005, Mr Worsfold was ready to retire. He agreed, however, to defer his retirement until September 2005 as the summer was the busiest time for the Sunwheels business and, if he continued to work over the summer, that would enable staff to take summer holidays. He was a little unsure as to precisely how much time he devoted to the Sunwheels business in 2005. We have concluded that he was working around three or four days a week between January 2005 and September 2005. Some weeks he might go in for five days, but in those weeks, he might tend to arrive late or leave early on some days.

102. At times material to this appeal, Mr Worsfold and Mr Mungavin were also shareholders in a company referred to as "Walgrove". Walgrove was dormant, although it had a cash balance and distributable reserves that would enable it to pay a dividend. In the tax year 2004-05, Walgrove and Sunwheels paid dividends to Mr Worsfold totalling £444,277.

The background to Mr Worsfold's decision to start buying and selling CFDs

103. Mr Worsfold knew the Montpelier group well. Mr Worsfold accepted that he was always interested to hear about tax planning opportunities that Montpelier had on offer. Mr Worsfold had also enjoyed personal hospitality from Mr Gittins and had stayed at Mr Gittins's home in Barbados in 2003. Mr Worsfold tended to have the discussions

with Montpelier and Mr Gittins and would relay the gist of those discussions to Mr Mungavin.

104.On 14 June 2004, Mr Gittins sent an email addressed to both Mr Worsfold and Mr Mungavin the title of which was "Income Loss Scheme – Step by Step Guide". which read

> Attached herewith some notes on the above scheme for your perusal.

Unfortunately, the attachment was not reproduced in the documentary evidence available to the Tribunal.

105.On 15 June 2004, Mr Gittins made a file note to the effect that:

> Terry [Worsfold] and Richard [Mungavin] need an income tax loss of around half million pounds for tax year 2004/2005 using the charity scheme

We concluded that Mr Worsfold and Mr Gittins had spoken following the email of 14 June 2004 and that the "scheme" referred to in that email was the charity scheme, referred to at [49], that Montpelier was promoting at the time.

106.On 15 June 2004, Mr Gittins sent an email addressed to Mr Worsfold that included the following paragraphs:

> Just a quick note to make sure that you fully understand that in my opinion the income tax loss scheme will not [last] much beyond the end of August and therefore we have a fairly short window to jump through. I would therefore be grateful if you could therefore let me know the amount of dividend that you finally decide on as soon as possible.

107.In cross-examination, Mr Worsfold said that neither he, nor Mr Mungavin, would have been interested in entering into tax planning arrangements whose sole purpose was to shelter tax on dividends paid (whether by Walgrove or any other company). He said that both he and Mr Mungavin would only have been interested in arrangements promoted by Montpelier that offered the prospect of profit. We have not accepted that evidence. First, Mr Worsfold's evidence was inconsistent with his admission in cross-examination that "he was always interested to know what tax planning opportunities there were". Second, on 21 June 2004, Mr Worsfold sent a letter to Mr Gittins that read as follows:

> Dear Watkin
>
> Please find enclosed the cheques from Richard, Anna, Dean and myself to purchase our interests in the trusts.
>
> If there is anything further you need, please let us know.

That letter enclosed cheques signed by Mr Mungavin, his wife Anna, Mr Worsfold and his son, Dean. Mr Worsfold suggested that the cheques might have related to some planning that Walgrove was considering involving the establishment of an employee benefit trust. However, Mr Gittins was clear that the cheques had nothing to do with that tax planning. Mr Gittins thought that the cheques might have related to a property

trading transaction he was discussing with Mr Worsfold at the time, but he was not able to say that the cheques did relate to any such transaction. Given that Mr Worsfold's letter was sent so soon after discussions between Mr Gittins and Mr Worsfold about the "charity scheme", we have concluded that it is more likely than not that the cheques were sent because Mr Mungavin and Mr Worsfold wanted to take part in the "charity scheme" (which Mr Gittins himself had described as "out and out tax avoidance") to shelter tax on dividends of around £500,000 that they expected to receive, or had already received.

108.The cheques referred to at [107] were not cashed (probably because the charity scheme was counteracted by legislation and so could not be implemented).

109. After Montpelier had developed the Pendulum arrangements as a successor to the "charity scheme", Mr Worsfold had a discussion with Jane Goodall at Montpelier which included a discussion of the possibility of Mr Worsfold starting to purchase and sell derivatives. Given that Montpelier regarded the Pendulum arrangements as producing tax losses that would enable their clients to avoid tax, we have concluded that Montpelier would have suggested to Mr Worsfold that he could enter into Pendulum arrangements instead of the defunct charity scheme and that the Pendulum arrangements would provide him with a tax loss that both he and Mr Mungavin could use to reduce their tax liabilities on dividends. However, in order for the Pendulum arrangements to work, Montpelier would have pointed out that Mr Worsfold would have to establish a trade of dealing in derivatives.

110.On 12 October 2004, Mr Worsfold sent Mr Gittins an email that included the following paragraph:

> We have both set up internet accounts with CMC. Question – do we set up the bank account first and pay £2k from the new account or do we pay £2k from normal account and set up new bank account later or doesn't it matter?

We have concluded from this email that Mr Worsfold regarded the establishment of internet accounts to enable him to deal in CFDs was part of tax planning arrangements. There would otherwise be no reason for Mr Worsfold to contact Mr Gittins, from whom he was accustomed to receiving suggestions for tax avoidance arrangements, on a matter as mundane as the opening of new bank accounts to facilitate online transactions in CFDs.

111.Mr Worsfold's evidence was that he was interested in starting derivative trading because of his interest in financial markets and his interest in developing an additional source of income and a means of keeping his brain active during his impending retirement. We accept that Mr Worsfold found those aspects of derivative trading attractive. However, we have concluded that the overwhelming reason why he decided to start buying and selling derivatives was to enable him to participate in arrangements that he believed would enable him to shelter income from tax. More specifically, we have concluded that Montpelier told him that the derivative with Pendulum offered the prospect (though not a guarantee, as the Pendulum CFD might produce a profit at Phase One) of reducing his tax liability but that, in order for that result to be achieved, he

would first need to establish a trade of dealing in derivatives. Therefore, when Mr Worsfold started buying and selling CFDs with CMC as discussed in the next section he did so as a stepping stone to securing a trading loss on the Pendulum CFD.

Mr Worsfold's purchase and sale of CFDs with CMC

112. On 26 October 2004 Mr Worsfold opened a new account which he named "Derivative Trading Account" with NatWest.

113. In or around November 2004, Mr Worsfold opened an account with CMC Group plc ("CMC") who provided an online platform on which its customers could trade CFDs. CMC allowed its customers taking positions on indices such as the FT-SE 100 or the US30 to trade on only a 1% margin. Mr Worsfold did not, however, start trading immediately and performed some limited research on economic and financial matters by, for example, downloading and printing out some market data from the BBC website on movements between sterling and the US dollar over the preceding twelve months and on historic commodity prices over a similar period. He also signed up to a Yahoo Finance newsgroup and downloaded and printed out articles on some topical financial matters.

114. On or around 21 January 2005, Mr Worsfold paid £2,000 into his account with CMC and entered into his first CFD transaction over that platform. Between 20 January 2005 and 5 April 2005, Mr Worsfold entered into a number of transactions involving CFDs over the CMC platform. Those transactions had the following characteristics:

(1) Typically, they involved Mr Worsfold taking a "long" position over either the FT-SE or the US30 index.

(2) He entered into 83 contracts of purchase or sale of CFD. Because he was trading on a 1% margin, he did not need to invest large amounts of his personal capital in those transactions. However, a number of his transactions involved him in taking on a large exposure to particular indices. For example, on 29 March 2005, he purchased 60 CFD contracts referencing the US30 index at a time when that index stood at 10,472. That was a notional investment of $628,320 in that index although Mr Worsfold would only have needed to provide 1% of this amount ($6,283.20) by way of margin to make the purchase. That was the largest acquisition he made. Most of the purchases he made involved him taking positions in the tens of thousands of dollars or pounds (albeit providing margin of only 1% of the notional amount of his investment), but there were several instances of him taking positions in excess of $100,000 in the US30 index.

(3) Between 20 January 2005 and 5 April 2005, on almost every weekday, Mr Worsfold would be purchasing or selling CFDs over the CMC platform. Typically he would make one or two such purchases or sales per day. He seldom if ever made more than 10 purchases or sales on any day over this period.

(4) As well as the 83 occasions on which he purchased or sold CFDs, there were 61 occasions on which he kept a CFD position open overnight with the result that that contract fell to be "marked to market" as discussed at [25].

(5) Mr Worsfold did not keep his CFD positions open for very long. Many CFDs were closed out within the same business day. Few positions were kept open for more than a few days, although there was a period between 18 March 2005 and early April 2005 where he had an open position in 40 contracts over the US30 index (an exposure of over $400,000, albeit requiring a margin of only 1% of that figure to support it).

(6) Therefore, on many days during this period, Mr Worsfold was taking on a large exposure to the US30 and FT-SE indices, although the size of that exposure was somewhat masked by the fact that he needed to provide only 1% of that exposure by way of margin. However, although on many days he had a large exposure to the indices, he tended to have that exposure for a relatively short space of time as he tended to close out his positions shortly after taking them on. Therefore, his daily profits and losses in this period were not very large. On many days, his profit or loss could be measured in the tens of pounds or dollars. On perhaps the same number of days, his profit or loss would be less than £500 or $500. There were some days, but not many, on which he made a profit or loss of more than $1,000 or £1,000 although, on 30 March 2005, he realised a profit (following the marking to market of his open positions) of $11,787.20 and on 29 March 2005 made a loss (following the marking to market of positions) of $7,176.

115.Overall, between 21 January 2005 and 5 April 2005, Mr Worsfold paid £50,000 into his account with CMC. As of 5 April 2005, the balance in that account was £42,000.

116.Mr Worsfold continued to buy and sell CFDs on the CMC platform after 5 April 2005 although there was little if any activity between 5 April 2005 and 19 May 2005. Between April 2005 and March 2006, he entered into 140 further transactions whose profile was broadly similar to that outlined at [114] above. Mr Worsfold continues to buy and sell CFDs over online platforms to this day.

117.Mr Worsfold used the internet to obtain financial information that he took into account when entering into CFD transactions. He tended to make decisions at the beginning of the day and towards the end of the day, having consulted the internet and looked at the news, would ask himself whether he should cash in his positions or leave them outstanding overnight. He would take particular care to keep abreast of the financial news at around 2.30 pm each day because that was when the New York stock exchange opened for trading. The financial information he obtained was, however, quite general in nature: Mr Worsfold spoke in terms of that information giving him a feel for "what's going on". Mr Worsfold did not suggest that he performed a detailed statistical analysis of financial data and he accepted that, given that he was not "trading at the coal face" (which we took to mean that he was not trading continuously throughout the day like people whose living depended entirely on derivatives trading) there would be occasions on which the information he had was a little out of date. He had no written strategy or business plan.

Mr Worsfold's transactions with Pendulum

118. Montpelier put Mr Worsfold in touch with Pendulum and provided him with a sophisticated investor certificate that was evidently necessary for regulatory purposes before Pendulum would discuss CFD arrangements with him. On 30 March 2005, Mr Worsfold wrote to Pendulum, enclosing his sophisticated investor certificate and asking for information on Pendulum's CFD offering. Once Mr Worsfold made contact with Pendulum, matters proceeded rapidly. On the very same day as that on which he had made contact, he sent Pendulum an Offer to Trade and Pendulum accepted that offer on the same day.

119. A summary of the key terms of Mr Worsfold's Pendulum CFD is set out in Appendix Two. The Index Target Levels and the designation of FT-SE as the Designated Index were provided by either Montpelier or Pendulum. Mr Worsfold did not propose them himself although he was evidently content with the figures that Pendulum had proposed since he decided to enter into a contract with Pendulum on those terms.

120. Like Mr Thomson, Mr Worsfold was late in paying his Initial Margin to Pendulum. However, Pendulum took no apparent action in response to this breach of contract.

121. Mr Worsfold incorrectly thought that, if his Pendulum CFD terminated in any of Phases Two to Five, he would receive the relevant percentage figure applied to the Designated Issue Value plus a payment equal to the Designated Issue Value. So, for example, Mr Worsfold incorrectly thought that, if the Pendulum CFD terminated after Phase Two, he would receive a total payment of £690,000 (i.e. £300,000 x 130% plus a further payment of £300,000 equal to the Issue Value of his Pendulum CFD). As noted at [36], that understanding was incorrect but Mr Worsfold was not even aware that the wording of the contract was ambiguous.

122. Before entering into his Pendulum CFD, Mr Worsfold made a rudimentary evaluation of the prospects of making a profit from that contract. He looked at "price earnings ratios"[12] and concluded that, if the price earnings ratio of the FT-SE 100 index stayed the same over the period of Phase Two, he would achieve success at Phase Two. He thought that there was a good prospect of success at Phase One. He thought that the likelihood of success in Phase Three was somewhat lower and that, if the Pendulum CFD entered Phase Four or Five, he would be taking a "significantly higher risk" of not making a profit.

123. Mr Worsfold had not heard of Pendulum before entering into the Pendulum CFD. He performed little due diligence on Pendulum before entering into that contract to check, for example, whether Pendulum would be able to honour its commitments under the Pendulum CFD although he did have some telephone conversations with Michael Darwyne that reassured him on this matter. He mistakenly believed that Pendulum held

[12] The "price earnings ratio" of a particular quoted company is its share price divided by its earnings per share. We have deduced that, when referring to the "price earnings ratio" of an index of shares such as FT-SE 100, Mr Worsfold was referring to some kind of average of the price earnings ratios of the 100 individual quoted companies that make up the index.

some kind of regulatory authorisation from the London Stock Exchange to "make a market in the FT-SE 100", but in fact Pendulum held no such authorisation and indeed page 2 of his Master Agreement with Pendulum stated, in large print under a heading entitled "Important Notice – FT-SE 100" that Pendulum had no connection with the London Stock Exchange.

124. In the bundle of documents was an unsigned specimen version of a "Professional Services Agreement" with MTM (Tax Consultants) Limited ("MTM"), a company in the Montpelier group. That agreement included provision for MTM's client to pay £500 in return for taxation advice:

> In respect of the UK tax implications and consequences of the client commencing the trade of the purchase and sale of derivative contracts, including but not limited to:
>
> a) General advice on the law
>
> b) Specific advice to the client
>
> c) Assistance with the preparation of accounts
>
> d) Assistance with tax returns and any negotiations with the Inland Revenue.

That template agreement also provided that, if HMRC determined that MTM's client was not trading in derivatives, MTM would fund the costs of appealing against that decision to the General or Special Commissioners and would also fund the costs of a further appeal to the High Court if necessary.

125. In his oral evidence, Mr Worsfold said that he was not sure whether he had entered into a Professional Services Agreement in relation to the Pendulum transaction with MTM or, if he had, whether he had done so before entering into that transaction or when HMRC started their enquiries into it. However, in a letter to HMRC dated 28 August 2007 he had confirmed that he did enter into a Professional Services Agreement with MTM and, while he could not locate a signed copy, its terms would have been similar to those of the template. We have, therefore, concluded that Mr Worsfold did enter into a Professional Services Agreement on terms similar to those set out in the template. Moreover, we have concluded that he entered into that agreement at or around the time he entered into the Pendulum CFD. That conclusion follows from the fact that the advice MTM were to give under that agreement related to the client commencing the trade of purchasing and selling derivatives. It therefore seems to us more likely than not that the agreement was entered into when Mr Worsfold had newly established his activity of buying and selling derivatives. If the agreement had been entered into when HMRC were enquiring into the transaction, the nature of the tax advice to be provided would have been expressed differently and would have referred specifically to HMRC's enquiries. Moreover, it seems to us unlikely that, for just £500, MTM would agree to fund the costs of appeals to both the General and Special Commissioners if HMRC were known to be pursuing enquiries into the transaction. By contrast, that provision makes more commercial sense if it was entered into in 2005, at which time MTM would not have realised that the transactions would be so controversial from HMRC's perspective.

126.Mr Worsfold was pressed in cross-examination as to his reasons for entering into the Pendulum CFD. The essence of his evidence was that he was primarily attracted by the prospect of making a profit on Phase One, Phase Two or, to a lesser extent, Phase Three of that CFD. He also said that he was attracted by the very generous financing that he was offered in the form of the Bayridge Loan. However, we do not accept that as a complete explanation of Mr Worsfold's rationale for entering into the Pendulum CFD. Given our findings at [111], we have concluded that Mr Worsfold's true motivation was to obtain the trading loss that he believed was likely to be generated by the Pendulum CFD[13]. Our conclusion is only reinforced by the existence of the Professional Services Agreement.

The value of Mr Worsfold's Pendulum CFD as at 5 April 2005

127.Pendulum sent Mr Worsfold an offer to repurchase his Pendulum CFD. In that document, Pendulum ascribed a value of £4,653 to the Pendulum CFD and indicated that they would be prepared to pay Mr Worsfold that sum to purchase his Pendulum CFD from him. Pendulum's calculation proceeded on the basis that there was a 1.3% or a "negligible" chance of the Pendulum CFD paying out at any of Phases Two to Five. Mr Pendulum's CFD had, on 30 March 2005, been expressed to have an Issue Value of £300,000. He did not have the requisite expertise to conduct his own valuation of the Pendulum CFD and therefore adopted Pendulum's figure when submitting his tax return for 2004-05. Since he considered he had paid £300,000 to acquire the Pendulum CFD, the result of adopting Pendulum's valuation was that he made a loss of some £295,437 on the Pendulum CFD[14].

128. Mr Worsfold accepted in cross-examination that "nothing dramatic" had happened to the FT-SE index over those 5 days[15]. He had no good explanation as to why the value of his Pendulum CFD was, at least to Pendulum's eyes, just 1.6% of the price he had apparently paid for it just 5 days earlier. Given our findings at [65], we have concluded that the apparent loss on the Pendulum CFD was precisely the result that was intended and that Mr Worsfold expected.

Mr Worsfold's approach to his tax returns and HMRC's enquiries

129. Mr Worsfold's witness statement contained little, if any, detail on the steps that he took to ensure that his tax return was accurate. He was asked in cross-examination whether he took any independent advice in relation to the Pendulum CFD. His response was:

[13] We are prepared to accept that Mr Worsfold found the generous terms of the Bayridge Loan attractive. However, as we have concluded, the Bayridge Loan was an integral part of the tax avoidance scheme and indeed enabled that tax avoidance scheme to operate. It was not an independent commercial reason for entering into the arrangements with Pendulum.

[14] Mr Worsfold also claimed that he made a loss on his online CFD activity, so the gross loss arising from his derivative activity according to his 2004-05 tax return was £296,943

[15] In fact, as noted at [155], FT-SE actually rose over the period so movements in FT-SE could not have explained such a dramatic reduction in the value of the Pendulum CFD.

Um, no. I spoke with [Pembroke], my accountant, the auditor of [Sunwheels]. I think I spoke to the Hong Kong guy[16] as well about it.

Mr Worsfold does not have any tax background and, unsurprisingly, did not himself research the law on "trading". His understanding was that the loss on his Pendulum CFD arose because of requirements as to UK GAAP. He took advice from his accountant that the accounting presentation he was adopting for the purposes of calculating his trading loss was correct. However, since Mr Worsfold said in an interview with HMRC that he had not received any "real advice" from his accountant we have concluded that the advice he received was cursory, was limited to accounting matters and did not cover the question of whether Mr Worsfold was entitled, as a matter of tax law, to claim relief for a trading loss said to have been incurred in connection with the Pendulum CFD.

130. On 30 January 2006, Mr Worsfold submitted his tax return for the 2004-05 tax year. He filled in the self-employment pages for that tax return in relation to a business he described as "derivative trading". He claimed a loss of £298,757[17] in connection with that averred trade and claimed to set the entirety of that loss "sideways" against other taxable income. Mr Worsfold has not pointed to any disclosure on the "white space" of that tax return that indicated there may be doubt as to whether the loss claimed was relievable. We have inferred that Mr Worsfold made no such disclosure.

131. On 19 January 2007, HMRC opened an enquiry into his tax return. During the course of that enquiry, HMRC asked Mr Worsfold to produce large quantities of information and asked detailed questions. Mr Worsfold has not made any submissions as to what conclusions we should draw from his response to HMRC's enquiries, but we have concluded that, like Mr Thomson, he was co-operative and provided most, if not all, of the information HMRC requested (at least where he could do so). During that correspondence he did not, however, admit as we have found that the predominant rationale for his decision to enter into the Pendulum CFD was to secure a relievable loss or that the overwhelming reason why he started his online CFD activities was to "establish" a trade to that he could claim that loss.

132. On 7 January 2009, HMRC issued a closure notice concluding that none of the trading loss that Mr Worsfold had claimed was deductible. Mr Worsfold appealed to HMRC against their closure notice on 22 January 2009 and HMRC agreed to postpone all of the tax and NIC in dispute pending resolution of that appeal. Discussions with HMRC continued but, on 1 March 2010, HMRC sent Mr Worsfold a "view of the matter" letter explaining that they stood by the conclusions set out in their closure notice. They offered Mr Worsfold a review of that conclusion and, on 23 April 2010,

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[16] This was someone who had attended a meeting between Mr Worsfold and Montpelier and gave him some tips on how to set up an online CFD account.

[17] The loss of £296,943 referred to in footnote [14] as increased by some other expenses.

upheld their conclusion on review. Mr Worsfold duly notified his appeal to the Tribunal.[18]

133. As with Mr Thomson, HMRC considered that Mr Worsfold's conduct in relation to the Pendulum CFD may have involved tax fraud. On 29 April 2013, they wrote to Mr Worsfold stating that they were enquiring into possible fraud under Code of Practice 9. They offered Mr Worsfold a similar "contractual disclosure facility" to that they had offered Mr Thomson and, like Mr Thomson, Mr Worsfold declined to admit fraud but explained that he was prepared to co-operate with HMRC's enquiry.

134. On 11 March 2014, both Mr Mungavin and Mr Worsfold attended a meeting with HMRC to discuss HMRC's investigation. The first part of that meeting was a joint meeting (at which Mr Mungavin and Mr Worsfold were both present). Mr Mungavin and Mr Worsfold then had separate meetings with HMRC (at which the other was not present) to discuss specific aspects of the Pendulum arrangements, and their particular tax positions. We have concluded that Mr Worsfold made at least two untrue statements in his discussions with HMRC:

> (1) He stated that he had never been offered an opportunity to participate in arrangements promoted by Montpelier other than the Pendulum CFD arrangements and an employee benefit trust (EBT) arrangement. In fact, as noted at [107], Mr Worsfold had got as far as sending Mr Gittins cheques to participate in the "charity scheme".
>
> (2) He stated that he was not aware of the ability to set trading losses off against other taxable income until after he entered into the Pendulum CFD. This was not true given the findings we have made at [111][19].

135. As with Mr Thomson, HMRC explained to Mr Worsfold that, if he settled his dispute with HMRC, HMRC might have more flexibility on penalties. In one email, HMRC indicated that they would consider a penalty in the range of 20% to 25% if Mr Worsfold accepted that the trading loss claimed was unavailable and that he had been negligent in the preparation of his tax return.

136. HMRC and Mr Worsfold did not settle their dispute although HMRC ultimately accepted that Mr Worsfold had not engaged in tax fraud (but remained of the view that he had been negligent). On 28 November 2014, HMRC issued Mr Worsfold with a penalty in relation to his 2004-05 tax return which they determined as follows:

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[18] We were not taken to Mr Worsfold's appeal to the Tribunal against the closure notice, but there was no suggestion that it was made late.

[19] We have reached our conclusion that Mr Worsfold gave misleading answers to some HMRC questions based on a note of the meeting that HMRC prepared. Mr Worsfold was invited to sign the note of that meeting but he declined to do so. However, in discussions with HMRC, his representative informed HMRC that, though the meeting notes would not be signed, they were "more or less agreed" which suggests to us that the meeting notes accurately record the specific questions we have referred to and Mr Worsfold's answers to those questions.

(1) They concluded that Mr Worsfold had behaved negligently in delivering an incorrect return. Therefore, the starting point was a penalty equal to 100% of the tax understated in that return.

(2) They did not discount the penalty at all to reflect "disclosure" (their practice being to discount the penalty by a maximum of 20% for such disclosure).

(3) They discounted the penalty by 30% (out of a maximum permitted under their practice of 40%) to reflect his "co-operation".

(4) They discounted the penalty by 15% (out of a maximum permitted under their practice of 40%) to reflect the "seriousness" of Mr Worsfold's behaviour.

(5) Therefore, in total they agreed to abate the penalty by 45%. They applied the figure of 55% to the additional amount that they considered Mr Worsfold owed (£76,235) to produce an aggregate penalty of £41,929.

137. Mr Worsfold appealed against the penalty on 15 December 2014. HMRC offered, and performed, a review of their decision to charge a penalty and, on 20 April 2015, upheld their conclusion on review. Mr Worsfold appealed to the Tribunal. It looks as though he made some failed attempts to submit his appeal to the Tribunal and was only successful on or around 30 September 2015, by which time his appeal was late. However, HMRC have made no objection to him being given permission to make a late appeal and we will give that permission.

PART FOUR: FINDINGS OF FACT RELATING TO MR MUNGAVIN'S APPEALS

Mr Mungavin's background

138. Since Mr Mungavin and Mr Worsfold were both business associates and friends, many of our findings as to Mr Worsfold's background apply equally to Mr Mungavin. Therefore, our findings in this section need to be read together with those in Part Three above.

139. In 1978, after leaving university, Mr Mungavin worked in Brussels for a car hire company. He left to start his own car hire business which he built up over the next ten years. During this period, he met Mr Worsfold, who was also working in Brussels and the two became friends. Mr Worsfold and Mr Mungavin formed Sunwheels Ltd in or around 1987. Mr Mungavin became a magistrate in 2005 and retired from his businesses with Mr Worsfold in 2015.

140. Mr Mungavin has had some interest in the financial markets since his early twenties and has held a number of accounts with stockbrokers since that time. During the period of their friendship and business association, Mr Mungavin has tended to discuss

financial matters with Mr Worsfold and to follow his lead[20]. He did not receive formal financial advice from Mr Worsfold, but he respected his judgement and opinions.

141.Like Mr Worsfold, Mr Mungavin was at material times a director of Walgrove and Sunwheels. In the 2004-5 tax year, he received a dividend of £396,664 from Walgrove which he declared on his tax return for that year.

The background to Mr Mungavin's decision to start buying and selling CFDs

142. Mr Mungavin had not, prior to the 2004-05 tax year claimed to be trading in CFDs although, as noted above, he had prior to then bought and sold shares as investments through accounts with stockbrokers.

143.Mr Worsfold had discussions with both Pendulum and Montpelier. Mr Mungavin trusted Mr Worsfold and was happy to base his decision on whether to participate in financial arrangements on Mr Worsfold's report of those conversations. We have already made, at [111], findings as to what prompted Mr Worsfold to start buying and selling CFDs. We have inferred that Mr Mungavin, like Mr Worsfold, was attracted by the prospect of realising a trading loss that could be set off against other taxable income. He realised, following Mr Worsfold's report of conversations with Montpelier that the loss (on the Pendulum CFD) could only be realised if he established a trade of dealing in derivatives. Therefore, we have concluded that Mr Mungavin's primary motivation in starting to deal in CFDs was as a means of obtaining a loss on the Pendulum CFD when he ultimately entered into it. The transactions in online CFDs that we describe in the next section were a stepping-stone to securing that loss.

144.In his oral evidence, Mr Mungavin gave the impression that he had only a hazy knowledge of tax aspects of the Pendulum arrangements. He said, for example, that he was not aware that Montpelier promoted tax-planning opportunities, and did not realise, until his accountant (Mr Stephen Briggs) told him, that he could set losses made in connection with the Pendulum CFDs off against his other income for tax purposes. We have not accepted that evidence. While we can accept that Mr Mungavin's understanding of the Pendulum arrangements, having been acquired "second hand" from Mr Worsfold, might have been less detailed than that of Mr Worsfold, we have concluded that Mr Mungavin would have been aware, before entering into the Pendulum CFD, of the core tax aspects of those arrangements and particularly the ability to use a trading loss to shelter income from tax.

Mr Mungavin's trading of CFDs with CMC

145.Unfortunately, Mr Mungavin suffered a flood at his home in around 2008 that destroyed a number of his personal and financial records. He remembers opening an account with CMC in around 2004 and, although we were not shown account opening documents, we have accepted that since records that Mr Mungavin has obtained from CMC show that he was effecting online transactions in CFDs from 11 January 2005.

[20] Indeed Mr Mungavin's witness statement in these proceedings was extremely short and said little more than that he agreed with what Mr Worsfold had said in his witness statement.

146. Between January 2005 and April 2005, Mr Mungavin paid some £68,000 into his account with CMC to use as margin for CFD transactions on CMC's platform. The CFD transactions that he entered into over this period had the following characteristics:

(1) Typically, they involved Mr Mungavin taking either a "long" position or a "short" position over either FT-SE 100 or the US30 index. (He also took some positions on individual stocks and also entered into foreign currency transactions, but the transactions involving the FT-SE 100 and US30 indices were by far the most numerous).

(2) Over the period, he entered into around 158 individual contracts of purchase or sale of CFDs[21]. Because he was trading on a 1% margin, he did not need to invest large amounts of his personal capital in those transactions. However, a number of his transactions involved him in taking on a large exposure to particular indices. For example, he would frequently take a position in 50 (or even more) contracts over a particular index and, with the FT-SE index standing at around 5,000 during the period in question, a purchase of 50 contracts over FT-SE involved him investing a notional £250,000 in FT-SE (even though, to make such an investment, he would need only have £2,500 standing to the credit of his account to serve as his 1% margin). Similarly, between 11 and 18 March 2005, Mr Mungavin bought 250 contracts over the US30 index which, given the level of the US30 index at that time, gave him an aggregate exposure to the index of some $2.6 million (although again, he only needed available margin of 1% of this figure to acquire such an exposure).

(3) As well as the 158 transactions referred to above, there were 89 occasions in the period on which Mr Mungavin left a CFD position open overnight with the result that the CFD was "marked to market" as described at [25].

(4) Over the period on almost every weekday, Mr Mungavin would be purchasing or selling CFDs over the CMC platform. Typically he would effect four or five transactions a day but almost never did he make more than 10 transactions in a day[22].

(5) Mr Mungavin did not keep his CFD positions open for very long. Many CFDs were closed out within the same business day sometimes within minutes of being entered into. Few positions were kept open for more than a few days.

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[21] The parties had different ways of describing the number of transactions entered into. Mr Mungavin described transactions by reference to the number of underlying contracts that were the subject of a CFD. So, for example, in the month of January 2005, he said that he had traded 544 contracts. In reaching that total he treated a CFD over 10 FT-SE 100 contracts as contributing 10 contracts to the total. By contrast, Officer Bradley in his witness evidence, focused on the number of individual transactions, concluding, for example, that Mr Mungavin effected 51 transactions in the month of January (with a purchase of 10 FT-SE 100 contracts counting as a single transaction for these purposes). The figure of 158 therefore represents the total transactions made (using Officer Bradley's methodology).

[22] On 15 April 2005, Mr Mungavin entered into 13 separate transactions.

(6) Even though Mr Mungavin was, on many days, making large notional investments in the US30 or FT-SE, the fact that he tended to keep those positions open for a short period of time meant that his scope for profit or loss was correspondingly reduced. However, given that he was often taking large aggregate positions in the indices, there was still scope for large profits or losses to arise over a short period of time. Therefore, although there were many occasions on which transactions resulted in profits or losses that could be measured in the tens of pounds or dollars, there were some days on which profits or losses could be measured in thousands of pounds or dollars. In March 2005, for example, Mr Mungavin's transactions involving the US30 index produced large profits and losses. There were a number of individual transactions over this index that produced profits in excess of $5,000 (and one transaction produced a profit of $36,512 which was the largest profit on an individual transaction that Mr Mungavin made over the entire period). A number of transactions also produced large losses, several of which were over $10,000. Mr Mungavin calculated that, in this month, he made a loss of nearly $50,000 on his US30 index transactions in March 2005.

(7) In April 2015, the risk inherent in Mr Mungavin's CFD transactions was further brought home. On 4 April 2005, CMC calculated that, following movements in the markets, he needed to have free equity in his account of £17,459.83 to provide the 1% margin for the various CFD transactions that were open on that date. However, he only had £11,361.26 in his account available for the purposes of providing margin. CMC sent him an email at 14.27 on 4 April 2005 requiring him to provide the additional margin required of £6,098.57. When he had not done so by 15.21 on the same day, CMC sold 270 contracts that Mr Mungavin had open over the USD index for a notional price of $2,795,580 with the result that Mr Mungavin realised a loss of $13,581. Mr Mungavin made further significant losses in the month of April 2005.

147. In May 2005, Mr Mungavin continued to buy and sell CFDs in his CMC account. After the volatility and losses of April 2005, profits and losses were much more modest, not least because Mr Mungavin was dealing in smaller quantities of CFDs and undertaking fewer transactions. By the end of May 2005, Mr Mungavin concluded that the capital he had invested in his CMC account had been "wiped out" and he did not wish to undertake any further transactions over the CMC platform.

148. Mr Mungavin's strategy when buying and selling online CFDs was similar in nature to that of Mr Worsfold, though they tended to buy CFDs referencing different indices. First thing in the morning at work they would discuss the market, consider financial articles on the internet and discuss possibilities as to what CFDs they might acquire that day. In cross-examination when asked how he expected to make a profit from his online CFD activity Mr Mungavin said:

> Through trading and making as sophisticated a conclusion [on] a particular day in the market as I could, discuss it with other friends and colleagues, read the financial press, see what's happening in the world and then take a view.

Mr Mungavin's transactions with Pendulum

149.Our findings as to the terms of the specific transactions that Mr Mungavin entered into with Pendulum are set out at Appendix Three. Like Mr Worsfold, Mr Mungavin did not himself propose relevant Index Target Levels to Pendulum but adopted suggestions that had been made to him by either Pendulum or Montpelier.

150.Mr Mungavin had not heard of Pendulum before he entered into the Pendulum CFD. He performed no specific due diligence on Pendulum (for example as to whether it could be expected to honour its financial obligations). He was, however, reassured by the fact that Mr Worsfold was happy to deal with Pendulum.

151.Mr Mungavin shared the same misunderstanding as Mr Worsfold as to the amount that he would receive in respect of the Pendulum CFD if it was successful in Phases Two to Five. Like Mr Worsfold, he was unaware that there was a fundamental ambiguity in his contract as to the amount that he would receive if the Pendulum CFD was successful at Phases Two to Five.

152.We have concluded that Mr Worsfold entered into a Professional Services Agreement as summarised at [125]. Since Montpelier dealt with Mr Mungavin and Mr Worsfold as a "unit" (although they communicated largely with Mr Worsfold alone), we have concluded that Mr Mungavin would also have entered into such an agreement and that the terms of that agreement would be similar to those summarised at [124] above.

153.Mr Mungavin did not mention, either in his witness statement, or his oral evidence any statistical or other analysis that he performed to assess the likelihood of profit on his Pendulum CFD. We have inferred that he performed no such analysis. Mr Mungavin said in his evidence that he thought he had a very good opportunity to make a profit at Phase One and, even if he failed to do so, he thought that Phase Two kept him "still in the picture". He had much less confidence that the Pendulum CFD would produce a profit if it went into Phase Three or beyond.

154. At some point Pendulum sent Mr Mungavin a document headed "Calculation for Offers to Repurchase CFDs". That document specified a "valuation date" of 5 April 2015 and stated that the "valuation" of Mr Mungavin's CFD was £4,653 as that date and summarised certain assumptions on which that valuation was based. Therefore, in this document Pendulum was either "valuing" Mr Mungavin's Pendulum CFD at £4,653, just 1.6% of its Issue Value or was offering to buy it back from Mr Mungavin for this price. Mr Mungavin said in his evidence that he had never seen this document before and was unable to say whether it had been used to calculate the loss claimed in his tax return for 2004-05. We will make due allowance for the passage of time and will not conclude that Mr Mungavin was telling a deliberate untruth in this evidence. However, as we have concluded, Mr Mungavin was expecting to make a trading loss in 2004-05 from his Pendulum CFD and the low valuation from Pendulum was needed in order to substantiate his claim to that loss. We have therefore concluded that Mr Mungavin did see Pendulum's repurchase offer and either used it himself to calculate the trading loss that he claimed or asked his accountants to do so.

155.In cross-examination, Mr Mungavin was asked whether he was concerned that, just five days after he had entered into his Pendulum CFD, Pendulum were prepared to buy it back for just 1.6% of its face value. Mr Mungavin affected to be stoical saying that "I entered into an arrangement and the market moved in the wrong way for me". However, in a letter of 29 August 2008, HMRC pointed out to Mr Mungavin that the level of FT-SE, which drove returns on the Pendulum CFD, was 4,900 on 30 March 2005 and 4,942 on 5 April 2005. Neither party referred us to primary evidence of the levels of FT-SE at various points. However, Mr Mungavin responded in detail to HMRC's letter on 30 September 2008. If HMRC's statement about FT-SE levels was inaccurate, Mr Mungavin would have said so. We have therefore concluded that HMRC's statement as to the levels of FT-SE was correct and movements in FT-SE could not have explained such a dramatic reduction in value of Mr Mungavin's Pendulum CFD. We have concluded that the answer Mr Mungavin gave in cross-examination was misleading; he was not concerned with Pendulum's low valuation because that was precisely the result he was expecting in order to obtain the desired tax loss.

Mr Mungavin's approach to his tax returns and HMRC's enquiries

156.Mr Mungavin's witness statement contained no detail on the steps that he took to satisfy himself that his tax return for 2004-05 was correct. In cross-examination he accepted that he obtained no independent advice in connection with the contract. In interview with HMRC on 11 March 2014, Mr Mungavin explained that Pembroke Consulting (who, as noted, acted as auditor of the various companies that Mr Mungavin owned with Mr Worsfold) had offered some advice as to how the trading loss could be used after it had arisen. However, we have concluded from Mr Mungavin's evidence that he obtained no advice on the threshold question of whether there was a trading loss in the first place. Rather, Mr Mungavin concluded that it was proper for him to claim a trading loss in connection with his CFD transactions in his tax return for 2004-05 because Mr Worsfold was doing so.[23]

157.Mr Mungavin submitted his tax return for 2004-05 in-time on 30 January 2006. He filled in the self-employment pages for a trade that he referred to as that of a "derivative trader". He claimed a loss in that trade of £348,850 and claimed to set the entirety of that loss "sideways" against other taxable income for 2004-05. He made a disclosure in the "white space" of his tax return that separated out the gross profits from his averred trading activities, but made no disclosure to the effect that there was any doubt as to whether he was carrying on a trade or whether the loss was relievable.

158.On 19 January 2007, HMRC opened an enquiry into Mr Mungavin's return for 2004-05. During their enquiry, HMRC asked for significant quantities of documentation and information and we have concluded that, in general, Mr Mungavin co-operated with HMRC's requests although he refused HMRC's requests for a meeting preferring, instead, to deal with questions in writing.

[23] Indeed, when asked in cross examination whether he obtained independent advice in relation to the Pendulum CFD, Mr Mungavin's answer was "What, over and above Mr Worsfold?" which demonstrates the extent to which he was relying on Mr Worsfold's assessment.

159.On 13 January 2009, HMRC issued a closure notice closing their enquiry concluding that none of the losses claimed were deductible. Mr Mungavin sent an in-time notice of appeal to HMRC on or around 28 January 2009. Some further discussions with HMRC evidently ensued. On 1 February 2010, HMRC sent Mr Mungavin a "view of the matter" letter in which they confirmed the conclusions expressed in their closure notice and offered a review. Mr Mungavin accepted the offer of a review and on 31 March 2010 HMRC upheld their conclusion on review. We were not able to determine when Mr Mungavin notified his appeal against the closure notice to the Tribunal but, since HMRC have made no submission to the effect that notification was late, we are proceeding on the basis that Mr Mungavin made an in-time appeal. To the extent he has not, we give him permission to notify his appeal to the Tribunal late.

160.HMRC started enquiries under Code of Practice 9 in relation to Mr Mungavin, just as they had with Mr Worsfold and Mr Thomson. Like the other two appellants, Mr Mungavin declined to admit fraud under the contractual disclosure facility and was vindicated in that decision because ultimately HMRC accepted that he had not been involved in tax fraud. As we have noted, Mr Mungavin attended a meeting (together with Mr Worsfold) to discuss both the Pendulum arrangements and his tax position generally.

161.We have concluded that Mr Mungavin also gave misleading answers to some of HMRC's questions. Like Mr Worsfold, he asserted that he was not aware of the ability to claim loss relief for losses on the Pendulum CFD until after that contract was unsuccessful at Phase One. As we have noted, that was untrue: the whole point of the Pendulum arrangement was to produce a relievable trading loss and Mr Mungavin must have been aware of that. He also stated that the motive to start buying and selling CFDs was to produce a separate source of income. That was misleading by omission. Mr Mungavin may have been attracted by the idea of earning income from trading CFDs but the overriding reason why he started doing so was to "establish" a financial trade so that he could ultimately claim a trading loss on the Pendulum CFD.

162.HMRC's Code of Practice 9 enquiry into Mr Mungavin's arrangements followed much the same path as that into Mr Worsfold and HMRC ultimately accepted that Mr Mungavin had not been involved in tax fraud. HMRC and Mr Mungavin reached no agreement during that enquiry and, on 28 November 2014, HMRC issued Mr Mungavin with a penalty determination. They calculated an applicable penalty percentage of 55% using exactly the same methodology that they had used to calculate the same penalty percentage for Mr Worsfold. They applied that penalty percentage to the additional income tax that they determined would have been payable had Mr Mungavin's return for 2004-05 been correct (£86,204) and concluded that Mr Mungavin owed a penalty of £47,412.

163.Mr Mungavin made an in-time appeal against HMRC's penalty determination on 15 December 2014. Following a request for a review, HMRC wrote to Mr Mungavin on 15 April 2015 to confirm that their decision remained unchanged. Mr Mungavin notified his appeal to the Tribunal on 7 May 2015 (within the applicable time limit) and in due course, the Tribunal directed that his appeals against the closure notice and penalty should be consolidated.

PART FIVE – THE LAW RELEVANT TO THESE APPEALS

164. These appeals relate to matters that took place several years ago and therefore the applicable legal provisions are largely found in ICTA rather than in the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA") and the Income Tax Act 2007 ("ITA 2007") which have effect now.

Relief for trading losses

165. At times relevant to these appeals, s380 of ICTA allowed taxpayers to claim relief for losses incurred in a trade by setting that loss against other taxable income arising in the same, or preceding, year. It provided, relevantly, as follows:

> **380 Set-off against general income**
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> (1) Where in any year of assessment any person sustains a loss in any trade, profession, vocation or employment carried on by him either solely or in partnership, he may, by notice given within twelve months from the 31st January next following that year, make a claim for relief from income tax on—
>
> (a) so much of his income for that year as is equal to the amount of the loss or, where it is less than that amount, the whole of that income; or
>
> (b) so much of his income for the last preceding year as is equal to that amount or, where it is less than that amount, the whole of that income;
>
> but relief shall not be given for the loss or the same part of the loss both under paragraph (a) and under paragraph (b) above.

166. Section 384 of ICTA set out conditions that needed to be met for a loss to be relievable under s380 providing, so far as relevant, as follows:

> **384 Restrictions on right of set-off**
>
> (1) Subject to subsection (2) below, a loss shall not be available for relief under section 380 unless, for the year of assessment in which the loss is claimed to have been sustained, the trade was being carried on on a commercial basis and with a view to the realisation of profits in the trade or, where the carrying on of the trade formed part of a larger undertaking, in the undertaking as a whole.
>
> …
>
> (9) Where at any time a trade is carried on so as to afford a reasonable expectation of profit, it shall be treated for the purposes of subsection (1) above with a view to the realisation of profits.

167. Thus, very broadly, the combined effect of s380 and s384 of ICTA is that, where a taxpayer incurs a loss in a trade in a particular year, that loss can be set off against other taxable income arising in the same year, or the previous year, but only where the requirements of s384 are met.

168. As the Upper Tribunal noted in *Seven Individuals v Revenue & Customs Commissioners* [2017] STC 874, s384 imposes two requirements. The first requirement

(which the Upper Tribunal referred to as the "commerciality limb") is that the trade must be carried on on a commercial basis. The second requirement (which the Upper Tribunal referred to as the "profits limb") is that the trade must be carried on with a view to the realisation of profits in the trade. The deeming provision in s384(9) of ICTA means that the profits limb can be satisfied if the trade is carried on so as to afford a reasonable expectation of profit. However, it does not follow from this that if the requirements of s384(9) are not met, the profits limb is necessarily not satisfied.

169.Section 381 contains a special regime that affords relief for losses arising in the early years of trade. Mr Thomson, but not the other appellants, made a claim for relief under this section. Section 381, as in force at the material times, provided relevantly as follows:

> **381 Further relief for individuals for losses in early years of trade**
>
> (1) Where an individual carrying on a trade sustains a loss in the trade in—
>
> (a) the year of assessment in which it is first carried on by him; or
>
> (b) any of the next three preceding years of assessment;
>
> he may, by notice given on or before the first anniversary of the 31st January next following the year of assessment in which the loss is sustained, make a claim for relief under this section.
>
> (2) Subject to section 492 and this section, relief shall be given under subsection (1) above from income tax on so much of the claimant's income as is equal to the amount of the loss or, where it is less than that amount, the whole of that income, being income for the three years of assessment last preceding that in which the loss is sustained, taking income for an earlier year before income for a later year.
>
> …
>
> (4) Relief shall not be given under subsection (1) above in respect of a loss sustained in any period unless the trade was carried on throughout that period on a commercial basis and in such a way that profits in the trade (or, where the carrying on of the trade forms part of a larger undertaking, in the undertaking as a whole) could reasonably be expected to be realised in that period or within a reasonable time thereafter.

170. Section 384 of ICTA does not apply for the purposes of s381. However, as the Upper Tribunal noted in *Seven Individuals v HMRC*, s381(4) contains its own "commerciality limb" which has a similar effect to the commerciality limb contained in s384(1). It also contains a profits limb which is drafted in different terms and has a different effect from that in s384(1).

171. The provisions set out above set out the conditions that must be met in order for loss relief to be available. The statutory provisions referred to below deal with how any loss is to be calculated.

172. Section 42(1) of Finance Act 1998 ("FA 1998"), which applied for income tax purposes for the 2004-05 tax year and is thus relevant to the appeals of Mr Worsfold and Mr Mungavin, provided for profits and losses to be calculated by reference to generally accepted accounting practice as follows:

> **42 Computation of profits of trade, profession or vocation**
>
> (1) For the purposes of Case I or II of Schedule D the profits of a trade, profession or vocation must be computed in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in computing profits for those purposes.

173. For the 2005-06 tax year, s42 of FA 1998 no longer had effect for income tax purposes and thus is not relevant to Mr Thomson's appeal. However, s42 of FA 1998 was rewritten as s25 of ITTOIA which makes identical provision as follows:

> **25 Generally accepted accounting practice**
>
> (1) The profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for income tax purposes.

The law relating to the penalties

174. The basic provision authorising the imposition of penalties in the case of inaccurate returns was, at the material times, contained in s95 of TMA 1970[24] which provided as follows:

> **95 Incorrect return or accounts for income tax or capital gains tax**
>
> (1) Where a person fraudulently or negligently—
>
> (a) delivers any incorrect return of a kind mentioned in section 8 or 8A of this Act (or either of those sections as extended by section 12 of this Act . . .), or
>
> (b) makes any incorrect return, statement or declaration in connection with any claim for any allowance, deduction or relief in respect of income tax or capital gains tax, or
>
> (c) submits to an inspector or the Board or any Commissioners any incorrect accounts in connection with the ascertainment of his liability to income tax or capital gains tax,
>
> he shall be liable to a penalty not exceeding the amount of the difference specified in subsection (2) below.
>
> (2) The difference is that between—

[24] Pursuant to s16 of the Social Security and Contributions Act 1992, a penalty under s95 of TMA 1970 and the associated right of appeal against any such applies to Class 4 National Insurance Contributions in the same way as it applies to income tax.

(a) the amount of income tax and capital gains tax payable for the relevant years of assessment by the said person (including any amount of income tax deducted at source and not repayable), and

(b) the amount which would have been the amount so payable if the return, statement, declaration or accounts as made or submitted by him had been correct.

(3) The relevant years of assessment for the purposes of this section are, in relation to anything delivered, made or submitted in any year of assessment, that, the next following, and any preceding year of assessment.

175. Section 100 of TMA 1970 provides for an officer of HMRC to determine the amount of penalty.

176. The relevant right of appeal against the penalties is set out in s100B of TMA 1970 as follows:

100B Appeals against penalty determinations

(1) An appeal may be brought against the determination of a penalty under section 100 above and, subject to sections 93, 93A and 95A of this Act and the following provisions of this section, the provisions of this Act relating to appeals shall have effect in relation to an appeal against such a determination as they have effect in relation to an appeal against an assessment to tax.

(2) Subject to sections 93(8) and 93A(7) of this Act on an appeal against the determination of a penalty under section 100 above section 50(6) to (8) of this Act shall not apply but—

(a) in the case of a penalty which is required to be of a particular amount, the Commissioners may—

(i) if it appears to them that no penalty has been incurred, set the determination aside,

(ii) if the amount determined appears to them to be correct, confirm the determination, or

(iii) if the amount determined appears to them to be incorrect, increase or reduce it to the correct amount,

(b) in the case of any other penalty, the Commissioners may—

(i) if it appears to them that no penalty has been incurred, set the determination aside,

(ii) if the amount determined appears to them to be appropriate, confirm the determination,

(iii) if the amount determined appears to them to be excessive, reduce it to such other amount (including nil) as they consider appropriate, or

> (iv) if the amount determined appears to them to be insufficient, increase it to such amount not exceeding the permitted maximum as they consider appropriate[25].

Case law authorities on meaning of "trade", "commercial basis", "view to realisation of profit" and "reasonable expectation of profit"

Meaning of "trade"

177. The statutory definition of "trade" is not very revealing. Section 832 of ICTA provides that:

> 'trade' includes every trade, manufacture, adventure or concern in the nature of trade.

178. Common law does not provide a comprehensive definition of "trade". Rather, as Etherton LJ noted in *Eclipse Film Partners (No 35) LLP v HMRC* [2015] STC 1429, determination of whether a trade exists involves a mixed question of fact and law. Etherton LJ said, at [112] of the reported judgment:

> The Income Tax Acts have never defined trade or trading further than to provide that (in the words of TA 1988, s 832(1) which was applicable to the relevant tax year) trade includes every trade, manufacture, adventure or concern in the nature of trade. As an ordinary word in the English language 'trade' has or has had a variety of meanings or shades of meaning. Its meaning in tax legislation is a matter of law. Whether or not a particular activity is a trade, within the meaning of the tax legislation, depends on the evaluation of the activity by the tribunal of fact. These propositions can be broken down into the following components. It is a matter of law whether some particular factual characteristic is capable of being an indication of trading activity. It is a matter of law whether a particular activity is capable of constituting a trade. Whether or not the particular activity in question constitutes a trade depends upon an evaluation of all the facts relating to it against the background of the applicable legal principles. To that extent the conclusion is one of fact, or, more accurately, it is an inference of fact from the primary facts found by the fact-finding tribunal.

179. Since the question of whether there is a trade will depend largely on matters of fact, previous court and Tribunal decisions are frequently of limited utility in determining whether a given activity amounts to a trade or not. However, the courts have given some guidance on the legal question, of what activities are capable, as a matter of law, of amounting to trades.

180. In *Ransom v Higgs* [1974] STC 539 at 553, Lord Wilberforce said:

[25] The above statutory provisions refer to the power of "the Commissioners" (of Inland Revenue) to reduce penalties on an appeal. However, it was common ground that, with the establishment of the First-tier Tribunal in 2009, and the enactment of the Tribunals Courts and Enforcement Act 2007, these provisions set out the powers of this Tribunal on the appeal against the penalties.

> 'Trade' cannot be precisely defined, but certain characteristics can be identified which trade normally has. Equally some indicia can be found which prevent a profit from being regarded as the profit of a trade sometimes the question whether an activity is to be found to be a trade becomes a matter of degree, of frequency, of organisation, even of intention, and in such cases it is for the fact finding body to decide on the evidence whether a line is passed The present is not such a case: it involves the question as one of recognition whether the characteristics of trade are sufficiently present. I do not think that we need here to get enmeshed in the intricacies—I am tempted to say sophistries—of primary or secondary facts or inferences. We are clearly in the realm of principle and of law.
>
> Trade involves, normally, the exchange of goods, or of services, for reward, not of all service, since some qualify as a profession, or employment, or vocation, but there must be something which the trade offers to provide by way of business. Trade, moreover, presupposes a customer (to this too there may be exceptions, but such is the norm), or, as it may be expressed, trade must be bilateral—you must trade with someone.

181.In the same case, Lord Morris of Borth-y-Gest quoted with approval the following dictum of Lord President Clyde in *ITC v Livingston* 11 TC 538 at 542:

> I think the test which must be used to determine whether a venture such as we are now considering is, or is not, "in the nature of trade" is whether the operations involved are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made.

182.In *Marson v Morton* [1986] STC 463, the High Court set out certain "badges of trade". An analysis of those "badges of trade" can be a useful approach to determining whether a trade is carried on. However, as that case itself recognises, the list is not a comprehensive statement and, at most, it provides common-sense guidance as to what conclusion is appropriate and that in each case it is necessary to "stand back and look at the whole picture". In *Eclipse Film Partners No 35 LLP v Revenue & Customs Commissioners* [2015] STC 1429, the Court of Appeal approached the question of whether a taxpayer was trading without referring to the "badges of trade" in circumstances where neither party argued its case by reference to the list. That was the position in this appeal and we, similarly, will not go through the "badges of trade" in detail but rather will consider conclusions that should be drawn from the facts as a whole.

183. The authorities do not outline a precise boundary between "speculation" and "trading". On one hand, some element of speculation, risk or uncertainty will be at the heart of many trading operations. For example, a retailer buys stock in the hope that it will be able to sell it at a profit, but cannot be sure whether this is possible. A film-maker may spend large sums making a film without knowing whether the public will be prepared to pay to see it in any numbers. However, activities that amount to pure speculation, without the application of a profit-making system, may not amount to the

carrying on of a trade. As Pennycuick J said in *Emanuel (Lewis) & Son Ltd v White (Inspector of Taxes)* 42 TC 369:

> 'The word "speculation" is not, I think, as a matter of language, an accurate antithesis either to the word "trade" or to the word "investment": either a trade or an investment may be speculative. On the other hand, it is certainly true, at any rate in the case of an individual, that he may carry out a whole range of financial activities which do not amount to a trade but which could equally not be described as an investment, even upon a short-term basis. These activities include betting and gambling in the narrow sense. They also include, it seems to me, all sorts of Stock Exchange transactions. For want of a better phrase, I will describe this class of activities as gambling transactions.

184.That approach was followed in *Salt v Chamberlain* [1979] STC 750 in which Oliver J said:

> Where the question is whether an individual engaged in speculative dealings in securities is carrying on a trade, the prima facie presumption would be… that he is not. It is for the fact-find tribunal to say whether the circumstances proved in evidence or admitted take the case out of the norm.

185. The courts have, on a number of occasions, considered situations where a taxpayer has entered into transactions for the purpose of avoiding, or reducing tax. A transaction or activity is not prevented from being of a "trading" character simply because the taxpayer enters into it for a purpose of avoiding tax. As Lord Morris of Borth-y-gest said in *FA & AB Ltd v Lupton* [1972] AC 634:

> But my Lords, once it is accepted, as it must be, that motive does not and cannot alter or transform the essential and factual nature of a transaction it must follow that it is the transaction itself and its form that must be examined. If the motive or hope of later obtaining a tax benefit is left out of account, the purchase of their shares by a dealer in shares and their later sale must unambiguously be classed as a trading transaction.

186.However, even though taxpayers' subjective motive of avoiding tax cannot "denature" a trading transaction, it is still necessary to examine whether the transaction is of a "trading" nature. Lord Morris continued his analysis in *Lupton* by saying:

> It is manifest that some transactions may be so affected or inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction. The result will be not that a trading transaction with unusual features is revealed but that there is an arrangement or scheme which cannot fairly be regarded as being a transaction in the trade of dealing in shares….
>
> There are, therefore cases, where, as Megarry J indicated [in the first instance decision], the fiscal element has so invaded the transaction itself that it is moulded and shaped by the fiscal elements. This was helpfully expressed by Megarry J as follows…:

> "If upon analysis it is found that the greater part of the transactions consists of elements for which there is some trading purpose or explanation (whether ordinary or extraordinary), then the presence of what I may call 'fiscal elements' inserted solely or mainly for the purposes of producing a fiscal benefit may not suffice to deprive the transaction of its trading status. The question is whether, viewed as a whole, the transaction is one that can be regarded as a trading transaction. If it is, then it will not be denatured merely because it was entered into with motives of reaping a fiscal advantage. Neither fiscal elements nor fiscal motives will prevent what in substance is a trading transaction from ranking as such. On the other hand, if the greater part of the transaction is explicable only on fiscal grounds, the mere presence of elements of trading will not suffice to translate the transaction into the realms of trading. In particular, if what is erected is predominantly an artificial structure, remove from trading, and fashioned so as to secure a tax advantage, the mere presence in that structure of certain elements which, by themselves could fairly be described as trading will not cast the cloak of trade over the whole structure."

187. In *Degorce v HMRC* [2016] STC 542, the Upper Tribunal characterised the distinction as being between:

> … the transaction which has the character of trading even though it may be motivated by tax considerations, and the transaction which, on proper analysis, is a tax-driven device which does not amount to trading at all.

Authorities on the interpretation of the "profits limb" and "commerciality limb" contained in s381 and s384 of ICTA

188. In *Samarkand Film Partnership (No 3) v Revenue & Customs Commissioners* [2017] STC 926, Henderson LJ concluded:

> … considerations of profitability cannot be determined from an assessment of the commerciality of a business. In my judgment it is wrong to regard the profitability and commerciality tests in the legislation as mutually exclusive and they necessarily overlap to an extent that will vary from case to case.

189. In *Seven Individuals v HMRC,* Nugee J having concluded that he was bound by the above statement decided, at [46] and [47] of the reported decision:

> The question whether … a trade is being carried on on commercial lines is not to my mind answered simply by a hope by the trader to make profits. A trade run on commercial lines seems to me to be a trade run in the way that commercially-minded people run trades. Commercially-minded people are those with a serious interest in profits, or to put it another way, those with a serious interest in making a commercial success of the trade. If therefore a trade is run in a way in which no-one seriously interested in profits (or seriously interested in making a commercial success of the trade) would run it, that trade is not being run on commercial lines.

> … In other words the concept of a trade carried on on commercial lines has an objective element to it, and cannot be satisfied by proof merely that the trade is well organised and that the trader had a purely subjective hope or desire to make a profit.

5 190. Guidance on the application of the commerciality limb can also be found in *Wannell v Rothwell (Inspector of Taxes)* [1996] STC 450.

> I was not shown any authority in which the court has considered the expression 'on a commercial basis', but it was suggested that the best guide is to view 'commercial' as the antithesis of 'uncommercial', and I do find that a useful approach. A trade may be conducted in an uncommercial way either because the terms of trade are uncommercial (for instance, the hobby market-gardening enterprise where the prices of fruit and vegetables do not realistically reflect the overheads and variable costs of the enterprise) or because the way in which the trade is conducted is uncommercial in other respects (for instance, the hobby art gallery or antique shop where the opening hours are unpredictable and depend simply on the owner's convenience). The distinction is between the serious trader who, whatever his shortcomings in skill, experience or capital, is seriously interested in profit, and the amateur or dilettante. There will no doubt be many difficult borderline cases well for the commissioners to decide; and such borderline cases could as well occur in Bond Street as at a car boot sale.

191. As noted above, the profits limb as applied for the purposes of s384 is somewhat different from that which applies for the purpose of s381 and I will therefore analyse these separately.

192. The profits limb set out in s381 of ICTA, which focuses on the period over which profits could "reasonably be expected" is clearly setting out an objective test and no particular difficulty arises from that.

193. The profits limb set out in s384 is more complicated. Having regard to the decision in *Seven Individuals v HMRC*, I have concluded that the profits limb in s384 operates as follows:

> (1) If a trade is carried on so as to afford a reasonable expectation of profit (an essentially objective test) then it satisfies the profits limb by virtue of the deeming provision in s384(9) of ICTA.
>
> (2) However, a trade does not have to satisfy the requirements of s384(9) in order to satisfy the profits limb. Section 384(9) is a deeming provision that sets out a sufficient, but not a necessary, condition for the profits limb to be satisfied.
>
> (3) If the trade is carried on with a "view to the realisation of profits" (within the meaning of s384(1)) it will also satisfy the profits limb. That test is, as Nugee J noted at [35] of *Seven Individuals v HMRC* "primarily at least" a subjective test that looks at the aim or purpose of the person carrying on the activity.

Decisions of the First-tier Tribunal

194. Both parties showed us authorities from the First-tier Tribunal as to how the "trading question" has been determined in particular cases. We regarded those as helpful explanations of how a fact-finding tribunal has approached the issue in particular cases. However, because those decisions are not binding on us and address factual issues rather than articulating distinct propositions of law, we will not quote from them in any detail in a decision which is already lengthy.

PART SIX – DISCUSSION

195. In order to determine these appeals, the Tribunal must determine the following issues in respect of each appellant[26]:

> (1) Whether he was carrying on a trade in the relevant tax years. (If he was not carrying on a trade, there can be no question of relief being given for a trading loss).
>
> (2) If he was trading, whether the trade was carried on on a commercial basis.
>
> (3) If he was trading on a commercial basis, whether he satisfied the “profits limb” of s384 of ICTA and, in Mr Thomson’s case, whether he satisfied the “profits limb” of s381of ICTA.
>
> (4) Whether he entered into his Pendulum CFD in the course of a trade. (If an appellant was trading, for example in CFDs online, but the Pendulum CFD was not entered into in the course of that trade, and did not itself amount to a trading transaction, an appellant could not claim trading loss relief for a loss incurred on the Pendulum CFD).
>
> (5) Whether the loss claimed in connection with the Pendulum CFD was correctly calculated in accordance with generally accepted accounting practice. (This question is academic, at least for the purposes of these appeals, if the appellants fail on any of questions (1) to (4) since in that case, the appellants will not be entitled to the reliefs that they have claimed, so the question of whether they have calculated their reliefs correctly would not arise.)
>
> (6) Whether he is liable to a penalty for negligently delivering a tax return.

196. In this section, we will answer Questions 1 to 4 and Question 6 in relation to each appellant separately. Question 5 raises accounting matters that are relevant to all appellants and so we will deal with it in its own section.

[26] The appellants did not answer a question which we posed in our directions of 27 April 2018 as to whether they agreed with HMRC’s formulation of the issues to be determined. We have therefore ourselves examined HMRC’s formulation critically before settling on the above list.

Discussion – Mr Thomson's appeal

Whether Mr Thomson was carrying on a trade

197. Mr Thomson clearly had an interest in the financial markets, but before 2005, his transactions in financial instruments involved him in buying and selling shares in the way that any private investor might, as demonstrated by the fact that he treated profits and losses on those sales as being subject to capital gains tax (and not income tax which would have been appropriate had he been trading in shares in prior tax years). Moreover, Mr Thomson had been an accountant for most of his working life. We do not consider that his five-week introductory course with Finspreads and his previous experience of purchasing and selling shares as investments would have given him the necessary expertise to conduct a trade of dealing in CFDs. As noted at [84], Mr Thomson accepted that he did not know how to value the Pendulum CFD and we have inferred that he lacked the expertise to value CFDs generally. The fact that Mr Thomson did not know how to value CFDs points firmly against the conclusion that he was trading in such instruments.

198. Because of his lack of expertise, Mr Thomson's purchases and sales of CFDs, whether with IG Index, Finspreads or Pendulum, were based on hunch and impression rather than rigorous financial or economic analysis, just as a private investor might make decisions. Mr Thomson was clearly aware of his lack of expertise: that is why his transactions in miniCFDs involved such modest amounts. His transactions with IG Index were more significant. Those transactions do have some characteristics of trading transactions: for example they were reasonably numerous. However, the fact that he bought and sold CFDs frequently is not determinative: rather Mr Thomson was simply making numerous speculative transactions that were not of a trading character. He paid only some £2,085 into his accounts with IFX and IG Index demonstrating that, even though he might transact frequently, he was not prepared, given his lack of expertise, to risk significant sums.

199. Mr Thomson's transactions on CFDs (whether online or with Pendulum) could only make a profit if his guess on the direction of the share prices or indices underlying his CFDs turned out to be correct. Because he did not have any particular skill or experience or large capital, he had no way of making money if markets moved in the "wrong" direction. For example, he could not buy CFDs in large quantities, break them up into smaller lots and sell them at a profit. He could not issue his own CFDs to provide a hedge and make a profit by reference to the margin between the sums he received to issue CFDs and the sums he had to pay to acquire CFDs. Therefore, he was engaged in pure speculation and at the mercy of the markets, making money if his chosen share prices or indices moved in one direction and losing money if they moved in the other. That activity did not involve the kind of risk that forms part of a trading venture; rather it was pure speculation that was very different from trading.

200. At the time he claimed to be trading in CFDs online, Mr Thomson was practising as an accountant. If he were truly trading in CFDs he would have needed to able to monitor market fluctuations frequently or risk losses if markets moved suddenly against him. However, given his professional practice, he could not do this.

201. Therefore, Mr Thomson had neither the time, nor the expertise to carry on a trade of dealing in CFDs and, unsurprisingly in the circumstances, the transactions that he effected lacked the hallmarks of trading transactions. Given our conclusions as to Mr Thomson's motives set out at [71], we agree with Ms Choudhury's submission that Mr Thomson was, in his online CFD transactions, seeking to give the appearance of trading.

202. For the reasons we have set out above, we have concluded that Mr Thomson did not carry on a trade of dealing in CFDs online or, in dealing with CFDs with Pendulum.

203. We have also concluded that the Pendulum CFD was not a one-off "adventure in the nature of trade" for the following reasons that are similar to those set out above:

(1) Mr Thomson used no particular skill or expertise when he decided to enter into the Pendulum CFD. He adopted the proposals of Pendulum or Montpelier as to the key financial terms of that CFD (for example the various index levels that would trigger a payout at Phases Two to Five) without performing any serious evaluation of his own as to the likelihood of the Pendulum CFD turning a profit.

(2) He was casual in his approach to the Pendulum CFD: for example paying his Initial Margin late and in failing to turn his mind to the precise terms and conditions of the Pendulum CFD on fundamental questions as to how much he would obtain if the Pendulum CFD terminated at Phases Two to Five.

(3) The Pendulum CFD also put Mr Thomson at the mercy of the markets in just the same way as the CFDs that Mr Thomson had entered into online. Phase One of the Pendulum CFD was pure speculation and offered a return that was analogous to the toss of a coin: if the Designated Swing Movement took place, Mr Thomson would double his money and receive a payment equal to the Initial Margin; if it did not then Mr Thomson would lose his Initial Margin[27]. Phases Two to Five of the Pendulum CFD similarly had no characteristics of a trading transaction and amounted to pure speculation.

(4) Once Mr Thomson's Pendulum CFD moved into Phase Two, he was potentially locked into a transaction that could last up to 25 years. That is much too long for the Pendulum CFD to be regarded as a trading transaction particularly since, as Mr Thomson accepted in cross-examination, there was nothing he could do in practice to control or limit his exposure (by for example acquiring a "stop loss" policy or selling the Pendulum CFD if he felt it was no longer likely to pay out)[28].

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[27] In fact, the return offered at Phase One was less favourable than betting on the toss of a coin. As we have concluded at Footnote 8, Mr Thomson's Pendulum CFD was much less than 50% likely to produce a profit at Phase 1, but Mr Thomson was only being offered the chance to double his money if it was successful.

[28] As we have noted, the Pendulum CFD was assignable, however, to assign it, Mr Thomson would need to find a willing purchaser.

204. Even if Mr Thomson's activities were completely unaffected by tax considerations, we would still have concluded that he was not carrying on a trade (or an adventure in the nature of trade). The tax considerations that shaped the entirety of Mr Thomson's activities involving CFDs (both with Pendulum and online) only reinforce that conclusion.

205. The most significant transaction that Mr Thomson entered into in connection with his averred financial trade was the Pendulum CFD. The whole structure of the Pendulum CFD was devised in order to produce a tax loss, which was not an economic loss (because it had been "ramped up" by the Bayridge Loan), for Mr Thomson and other users of the scheme. In order to "ramp up" the amount of tax loss that the arrangements produced, without a corresponding increase in economic loss, the Pendulum arrangements needed to contain the uncommercial Bayridge Loan which made the Pendulum arrangements a paradigm example of a "tax driven device". Since Mr Thomson only started buying and selling CFDs online so that he could give the appearance of trading, as a stepping stone to obtaining the loss on the Pendulum CFD, the entirety of his activity in CFDs (whether with Pendulum or online) was tainted. Therefore, applying the distinction set out in *Degorce* referred to at [187], this is not a case of Mr Thomson entering into trading transactions with a fiscal motive. Rather, the whole structure of Mr Thomson's averred trading in CFDs with both Pendulum and online was a tax-driven device ultimately designed to achieve his goal of making a relievable tax loss on the Pendulum CFD.

206. Our conclusion is that Mr Thomson was not carrying on a trade in 2005-06.

Commercial basis

207. Even if Mr Thomson were carrying on a trade, he did not carry it on on a commercial basis. Many of the points we have made at [197] to [206] are relevant to the question of whether any trade was carried on on a commercial basis, so we can express our conclusions on this issue quite briefly.

208. We do not consider that, in the words of Nugee J in *Seven Individuals v HMRC* Mr Thomson ran his CFD activity (including the activity of acquiring the Pendulum CFD) in a way someone "seriously interested in profit" would run it.

209. Someone "seriously interested in profit" would not engage in derivatives trading with such limited expertise in the area. We recognise that some derivatives traders will have more expertise than others. However, Mr Thomson did not have even the bare minimum expertise (for example the ability to value the commodity in which he said he was trading) that would be necessary to demonstrate a serious interest in profit. Similarly, someone "seriously interested in profit" would have ensured that they could devote much more time to the activity and keep abreast of market developments throughout any day on which they had positions open. No-one "seriously interested in profit" would have carried on CFD trading as a side-line to an accounting practice. Someone "seriously interested in profit" would not carry on an activity that amounted to pure speculation on movements in share prices and indices over short periods that was completely outside their control.

210. Mr Thomson was the kind of "amateur or dilettante" that the High Court referred to in the extract from *Wannell v Rothwell* referred to at [190]. He set store by the research that he performed before making a purchase or sale, but this was not different in substance from the kind of research that a private investor might make before investing surplus cash. Therefore, his evaluation of the likelihood of profit on both his online CFD trading and the Pendulum CFD was based largely on impression and intuition, albeit supplemented by some information from internet bulletin boards and such like, rather than rigorous analysis. Someone "seriously interested in profit" would have taken much more care to ground their decisions in objective analysis rather than just "having a feel for something".

211. We are prepared to accept that Mr Thomson hoped to make a profit from his transactions in CFDs in the narrow sense that, if offered a choice, he would prefer to make an economic profit from those activities than to make an economic loss. However, as we conclude in the next section dealing with the "profits limb", our overall conclusion is that, as a subjective matter, he was indifferent to whether his CFD transactions produced an economic profit or an economic loss. What was most important to him was that, once he had established a trade of dealing in CFDs (which he hoped to do without taking much risk), he could obtain the real prize which was the tax loss on the Pendulum CFD. That is a further reason why he was not conducting his activity in the way someone "seriously interested in profits" would.

212. We also consider that Mr Thomson's activity involving online CFDs lacked the scale necessary to be run on a "commercial basis". While the CFDs that he bought were volatile, Mr Thomson took such steps to control his risk that he could not have been interested in serious commercial profit. As we have found, he wanted to give the <u>appearance</u> of trading rather than actually running a trade on a commercial basis.

213. For those reasons, even if Mr Thomson was carrying on a trade, he did not do so on a commercial basis.

The profits limb

(a) Section 384 of ICTA

214. We do not consider that Mr Thomson carried on his transactions in CFDs "with a view to the realisation of profits" for the purposes of s384(1) of ICTA. As noted at [193(3)], this aspect of the test is primarily subjective and looks primarily at the intentions of the taxpayer concerned.

215. Mr Thomson did not enter into his CFD transactions for the purpose of making a profit. We have already given reasons for reaching a similar conclusion on other aspects of the trading question addressed elsewhere in this decision and, therefore, we will express those reasons briefly as follows:

(1) Mr Thomson's decision to start buying and selling CFDs was not motivated by a wish to make a profit. Rather, his motive was to obtain a tax loss from the Pendulum derivative.

(2) Mr Thomson engaged in online CFD transactions on a modest scale and ensured that his risk was carefully controlled. He did this, not to enhance the profit-making potential of those transactions but rather, to give the "appearance of trading" so that, when he entered into the Pendulum derivative the "loss" resulting would be eligible for relief as a trading loss.

(3) He performed little real analysis of the prospect of making a profit from his CFD transactions. His analysis of the Pendulum CFD, in particular, was surprisingly cursory given that he was, at least notionally, paying £325,000 to acquire rights under that contract. He accepted, substantially unmodified, Pendulum's suggestions for the index target levels and other financial terms relevant to the Pendulum CFD. He did not perform a detailed review of the financial terms of the Pendulum CFD with the result that he was not even aware that there was uncertainty as to how much he might receive if the Pendulum CFD was successful. Still less did he seek to resolve that uncertainty by discussions with Pendulum.

216.Nor could Mr Thomson's CFD activities offer a "reasonable expectation of profit" (so as to fall within the scope of the deeming provision in s384(9) of ICTA) for the following reasons:

(1) Someone with such little experience in CFD dealing as Mr Thomson, who was carrying on his activity while also practising as an accountant, could not reasonably expect to make a profit in a market where others with more expertise and more time were also participating.

(2) Little, if any, evidence was given that Mr Thomson's transactions in CFDs could reasonably be expected to produce a profit. Mr Thomson's online transactions in CFDs were based largely on hunch and impression and were not backed up by rigorous analysis.

(3) Mr Gittins made it clear that Pendulum thought that the Pendulum CFD, which was Mr Thomson's most significant individual CFD transaction, had little prospect of making a profit (since Pendulum thought it unnecessary to hedge even part of its exposure). We considered that Mr Gittins (and Pendulum) were much more experienced in the financial markets than Mr Thomson. If Pendulum and Mr Gittins thought that the Pendulum CFD was unlikely to produce a profit, we do not consider it is reasonable to assume that it would produce a profit over any reasonable timescale. Moreover, the amount that Mr Thomson invested in the Pendulum CFD dwarfed the scale of his online CFD transactions. There was no reasonable prospect of Mr Thomson's CFD transactions as a whole making a profit if the Pendulum CFD failed to do so.

(b) Section 381 of ICTA

217.We have concluded at [216] that Mr Thomson's CFD transactions had no reasonable expectation of profit. It follows that, for the purposes of s381(4) of ICTA, those transactions could not reasonably be expected to produce profits in the period in which he entered into them or within a reasonable time thereafter.

Whether the Pendulum CFD entered into in the course of any trade

218.Since Mr Thomson did not carry on any trade, the question of whether he entered into his Pendulum CFD in the course of a trade does not arise. We will nevertheless record our view that, if Mr Thomson had been carrying on a trade (consisting of dealing in CFDs online), his Pendulum CFD was not carried on in the course of that trade. That is broadly for the same reasons as outlined at [203] above. The Pendulum CFD did not itself have the hallmarks of trading and had a very different economic profile from that of CFDs he bought and sold online.

Discussion – Mr Thomson's appeal – the penalties

219.Mr Thomson, in his tax return for 2005-06 claimed to set a trading loss against other taxable income when he was not entitled to do so. He therefore delivered an incorrect return for the purposes of s95 of ICTA and, if he did so negligently (HMRC not alleging he did so fraudulently), he is liable to a penalty under s95. In this section, we determine whether the return was delivered negligently and, if so, the amount of penalty that is chargeable.

Negligence

220.We consider that the test of negligence is that set out by Judge Berner in *Anderson v HMRC* [2009] UKFTT 258 at [22]. In particular, it is necessary to consider

> …what a reasonable taxpayer, exercising reasonable diligence in the completion and submission of the return, would have done.

That formulation was cited with approval by the Upper Tribunal in *Colin Moore v HMRC* [2011] UKUT 239.

221.The burden is on HMRC to demonstrate that Mr Thomson negligently submitted an incorrect return applying the above test. We are in no doubt that they have discharged that burden.

222.First, Mr Thomson was a professional man who advised on tax matters. A reasonable tax professional in Mr Thomson's position would have realised that he was entering into arrangements that produced the apparently magical result of causing his tax liability on income he had received to disappear. He would have realised that the whole construct depended on the proposition that he was trading in derivatives despite lacking both the time and the skill to undertake such a trade. He would have realised, at the very least, that the proposition that he was carrying on a trade was debatable and required investigation and analysis.

223.Mr Thomson performed no material investigation or analysis. He did not check the law on what amounted to a trade himself. Nor did he instruct a professional to look at what he had actually done and express a view on whether it amounted to a trade, carried on on a commercial basis with a view to profit or not. Mr Thomson saw the opinion of Adrian Shipwright referred to at [48] in late 2004. That opinion would not, however, have given a reasonable taxpayer in Mr Thomson's position comfort that he was carrying on a trade on a commercial basis with a view to profit since the advice on this

issue was generic and did not take into account the actual transactions that Mr Thomson had effected.

224. If Mr Thomson had performed a proper analysis of the law and applied that to his own activities, it might have been reasonable for Mr Thomson to rely on his own belief that the Pendulum arrangements produced the relievable trading loss he was claiming. However, Mr Thomson performed no such proper analysis. Moreover, a reasonable tax professional would have realised that his own analysis of the efficacy of the arrangements might be influenced by a wish to obtain the tax saving that was being offered and taken particular care to ensure that, if he "advised himself" on the arrangements, his advice was appropriately objective and dispassionate. Mr Thomson took no such care. No doubt because he wanted to reduce his tax liability he performed only the most cursory analysis of the law before concluding that he could properly claim the loss. That falls short of taking reasonable care.

Mitigation

225. We have set out at [95] our conclusions as to how HMRC determined by how much to mitigate the penalties. We are not bound to follow HMRC's approach. Under s100B of TMA 1970, we have full power to determine the amount of penalty payable. Our jurisdiction is not, therefore, "supervisory" in the sense that we are limited to deciding whether HMRC applied their own policy reasonably.

226. We consider, however, that HMRC's approach in discounting penalties by reference to concepts of "disclosure", "seriousness" and "co-operation" is appropriate. That approach properly recognises, for example, that an early admission of a mistake should attract a reduction in penalty, that more serious errors should attract larger penalties and that, where a taxpayer is open and co-operative with HMRC in dealing with a dispute, that is a mitigating factor. Mr Thomson is not arguing that we should not refer to the three factors HMRC have identified, that we should give them different weight or that there are other factors we should take into account when deciding what level of penalty to set. We have concluded that HMRC have identified the relevant factors that should be considered when determining the level of a penalty that is chargeable and we will consider those factors. Moreover, we consider that the weighting that HMRC have given the relevant factors (up to 20% mitigation for "disclosure", up to 40% for "seriousness" and up to 40% for "co-operation") are correct and appropriate.

227. We agree that no mitigation of the penalty for "disclosure" is appropriate. Mr Thomson has argued that HMRC were seeking to put pressure on him to settle his dispute and admit that he had been involved in fraud as part of HMRC's enquiry under Code of Practice 9 and that their failure to give any discount for "disclosure" was effectively a "punishment" for him refusing to admit fraud. We do not agree. HMRC gave him no discount for "disclosure" because he made no disclosure to the effect that his return was incorrect. Having negligently submitted an incorrect tax return, in the face of weighty evidence to the contrary, he has continued to assert that his tax return was, in fact, correct. It is his prerogative to defend his return up until the point when it is finally determined to be wrong, but he cannot expect HMRC or the Tribunal to reduce

a penalty on the basis that he has made a disclosure of a mistake if he chooses to exercise that prerogative and argue that he made no mistake.

228. HMRC have decided to mitigate the penalty by 32.5% (out of a maximum of 40%) to reflect Mr Thomson's co-operation during their dispute. Put another way, HMRC are saying that Mr Thomson's co-operation was such as to attract 81.25% (32.5/40) of the maximum possible reduction. Mr Thomson has made few detailed submissions on this issue beyond noting that he co-operated "extensively" with HMRC's enquiry. We agree that Mr Thomson co-operated extensively. HMRC recognise this because they have given him a high discount for co-operation. Mr Thomson seems to feel that the discount should have been greater (though he has not specified what discount would be appropriate). Our conclusion is that a 32.5% discount for "co-operation" is appropriate and reflects Mr Thomson's extensive co-operation but also notes that throughout HMRC's enquiry Mr Thomson never explained clearly to HMRC that he participated in the Pendulum arrangements to secure a tax advantage.

229. HMRC have decided to mitigate the penalty by 25% (out of 40%) to reflect the "seriousness" of Mr Thomson's error. Put another way, HMRC consider that Mr Thomson should be given 62.5% (25/40) of the maximum reduction for serious which indicates that they consider his error was well below halfway up a scale of "seriousness".

230. Mr Thomson has made few if any submissions to why HMRC's view on this issue is incorrect and has not suggested an alternative approach to the question of seriousness. Our own impression is that HMRC's determination is correct. Mr Thomson's error involves negligence only and not fraud, so any determination of "seriousness" has to take that into account. That said, Mr Thomson is a professional man. At the time, he had a professional practice that involved giving others tax advice. He must have realised that the tax position he was advancing was, at the very least, debatable but he took no adequate steps to check that he could properly claim the losses at issue. Those losses were material and significantly reduced Mr Thomson's taxable income for the years at issue. Had HMRC not identified Mr Thomson's error, the exchequer would have suffered the loss of a significant sum of money. We therefore consider that Mr Thomson's error was at the upper end of the scale of seriousness for a taxpayer submitting a negligent return, but nowhere near the top of the scale of seriousness overall (since fraudulent actions are self-evidently more serious than negligence).

231. Overall, HMRC have charged Mr Thomson a penalty at 42.5% of the maximum. We consider that determination to be correct.

Discussion – Mr Worsfold's appeal – the trading issue

Whether Mr Worsfold was trading

232. Mr Worsfold was not carrying on any trade of dealing in CFDs in the 2004-5 tax year. Our reasons are broadly similar to those that we gave in the context of Mr Thomson's appeals and we will therefore summarise certain aspects of our reasoning only.

233.Like Mr Thomson, Mr Worsfold did not have the necessary expertise or skill to conduct such a trade. Until 2004-5, while he had an interest in financial markets, his experience of them had been limited to investing surplus funds from time to time in a "small way". His professional life would not have given him a deep knowledge of financial instruments or equipped him with the skills necessary to deal in them successfully. He did not even have the skills necessary to value the Pendulum CFD which points firmly against the conclusion that he was engaged in a trade that included dealing in that CFD.

234.Like Mr Thomson, Mr Worsfold did not have the time necessary to conduct a trade of dealing in CFDs. He entered into his first online CFDs in January 2005. At that time, he was still working three or four days a week and did not retire until September 2005. We accept that the Sunwheels business was failing and we have therefore concluded that Mr Worsfold had more time available to him than did Mr Thomson. However, the business was still busy enough for him to agree to defer his retirement. Moreover, he evidently did not have the time to check the status of the markets continuously through the day: his evidence at [117] suggest that he would check it at fixed intervals during the day. We regard that as inconsistent with the conduct of a trade in volatile CFDs whose price and value could move every second.

235.As with Mr Thomson, we have concluded that Mr Worsfold lacked the profit motive that would be characteristic of a person carrying on a trade. Like Mr Thomson, we have concluded at [111] that Mr Worsfold saw the activity of buying and selling online CFDs as a means of "establishing a financial trade" which would enable him to obtain the real prize of a loss on the Pendulum CFD at the end of the tax year. We accept that the scale of Mr Worsfold's transactions in online CFDs was greater than that of Mr Thomson. He may well have enjoyed the excitement of those transactions more than Mr Thomson and he did not seek to control his risk to the same extent that Mr Thomson did. However, that does not change the fact that Mr Worsfold regarded his transactions in online CFDs as a stepping stone in a tax avoidance scheme with the result that the ordinary motivation of a trader to make a profit was absent.

236.While Mr Worsfold's CFD activities had a greater scale than those of Mr Thomson, they remained purely speculative and like Mr Thomson, Mr Worsfold had no way of making money unless share prices and indices, over which he had no control, moved in a particular direction. He exhibited no more rigour in his analysis of possible transactions than Mr Thomson and ultimately was engaged in pure speculation that was the very different from trading.

237.Nor, for reasons that are identical to those outlined at [203] was the Pendulum CFD capable or amounting to a trading transaction either alone, or viewed together with the online CFD activity.

238.Therefore, based only on an analysis of the transactions that Mr Worsfold effected and his motivations for entering into those transactions, we would have concluded that he was not carrying on a trade of dealing in CFDs in the 2004-05 tax year. The principle set out in *Lupton* and *Degorce* serves only to reinforce that conclusion. The totality of

Mr Worsfold's transactions in CFDs, whether with Pendulum or online, was a "tax-driven device" designed to secure a tax loss that did not represent an economic loss.

Commercial basis

239.The points we have made at [207] to [212] above apply equally to Mr Worsfold. While the scale of Mr Worsfold's transactions in online CFDs was greater than the scale of Mr Thomson's transactions, he did not carry out those transactions in the way a person "seriously interested in profit" would.

The profits limb

240.Only the profits limb in s384 of ICTA is relevant to Mr Worsfold. The points that we have made at [214] to [216] apply equally to Mr Worsfold. He did not enter into his CFD transactions (whether with Pendulum or online) with a "view to profit" because he was not motivated by a subjective wish to make a profit from them. Of course, if he was offered a choice between making a commercial profit and making a commercial loss, he would have preferred to make a commercial profit. However, the real prize that he was seeking was a relievable tax loss on the Pendulum CFD. That conclusion is not affected by the fact that Mr Worsfold's online CFD transactions had a greater scale than those of Mr Thomson.

241. Similarly, as with Mr Thomson's transactions there could have been no reasonable expectation that Mr Worsfold's CFD transactions would produce a profit over any particular period. Mr Worsfold lacked the expertise for any expectation of profit to be reasonable. The analysis that Mr Worsfold put forward to justify his assertion that his CFD transactions could reasonably expect to be profitable was cursory and superficial. Merely keeping abreast of financial news daily, or even at regular intervals during a day, could not underpin a reasonable expectation of profit in connection with his online CFD activity when prices would move by the second. Nor could a rudimentary analysis of price/earnings ratios underpin a conclusion that it was reasonable to expect that the Pendulum CFD would produce a profit.

Discussion – Mr Worsfold's appeal – the penalties

Negligence

242.Mr Worsfold delivered an incorrect return for 2004-05 as he claimed relief for trading losses that was not available.

243.We are satisfied that Mr Worsfold negligently gave an incorrect return. Mr Worsfold did not himself have any significant knowledge of tax law. Therefore, we accept that he himself might not have realised that it was highly unlikely from the very beginning that his transactions in CFDs, whether online or with Pendulum, involved him carrying on a trade on a commercial basis with a view to a profit. However, a reasonable taxpayer in Mr Worsfold's position would have realised that he was participating in a tax avoidance scheme that produced the apparently magical result of eliminating his tax liability on a sizeable proportion of his income. A reasonable taxpayer in that position would have wanted some reassurance that the result contended for would be in accordance with the law.

244.As we have noted, Mr Worsfold's witness statement was lacking in any real detail as to the steps that he took to check he was entitled to the trading loss. He checked the GAAP treatment of the derivative with his accountant but did not say that he took any steps to check that he was indeed trading on a commercial basis with a view to profit. To check this point he would, at the very least, have had to go through, with someone experienced in tax matters, the detail of his CFD transactions (both online and with Pendulum) and his object in being party to those transactions. It would not have been a brief conversation and, if Mr Worsfold had checked the tax analysis, he would have remembered and he would have said so. Our conclusion, therefore, is that Mr Worsfold failed to take reasonable steps to check whether the tax loss that he was claiming was indeed due.

245.Mr Worsfold was much less knowledgeable about tax matters than Mr Thomson. We have, therefore, considered whether it was reasonable for him to conclude that because Montpelier had promoted the arrangements, and because Montpelier were knowledgeable on tax issues, the loss claimed was likely to be available. As we have noted, Mr Worsfold chose not to make any detailed submissions (whether in writing or orally) to explain why he had not been negligent (as is his prerogative given that the burden is on HMRC to establish negligence). However, while we can accept that Mr Worsfold might have assumed that Montpelier knew what they were doing, this assumption of itself does not amount to the taking of reasonable care in the preparation of his tax return. He knew, from his discussions with Montpelier, that for the Pendulum CFD to produce the desired tax loss, he first needed to establish a trade of dealing in CFDs. Therefore, he would have realised that, whether he had established such a trade would depend on what he actually did. He should, therefore, have realised that there could be no assurance, whether from Montpelier or anyone else, that the trading loss claimed was available without at least some analysis of the nature of his online CFD activity. As we have said, Mr Worsfold has not put forward any real evidence that he commissioned or understood any such analysis and without doing so, it was not reasonable for him to rely on a mere assumption that Montpelier must have considered the scheme to work.

Mitigation

246. For reasons that we have given in connection with Mr Thomson's appeal, we will approach the determination of the appropriate penalty by considering the factors that HMRC considered (even though we are not bound to do so).

247.Mr Worsfold's closing submissions make little reference to the penalty. It seems clear that he considers that HMRC were wrong to discount the penalty by only 30% for "co-operation" and that he should have been given some reduction for "disclosure". He has said nothing at all about the way HMRC have approached "seriousness".

248.For reasons that we have given in connection with Mr Thomson's appeal, we consider that no reduction for "disclosure" is appropriate.

249.HMRC mitigated the penalty by 30% (out of 40%) for "co-operation" which suggests that they consider he should be given 75% of the maximum reduction. We think that is appropriate. Mr Worsfold co-operated to a significant extent with HMRC's

enquiries and so should be given a significant reduction to reflect that. However, he has not told HMRC the full story about why he entered into the Pendulum derivative, or his online CFD activity, in the first place and indeed in his interview with HMRC made untrue statements about the importance of the tax loss. In those circumstances, a reduction of 30% for "co-operation" is appropriate.

250. HMRC have given a 15% reduction (out of 40%) by reference to the "seriousness" of Mr Worsfold's behaviour. Put another way, therefore, HMRC have concluded that Mr Worsfold's behaviour is well over halfway up a scale of seriousness. We think that approach overstates the seriousness of Mr Worsfold's actions. First, his tax return was not incorrect because of fraud on his part, so that necessarily limits the seriousness of his behaviour. Moreover, Mr Worsfold knew less about tax than did Mr Thomson. Consequently, while he has still fallen short of an objective standard, it would have been less obvious to him than it was to Mr Thomson that reassurance on the central question of whether he was trading on a commercial basis with a view to profit was necessary before he could reasonably submit a tax return claiming such a large trading loss from an artificial tax avoidance scheme.

251. Mr Worsfold's actions, therefore, were less serious than those of Mr Thomson. Since we are discounting Mr Thomson's penalty by 25% to take into account seriousness, we will discount Mr Worsfold's penalty by 30%.

252. Our overall conclusion, therefore, is that Mr Worsfold is liable to penalty that must be calculated by applying a penalty percentage of 40% (and not the 55% that HMRC have used). Our calculation is that the amount of penalty due thereby reduces from £41,929 to £30,493, but we will give the parties liberty to apply if they consider that arithmetic calculation is wrong.

Discussion – Mr Mungavin's appeal

Whether Mr Mungavin was carrying on a trade

253. Of the three appellants, Mr Mungavin's online CFD activities had the greatest scale and he took real risk in those activities, as demonstrated by the fact that, between January 2005 and April 2005, he lost a significant amount of money. Moreover, while he was ostensibly still working full-time at Sunwheels at the time he claimed to be trading in CFDs, we have concluded that he was putting less time into that business than was Mr Worsfold. Therefore, we have concluded that Mr Mungavin spent more time than the other appellants on his CFD activities.

254. Nevertheless, we have concluded that Mr Mungavin was not carrying on a trade in 2004-05. The reasons we have given for reaching a similar conclusion in Mr Worsfold's and Mr Thomson's appeals apply in just the same way to Mr Mungavin's appeal. We will not repeat all of those reasons but, in recognition of the fact Mr Mungavin's transactions in online CFDs had a somewhat greater scale than those of the other appellants will highlight particular points only.

255. While Mr Mungavin's CFD activities had a certain scale, they were not conducted in a way that someone carrying on a trade would conduct them. Mr Mungavin had

insufficient expertise to make sound judgements as to how to make a profit from online CFDs whose price would move by the second. His judgements were therefore amateurish and impressionistic and depended largely on information that he gleaned from reading the financial press and discussions with Mr Worsfold and others. Moreover, no amount of reading the financial press, and no scale of online CFD transactions, could alter the fact that Mr Mungavin's transactions were purely speculative. Like both other appellants, he could only make a profit if markets, over which he had no control, moved in a particular direction and he was therefore engaging in pure speculation that was very different from trading.

256. In addition, as with the other appellants, Mr Mungavin was not motivated by the same commercial considerations that would motivate someone carrying on a trade. Like both Mr Thomson and Mr Worsfold, he regarded his online CFD transactions as part of the process by which he would "establish a trade" so that he could secure a trading loss when he eventually acquired the Pendulum CFD. More than any of the other appellants, he was enthused by the process of establishing that trade, and he took more risks than the other appellants when seeking to establish the trade. However, his underlying motive for entering into his online CFD transactions was no different from that of Mr Thomson and Mr Worsfold: he viewed those transactions as a stepping stone to obtaining a tax loss.

257. Mr Mungavin's Pendulum CFD was in all material respects identical to that of Mr Worsfold. Therefore, the analysis at [237] applies to Mr Mungavin just as it did to Mr Worsfold. The Pendulum CFD, whether viewed on its own, or in conjunction with Mr Mungavin's online CFD activity, was not a trading transaction.

258. Finally, the principle articulated in *Lupton* and *Degorce* applies in just the same way to Mr Mungavin's activities as it does to those of the other appellants. His activities were part of the same contrived arrangements, far removed from the world of genuine trading, as those of the other appellants.

Commercial basis

259. We do not consider that Mr Mungavin carried on his activities on a commercial basis for reasons that we have set out at [207] to [211] in connection with Mr Thomson's appeals. The fact that Mr Mungavin's online CFD activities had a greater scale than those of Mr Thomson, and the fact that he devoted more time to them than did Mr Thomson does not alter our conclusion as Mr Mungavin simply did not conduct his activities in the way that someone seriously interested in profit would conduct them.

The profits limb

260. Only the profits limb set out in s384 of ICTA is relevant to Mr Mungavin. His transactions fail the profits limb for the same reason that Mr Worsfold's and Mr Thomson's transactions fail. To the points we have made at [214] to [216] we would only add that the fact Mr Mungavin made such a large loss in his online CFD dealings between January and April 2005 points firmly against the conclusion that those transactions had any reasonable prospect of making a profit. Moreover, Mr Mungavin did not even claim to have performed any evaluation of the prospects of the Pendulum CFD making a profit, so there is even less reason to expect that his Pendulum CFD

would make a profit than is present in connection with the other appellants' Pendulum CFDs.

Discussion – Mr Mungavin's appeal – the penalties

261.Mr Mungavin took no adequate steps to check that he was entitled to the tax relief that he was claiming. He was negligent in submitting an incorrect return for the same reasons that Mr Worsfold was negligent in submitting his return. In particular, we do not consider a reasonable taxpayer in Mr Mungavin's position would have assumed simply because his friend and business partner was claiming relief for trading losses that he could claim relief. Therefore, for reasons that are essentially the same as those we have given in connection with Mr Worsfold's appeal, we consider that Mr Mungavin was liable to a penalty under s95 of ICTA.

262.The next question is how much penalty should be charged. We consider that the factors relevant to the determination of Mr Mungavin's penalty are in all material respects the same as those relevant to Mr Worsfold's penalty. Our conclusion, therefore, for reasons that are essentially the same as those set out at [246] to [252], is that Mr Mungavin should be charged a penalty at the rate of 40%.

PART SEVEN – ACCOUNTING MATTERS

The relevance of accounting evidence

263.Section 42 of Finance Act 1998 (which is relevant to the appeals of Mr Mungavin and Mr Worsfold) and the rewritten version of that provision in s25 of ITTOIA (which is relevant to Mr Thomson's appeal) provide that any trading profit or loss that the appellants realise has to be determined in accordance with UK generally accepted accounting practice ("UK GAAP").

264.HMRC make the point in these appeals that, even if the appellants did suffer a trading loss in the tax years at issue, they have not calculated that loss in accordance with UK GAAP. Had UK GAAP been applied properly, HMRC argue that the trading loss would have been much smaller. We do not need to determine this issue because we have concluded that no appellant was carrying on a trade of dealing in derivatives and cannot, therefore, have realised any trading loss (however calculated). For completeness, we will nevertheless set out some conclusions on the accounting issues, though those conclusions will necessarily be more general than they would be if the appellants' appeals hinged on the correct accounting treatment.

The parties' respective positions

The appellants' position and evidence

265.Prior to the hearing of the appeal, only Mr Thomson relied on accounting evidence (from Mr Wiltcher). At the hearing, Ms Graham-Wells applied for that accounting evidence to be taken as applying to both Mr Worsfold and Mr Mungavin as well. HMRC objected to that application. However, since HMRC's expert (Mr Harrap) was proceeding on the basis that the accounting principles applicable to all three appellants were the same, we did not think that HMRC would be prejudiced if Mr Worsfold and Mr Mungavin were permitted (albeit belatedly) to rely on the same evidence that Mr

Thomson was relying on. We also gave the appellants permission to rely on evidence in the form of email exchanges between Mr Wiltcher and the Association of Chartered and Certified Accountants ("ACCA") and the Institute of Chartered Accountants of England and Wales ("ICAEW"). That evidence was served late, and Ms Choudhury objected to its late admission. However, on balance it seemed to us that it should be admitted as it was relevant and not prejudicial to HMRC to admit it late.

266. Therefore, all appellants relied on evidence from Mr Wiltcher and on the correspondence between him and the ACCA and ICAEW.

267. Mr Wiltcher is a Chartered Tax Adviser and chartered accountant. He has extensive experience in the preparation and audit of accounts prepared under UK GAAP. We therefore accepted he had the requisite experience to offer opinion evidence on UK GAAP.

268. Mr Wiltcher disclosed in his report that he is a managing partner of Greystone LLC which audits the accounts of Montpelier Group (Tax Consultants) Ltd. In cross-examination, he clarified this point. Greystone LLC had previously audited Montpelier Group (Tax Consultants) Limited, but Mr Wiltcher was not a partner involved in that audit. By the date of the hearing, the only company in the Montpelier group that Greystone LLC audited was Montpelier Trust and Corporate Services Limited and Mr Wiltcher was a partner involved in that audit. We had some concern as to whether Mr Wiltcher had the requisite independence to enjoy the special privilege of being permitted to give opinion evidence. However, on balance, and since Mr Harrap is himself an employee of HMRC as discussed below, we have decided that Mr Wiltcher was no less independent than Mr Harrap and that therefore both should be permitted to give expert opinion evidence.

269. However, although Mr Wiltcher is qualified to give independent expert opinion evidence, we found his report to fall short of the standard to be expected of expert evidence. The report was extremely short and, ignoring "boiler plate" wording amounted simply to a bare statement that Mr Thomson's accounts were in compliance with UK GAAP. He did not provide any reasons or refer to the precise provisions of "UK GAAP" (which embraces a large volume of material) on which he had relied. He was expressing an opinion on the accounting for Mr Thomson's transactions involving the Pendulum CFD and the Bayridge Loan but did not say in his report (and was not able to explain in cross-examination) precisely what documents he had seen. He said that he was expressing an opinion on Mr Worsfold's accounts, but accepted that he had not seen a copy of his profit and loss account. Crucially, Mr Wiltcher said nothing at all in his report about FRS5 which formed the backbone of Mr Harrap's analysis as to why the appellants' accounts had not been prepared in accordance with UK GAAP.

270. Our understanding of Mr Wiltcher's opinion, at a high level, is as follows:

(1) The appropriate accounting standard to follow was the Financial Reporting Standards for Small Entities ("FRSSE"). That is a cut-down version of UK GAAP that is relevant to the accounts of smaller entities.

(2) Applying FRSSE, Mr Thomson realised a loss on his Pendulum CFD equal to the difference between the cost of that CFD (£325,000) and its fair value at the end of the 2005-06 tax year of just £6,500[29]. A similar principle applied to Mr Mungavin and Mr Worsfold.

5 (3) Finance costs on the Bayridge Loan would not have affected the calculation of any appellant's profit or loss for the period.

(4) Even though the Bayridge Loan was on terms favourable to the appellants, that loan had no effect on the appellants' profit or loss for the period. That was because paragraph 12.3 of FRSSE requires borrowings
10 (such as the Bayridge Loan) to be initially stated in the balance sheet at the fair value of the consideration received. The consideration that the appellants received when they took out their Bayridge Loan was the discharge of their obligation to Pendulum to pay the Margin Call Balance. There was no requirement in FRSSE to ascertain the fair value of the
15 appellants' liability under the Bayridge Loan. Therefore, Mr Thomson's accounts should have initially recognised his Bayridge Loan as a liability of £308,750 (the amount of his Margin Call Balance) and, since finance costs were immaterial, that amount would never fall to be adjusted with the result that the Bayridge Loan did not affect Mr Thomson's profit and loss
20 computed under UK GAAP for the 2005-06 tax year. A similar principle applied to the other appellants.

(5) FRS5, on which Mr Harrap placed great emphasis, was relevant and applied. However, it did not alter the fundamental requirement in paragraph 12.3 of FRSSE that the Bayridge Loan be stated as a liability equal in
25 amount to the consideration that the appellants received. Therefore, FRS5 did not apply in the manner for which Mr Harrap argued.

HMRC's position and evidence

271. HMRC relied on expert evidence from Stephen Harrap. He has been a Fellow of the ICAEW since 1993. He is an employee of HMRC but he explained the steps that he
30 took generally, and in this appeal in particular, to offer dispassionate and independent expert evidence. We were prepared to allow him to give expert opinion evidence having heard his explanation of these issues.

272. Mr Harrap's expert report was much more comprehensive than that of Mr Wiltcher. It explained in considerable detail the view he had come to, the conclusions
35 underpinning that view and the particular aspects of UK GAAP that he had relied on in coming to his view. In very broad summary, Mr Harrap's view was as follows (using Mr Worsfold's transactions as an example):

(1) FRS5 was as applicable to the accounts of smaller entities prepared under FRSSE as it was to larger entities. It requires financial statements to
40 report the substance of transactions and, in particular, requires that a group

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[29] Mr Wiltcher was not asked to, and did not, express any opinion on whether this valuation was correct.

or series of transactions that achieves or is designed to achieve an overall commercial effect to be viewed as a whole. A key step in reporting the "substance" of any transaction is to identify its effect on assets and liabilities.

5 (2) The Pendulum CFD and the Bayridge Loan were a group or series of transactions that should be viewed as a whole. The substance of Mr Worsfold's transactions was that: (i) he reduced his assets (by paying £15,000 in cash by way of Initial Margin); and (ii) he increased his liabilities pursuant to the Bayridge Loan.

10 (3) Pendulum's valuation of Mr Worsfold's Pendulum CFD assessed the prospects of it paying out at Phase Two to Five as "negligible". Therefore, although the Bayridge Loan would become repayable early if the Pendulum CFD made a profit at any of Phases Two to Five, that possibility could be ignored, so it could be assumed that the Bayridge Loan would only become 15 repayable in 50 years' time.

(4) FRSSE requires borrowings to be stated at the fair value of the consideration received. The fair value of an interest free loan such as the Bayridge Loan with a 50-year term would not be its face value. Rather, he calculated that the fair value of the Bayridge Loan was around £3,611.

20 (5) Therefore, the change in Mr Worsfold's net assets as a consequence of entering into the composite arrangement was (i) his assets were reduced by £15,000 when he paid the Initial Margin to Bayridge; (ii) his liabilities were increased by £3,611 when he took on the Bayridge Loan; and (iii) in return for paying £15,000 and taking on the liability under the Bayridge Loan, Mr 25 Worsfold acquired the Pendulum CFD.

(6) The "cost "of Mr Worsfold's Pendulum CFD was, therefore £18,611 when acquired. If its value as at 5 April 2005 was just £4,653, the result was that a loss of £13,958 was realised on the Pendulum CFD. To that, Mr Harrap would add £1 representing the accretion of the fair value of the 30 Bayridge Loan towards the £285,000 ultimately repayable in 50 years' time. So Mr Harrap's opinion was that Mr Worsfold's true loss under UK GAAP was £13,959.

273. Mr Harrap said that a similar line of reasoning applied to the other appellants, albeit with slightly different figures. He calculated Mr Thomson's loss under UK GAAP as 35 £19,047 and Mr Mungavin's loss as £13,959.

Accounting issues – Discussion

274. We were confronted with sharply conflicting expert evidence. Moreover, neither expert had submitted written reports reflecting on the other's opinion[30]. There was no formal statement from the experts as to which matters they agreed on, on which areas

[30] During the hearing on 6 December 2017, HMRC requested permission to serve a further export report from Mr Harrap (which included a reflection on Mr Wiltcher's expert opinion as set out in his answers to questions in cross-examination). However, we decided that it was by then too late for further expert evidence to be served and refused permission (and have given our reasons separately).

they disagreed (or why). Mr Wiltcher expressed some views in his oral answers to questions in cross-examination as to why he regarded Mr Harrap's opinion as incorrect. Mr Harrap was not cross-examined by the appellants for reasons outlined at [6] above.

275. We regard this as a salutary lesson in how expert evidence should be given at the Tribunal. With hindsight, more exacting directions for expert evidence could usefully have been made. In fact, with hindsight, the Tribunal may well have derived much more assistance from the views of a single expert.

276. There is no real alternative to deciding between the two conflicting opinions that Mr Wiltcher and Mr Harrap have expressed[31]. It would not be feasible for us to read all relevant aspects of UK GAAP and come to our own view. The subject area is too technical for that: indeed that is precisely why the Tribunal would have been assisted from focused expert evidence.

277. We thought that both experts' opinions left questions unanswered. Neither fully satisfied us.

278. Mr Wiltcher's opinion suffered from the very considerable defect that his expert report contained few, if indeed any, reasons or analysis. His report simply did not address FRS5 which formed the entire cornerstone of Mr Harrap's analysis. Moreover, his conclusion (that all appellants had realised sizeable accounting losses in connection with the arrangements) seemed inconsistent with the substance of matters (which FRS5 required to be taken into account) since, as we have noted, the accounting loss that the appellants were recording was not an "economic loss" in any realistic sense. We attached little weight to the correspondence with the ACCA and ICAEW even though that correspondence tended to suggest that those professional bodies agreed with Mr Wiltcher's analysis. Since Mr Wiltcher's own expert report did not analyse the FRS5 point, we are not satisfied that he would have put the ACCA or ICAEW on notice of facts that made FRS5 relevant and so we are not satisfied that the ACCA or ICAEW would have taken this issue into account when expressing their opinion.

279. Mr Harrap's opinion seemed to us to contain a leap of logic that we never entirely understood. He acknowledged that paragraph 12.3 of FRSSE required the Bayridge Loan to be valued at the consideration <u>received</u>. Yet the reasons he gave as to why the Bayridge Loan should have been recorded at its (low) fair value focused on the low value of the consideration that the appellants were <u>giving</u> (i.e. the absence of a promise by the appellants to pay interest, and the fact that the appellants were obliged only to repay principal in 50 years' time). That, therefore, gave rise to the obvious question of precisely what consideration the appellants received under the Bayridge Loan. We understood Mr Harrap's opinion to be that, since the Bayridge Loan was always intended to be the only means by which the appellants would pay the Margin Call Balance, the appellants did not, applying a "substance over form" approach, have any separate obligation to pay the Margin Call Balance so the discharge of that obligation could not be regarded as the consideration received by the appellants and, instead, the

[31] Given that this issue does not actually need to be determined to decide this appeal we consider it would be disproportionate to require the parties to exchange further expert reports.

"consideration received" under the Bayridge Loan was the loan itself. Since we are used to analysing the concept of "consideration" in contractual terms, we found this explanation difficult to follow, although we are prepared to accept that is supportable in accounting terms.

5 280.As we have noted, we do not need to decide this issue in order to determine the appeal. However, if it were necessary, we would have concluded that, of the two opinions we were given, Mr Harrap's opinion was more likely to be correct with the result that, if the appellants were entitled to relief for trading losses, the amounts available for relief would be the much lower amounts that Mr Harrap calculated. While 10 we could not follow the entirety of his reasoning, his report was much more scholarly, and had clearly considered relevant issues in detail. The end result that Mr Harrap favoured (that, applying a "substance over form" approach, no appellant had made a loss on the Pendulum CFD) accorded with our own finding that the loss the appellants were claiming had been artificially "ramped up" by the Bayridge Loan. The fact that 15 Mr Wiltcher's report did not engage with FRS5 at all, together with its lack of rigour and reasoning, significantly reduced its weight. Moreover, Mr Wiltcher's conclusion seemed to us to be at odds with the "substance" of the transactions effected.

PART EIGHT – CONCLUSIONS

Our overall conclusion

20 281.All appellants' appeals against HMRC's closure notices are dismissed.

282.All of the appellants are liable to a penalty under s95 of ICTA as follows:

(1) Mr Thomson is liable to a penalty in the amount that HMRC have determined and his appeal against the penalty is dismissed.

(2) HMRC must recalculate Mr Mungavin's and Mr Worsfold's penalty on 25 the basis that the applicable penalty percentage is 40%, instead of 55%. The appeals of Mr Mungavin and Mr Worsfold against the penalty are allowed to that extent.

Effect of the appellants' failure to cross-examine Officer Bradley and Mr Harrap

283.It is clear that all of the appellants feel that they have been prejudiced by the fact 30 that they did not, through their choice of counsel, cross-examine Officer Bradley and Mr Harrap. However, for the reasons set out below, we do not consider that this has affected our overall determination of their appeals.

284.The appellants' claims for loss relief which is the subject of this appeal have failed because none of them was carrying on a trade, on a commercial basis, with a view to 35 profit. That in turn was because of the transactions that the appellants undertook and, where relevant, their subjective reasons for undertaking them. No evidence from Officer Bradley was needed to establish that the appellants' transactions lacked the hallmarks of trading: that was evident from the transactions themselves. Similarly, we did not need Officer Bradley's evidence to determine that the appellants all entered into 40 their CFD transactions online and with Pendulum in order to generate a tax loss that did not correspond to an economic loss as that emerged clearly both from the appellants'

dealings with Montpelier and the artificial nature of the Pendulum arrangements. Officer Bradley has given evidence that points in the same direction. However, the appellants would have failed in their appeals against HMRC's closure notices even if Officer Bradley had not given evidence at all[32].

285. As we have noted, Mr Harrap's evidence went to the amount of any tax loss that was available. Since we have concluded that the appellants were not entitled to relief for any tax loss, it was not necessary to hear evidence as to the amount of any tax loss. Therefore, the fact that Mr Harrap was not cross-examined by the appellants' chosen counsel has not altered the outcome of these appeals.

286. Turning to the penalties, Officer Bradley did not need to give evidence to establish that the appellants were negligent in the submission of their tax returns. The taxpayers' negligence was established by reference to their own failure to take reasonable care to establish the returns were correct. Officer Bradley explained the process that HMRC took to mitigating the penalties, but that was evident from the penalty notices themselves and the explanations accompanying them. As we have noted, we have considered for ourselves the extent to which the penalties should be reduced and therefore Officer Bradley's evidence has not had a material effect on the outcome of the appellants' appeals against penalties either.

Appeal rights

287. 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.

JONATHAN RICHARDS
TRIBUNAL JUDGE

RELEASE DATE: 16 JULY 2018

[32] Since HMRC issued closure notices under s28A of TMA 1970 (and not "discovery assessments" under s29 of TMA 1970), the burden is entirely on the appellants to demonstrate that the closure notices overstated their liability to tax.

APPENDIX ONE – DETAILS OF MR THOMSON'S TRANSACTIONS WITH PENDULUM

1. In or around March 2006 Mr Thomson and Pendulum entered into a Master Agreement (Version 10) containing template terms.

2. On 29 March 2006, Mr Thomson sent Pendulum an Offer to Trade offering to enter into a CFD on the terms of the Master Agreement with the following principal terms:

Designated Issue Value	£325,000
Designated Index	FT-SE 100
Phase One period	29 March 2006 to 4 April 2006
Designated Swing Movement[33]	Up by 165 points or down by 160 points
Initial Margin[34]	£16,250
Margin Call Balance[35]	£308,750

3. The Offer to Trade proposed that the following terms would apply if the contract was not successful at Phase One and moved into subsequent phases:

Phase	CFD period in years	Index Target Level	Profit as % of Issue Value
Phase Two	2	8,780	130%
Phase Three	7	11,340	210%
Phase Four	15	24,600	450%
Phase Five	25	63,050	1200%

4. On 29 March 2016, Pendulum sent Mr Thomson an Acceptance Confirmation Note accepting the offer that had been made in the CFD Offer to Trade, but making small changes to the Index Target Levels that Mr Thomson had proposed. The Acceptance Confirmation Note concluded by telling Mr Thomson that he had a binding contractual obligation pursuant to Clause 8.4.2 of the Master Agreement to pay the Initial Margin within 5 days.

5. Mr Thomson paid the Initial Margin late, on or around 2 May 2006, about a month after the contractual due date.

6. Also on 29 March 2016, Mr Thomson entered into a loan agreement with Bayridge having a principal amount of £308,750 having terms similar to those set out at [38] of this decision.

7. Mr Thomson's contract was not successful at Phase One. On 5 April 2006, the day following the end of Phase One, Pendulum sent Mr Thomson a notice requiring him to pay the margin call balance of £308,750 that was due. Mr Thomson's obligation to pay

[33] If FT-SE moved by more than this, the contract would be successful at Phase One. See paragraph [30(3)] of the main body of the decision.

[34] The amount that would need to be paid in cash on inception of the contract and which would determine the amount of return if the contract was successful at Phase One.

[35] The balance (Designated Issue Value less Initial Margin) that would need to be paid up if (as turned out to be the case) the CFD was not successful at Phase One and it moved into Phase Two.

the Margin Call Balance was discharged by means of the method of "book entries" outlined at [40].

8. Mr Thomson's Pendulum CFD did not achieve success in Phase Two or Phase Three. Therefore, his Pendulum CFD remained in existence as at the date of the hearing and his loan from Bayridge remained outstanding as at that date as well.

APPENDIX TWO – DETAILS OF MR WORSFOLD'S TRANSACTIONS WITH PENDULUM

1. In or around March 2005, Mr Worsfold and Pendulum entered into Version 9 of a Master Agreement setting out template terms.

2. On 30 March 2005, Mr Worsfold sent Pendulum an Offer to Trade offering to enter into a CFD on the terms of the Master Agreement with the following principal terms:

Designated Issue Value	£300,000
Designated Index	FT-SE 100
Phase One period	30 March 2005 to 4 April 2005
Designated Swing Movement[36]	Up by 110 points or down by 100 points
Initial Margin[37]	£15,000
Margin Call Balance[38]	£285,000

3. The Offer to Trade proposed that the following terms would apply if the contract was not successful at Phase One and moved into subsequent phases. Mr Worsfold accepted that he did not derive these numbers himself; they were supplied to him by Pendulum.

Phase	CFD period in years	Index Target Level	Profit as % of Issue Value
Phase Two	2	7,500	130%
Phase Three	7	9,700	210%
Phase Four	15	20,800	450%
Phase Five	25	54,000	1200%

4. On 30 March 2015, Pendulum sent Mr Worsfold an Acceptance Confirmation Note accepting the offer that had been made in the CFD Offer to Trade. The Acceptance Confirmation Note concluded by telling Mr Worsfold that he had a binding contractual obligation pursuant to Clause 8.4.2 of the Master Agreement to pay the Initial Margin within 5 days.

[36] If FT-SE moved by more than this, the contract would be successful at Phase One. See paragraph [30(3)] of the main body of the decision.

[37] The amount that would need to be paid in cash on inception of the contract and which would determine the amount of return if the contract was successful at Phase One

[38] The balance (Designated Issue Value less Initial Margin) that would need to be paid up if (as turned out to be the case) the CFD was not successful at Phase One and it moved into Phase Two.

5. Mr Worsfold paid the Initial Margin on or 24 May 2005, around six weeks after the contractual due date.

6. Also on 31 March 2015, Mr Worsfold entered into a loan agreement with Bayridge having terms similar to those set out at [39] of this decision.

7. Mr Worsfold's contract was not successful at Phase One. On 6 April 2005, two days following the end of Phase One, Pendulum sent Mr Worsfold a notice requiring him to pay the Margin Call Balance of £285,500 that was due. That obligation was discharged by means of the system of book entries described at [40].

APPENDIX THREE – DETAILS OF MR MUNGAVIN'S TRANSACTIONS WITH PENDULUM

1. The terms of Mr Mungavin's transactions with Pendulum were, in all material respects, the same as those of Mr Worsfold. The description in Appendix Two therefore applies in all material respects to the transactions that Mr Mungavin entered into. We will make only the following additional findings in relation to Mr Mungavin's transactions:

(1) Mr Mungavin did not produce a copy of the Master Agreement signed by Pendulum. However, we are satisfied that he and Pendulum did enter into a Master Agreement and CFDs under the terms of that Master Agreement not least since the parties' conduct was entirely consistent with them having entered into such an agreement.

(2) Mr Mungavin had not, prior to the hearing, produced a copy of a loan agreement with Bayridge. HMRC did not, therefore, accept that he had entered into such a loan. However, during the hearing, Mr Worsfold produced a copy of Mr Mungavin's signed agreement. He was evidently in the habit of dealing both with his own paperwork and that of Mr Mungavin (since they were friends and business parties) and we accept that somehow or other Mr Worsfold obtained a copy of Mr Mungavin's agreement with Bayridge but overlooked it. We have, therefore, accepted that Mr Mungavin entered into a loan agreement with Bayridge that was in all material respects the same as that between Mr Worsfold and Bayridge.

(3) Mr Mungavin has not produced any documentary evidence demonstrating that he paid the Initial Margin to Pendulum partly because the flood at his home in 2008 destroyed a lot of his financial records. We have, however, accepted that he did pay that Initial Margin as, had the Initial Margin not been paid, Pendulum would, even if it had allowed him a period of grace, would in due course have exercised its right to terminate the CFD. The fact that Pendulum did not do so, and sent him notifications and requests for further payment when his CFD entered into Phase Two indicates to us that the Initial Margin was paid.

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