Appeal number FTC/48/2013

INCOME TAX – tax avoidance scheme – whether there was transfer of overseas securities and payment of manufactured overseas dividend when relevant statutory provisions construed purposively and transactions viewed realistically - no – whether annual payment not payable under deduction and retention of income tax was deductible for purposes of income tax - no – if payment deductible as payment of manufactured overseas dividends treated as annual payments within section 349(1) ICTA 1988 whether Section 3 ICTA 1988 restricts tax relief to higher rate – yes – appeal by Appellant dismissed and appeal by Respondents allowed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

ANDREW CHAPPELL

Appellant

- and –

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: Mr Justice Simon
Judge Greg Sinfield

Sitting in public in London on 7 and 8 July 2014

David Ewart QC and Edward Waldegrave, counsel, instructed by NT Advisers LLP, for the Appellant

David Goy QC and Aparna Nathan, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. In his self-assessment tax return for the tax year 2005-06, the Appellant ('Mr Chappell') claimed a deduction from his total income of £303,123 in respect of two payments. He claimed that he was entitled to deduct the payments in computing his income for tax purposes because they were manufactured overseas dividends ('MODs'), as defined by paragraph 4(1) of Schedule 23A to the Income and Corporation Taxes Act 1988 ('ICTA'), and thus were 'annual payments' within section 349(1) of ICTA and regulation 2B(3) of the Income Tax (Manufactured Overseas Dividend) Regulations 1993 (the 'Regulations').

2. The payments had been made as part of a marketed tax avoidance scheme which was designed to enable Mr Chappell to avoid tax on part of his income that would otherwise be subject to income tax. The transactions that he entered into left him in exactly the same position when they completed as he was before they began save for the payment of fees. The scheme did not have any commercial or other purpose apart from the avoidance of tax.

3. In a closure notice dated 1 November 2010, the Respondents ('HMRC') amended Mr Chappell's self-assessment to disallow the deduction and bring the £303,123 into the charge to tax. Mr Chappell appealed to HMRC against the closure notice and notified the appeal to the First-tier Tribunal ('the FTT').

4. Mr Chappell contended that the payments were MODs as defined by paragraph 4(1) of Schedule 23A to ICTA, that the MODs were paid in circumstances prescribed by regulation 2B(2) of the Regulations and that, by virtue of regulation 2B(3) of the Regulations, the amounts paid were treated as if they were annual payments within section 349(1) of ICTA and reduced his income. HMRC's principal argument was that, applying 'the *Ramsay* principle' derived from the decision of the House of Lords in *W. T. Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300, [1981] STC 174 ('*Ramsay*') and the line of cases that followed it, the payments did not fall within section 349(1). HMRC also put forward two alternative arguments. First, even if the payments were annual payments under regulation 2B(3), Mr Chappell was not entitled to deduct the payments from his income because the Regulations did not provide for tax to be deducted at source from such payments. Secondly, even if the payments were annual payments and could be deducted from income, the effect of section 3 of ICTA was that Mr Chappell was liable to tax at the basic rate on the income out of which he made the payments and was therefore only entitled to tax relief at the higher rate.

5. In a decision released on 21 December 2012, [2013] UKFTT 098 (TC), ('the Decision'), the FTT (Judge John Walters QC and Tym Marsh) accepted HMRC's *Ramsay* argument and dismissed Mr Chappell's appeal. That conclusion disposed of the appeal but, in case they were wrong and since they had heard full argument on them, the FTT also considered HMRC's alternative arguments. The FTT accepted HMRC's contention that Mr Chappell was not entitled to deduct the payments from his income because regulation 2B(3) of the Regulations did not provide that the

payment can or must be made under deduction of tax. However, the FTT rejected HMRC's submissions on the effect of section 3 of ICTA.

6. Mr Chappell now appeals to the Upper Tribunal. He contends that the FTT erred in law in deciding the *Ramsay* argument and the first alternative argument, the technical annual payment contention, in HMRC's favour. In their response to the Appellant's notice of appeal, HMRC submitted that the FTT's conclusions on the *Ramsay* argument and the technical annual payment issue were correct. They also contended that the FTT reached the wrong conclusion in respect of the section 3 of ICTA issue.

The Scheme

7. The facts, which were not substantially in dispute, were set out by the FTT in the Decision and can be summarised as follows.

8. On 29 July 2005, Mr Chappell entered into a 'Global Master Securities Lending Agreement' (the 'GMSLA') with a company called Barsbury Limited ('Barsbury'). Under the terms of the GMSLA, securities could be lent by Barsbury to Mr Chappell, secured against 'collateral'. The terms of each loan of securities were to be agreed before the loan was made. The GMSLA provided that, where interest or dividends were paid in respect of securities which had been loaned to him, Mr Chappell was required to pay a corresponding amount to Barsbury.

9. On 29 July 2005, Mr Chappell and Barsbury both signed a letter (the 'Stock Loan Letter') from Mr Chappell to Barsbury setting out the terms of a loan of securities under the GMSLA. Under the terms of the Stock Loan Letter, Mr Chappell borrowed from Barsbury loan notes (the "Loan Notes") issued by a company called Santi Crescent Limited ('SCL'). The nominal value of the borrowed Loan Notes was £6,377,280. The Loan Notes were to be transferred to Mr Chappell on 29 July 2005 and were to be returned to Barsbury on 9 August 2005 (or earlier if Mr Chappell so chose).

10. The Loan Notes were governed by a 'Loan Note Instrument' issued by SCL on 29 July 2005 (the 'Loan Note Instrument'). The Loan Note Instrument provided that SCL would pay interest in respect of the Loan Notes at a rate of about 4.8% per annum. Interest was to be calculated on a daily basis, and was to be paid by SCL as follows:

(1) on 2 August 2005, interest was payable in arrears in respect of the period from 29 July 2005 to 2 August 2005;

(2) on 4 August 2005, interest was payable in arrears and in advance in respect of the period from 3 August 2005 to 27 July 2006;

(3) on 28 July 2006, interest was due in respect of that day only; and

(4) on 27 July 2007 (which was the day before the Loan Notes' 'Final Redemption Date'), interest was payable in arrears in respect of the period from 29 July 2006 to 27 July 2007.

11. On 1 August 2005, Mr Chappell sold the Loan Notes to a company called Berry Lane Limited ('BLL'), by a 'Loan Note Sale Agreement' signed on that day. BLL paid Mr Chappell £6,373,804 for the Loan Notes.

12. On 2 August 2005, interest was due from SCL in respect of the Loan Notes, for the period from 29 July 2005 to 2 August 2005. This amounted to £4,164 (rounded to the nearest £1). As required by the GMSLA, Mr Chappell made an equivalent payment (i.e. of £4,164) to Barsbury. This is one of the two payments in respect of which Mr Chappell seeks a deduction from his income.

13. On 4 August 2005, interest was due from SCL in respect of the Loan Notes, for the period from 3 August 2005 to 27 July 2006. This amounted to £298,959 (rounded to the nearest £1). As required by the GMSLA, Mr Chappell made an equivalent payment (i.e. of £298,959) to Barsbury. This is the second payment in respect of which Mr Chappell seeks a deduction from his income.

14. On 5 August 2005, Mr Chappell purchased SCL Loan Notes with a nominal value of £6,377,280 from a company called Qintar Limited ('QL'), by a 'Loan Note Sale Agreement' signed on that day. Mr Chappell paid QL £6,073,588 for these Loan Notes.

15. On 5 August 2005, Mr Chappell transferred the Loan Notes which he had acquired from QL to Barsbury, in repayment of the loan made under the Stock Loan Letter.

Issues

16. There were three issues in the appeal before the FTT, namely:

(1) The *Ramsay* issue: i.e. whether, viewed realistically, there were payments for the transfer of the Loan Notes within the meaning of section 349(1) of ICTA, construed purposively.

(2) The technical annual payment issue: i.e. whether Mr Chappell was precluded from deducting the payments from his income because the Regulations provided that no tax was required to be deducted at source from the payments.

(3) The section 3 of ICTA tax relief issue: i.e. whether section 3 applied so that Mr Chappell was liable to income tax at the basic rate on the annual payments and only entitled to tax relief at the higher rate on such payments.

The same issues arise in the appeal to the Upper Tribunal.

Issue 1: the *Ramsay* principle

17. Schedule 23A to ICTA 1988 provides, so far as material, as follows:

> 1(1) In this Schedule –
>
> **...**

'dividend manufacturing regulations' means regulations made by the Treasury under this Schedule;

…

'manufactured overseas dividend' shall be construed … in accordance with paragraph … 4 below, as shall references to the gross amount thereof;

'overseas dividend' means any interest, dividend or other annual payment payable in respect of any overseas securities;

'overseas dividend manufacturer' has the meaning given by paragraph 4(1) below;

…

'overseas securities' means –

(a) shares, stock or other securities issued by a government or public or local authority of a territory outside the United Kingdom or by any other body of persons not resident in the United Kingdom;

…

'prescribed' means prescribed in dividend manufacturing regulations;

…

'securities' includes any loan stock or similar security;

'transfer' includes any sale or other disposal;

…

4(1) This paragraph applies in any case where, under a contract or other arrangements for the transfer of overseas securities, one of the parties (the 'overseas dividend manufacturer') is required to pay to the other ('the recipient') an amount representative of an overseas dividend on the overseas securities; and in this Schedule the 'manufactured overseas dividend' means any payment which the overseas dividend manufacturer makes in discharge of that requirement.

...

8(1) Dividend manufacturing regulations may make provision for –

(a) such … manufactured overseas dividends as may be prescribed,

(aa) such persons who receive, or become entitled to receive, … manufactured overseas dividends as may be prescribed, or

(b) such … overseas dividend manufacturers as may be prescribed,

to be treated in prescribed circumstances otherwise than as mentioned in paragraph … 4 above for the purposes of such provisions of the Tax Acts as may be prescribed.

…

18. Regulation 2B of the Regulations provides as follows:

> (2) The circumstances prescribed are where the manufactured overseas dividend is representative of an overseas dividend on an overseas security that represents a loan relationship.
>
> (3) Where the payer of a manufactured overseas dividend to which paragraph (2) applies is neither a company nor carrying on a trade in circumstances where the manufactured overseas dividend is taken into account in computing the profits of that trade, the manufactured overseas dividend shall be treated, for the purposes of the provisions of the Tax Acts relating to the charge to tax under schedule D and so far as the payer is concerned, as if the amount paid was an annual payment, within section 349(1) of the Taxes Act, but so that no amount is required to be deducted on account of income tax from the amount of the payment, or accounted for under section 350 of that Act.
>
> (4) Where the recipient of a manufactured overseas dividend to which paragraph (2) applies is neither a company nor carrying on a trade in circumstances where the manufactured overseas dividend is taken into account in computing the profits of that trade, the manufactured overseas dividend shall be treated, for the purposes of the provisions of the Tax Acts relating to the charge to tax under schedule D and so far as the recipient is concerned, as an overseas dividend of an amount equal to the amount of the manufactured overseas dividend received by him, but not so as to entitle the recipient to claim relief under Part XVIII of the Taxes Act in respect of any tax attributable to the manufactured overseas dividend received.
>
> (5) For the purposes of paragraph (2), an overseas security shall be taken to represent a loan relationship if a company holding that security would have a loan relationship within the meaning of section 81 of the Finance Act 1996.
>
> …

19. In *Barclays Mercantile Business Finance Limited v Mawson* [2005] STC 1 (‘*BMBF*’), Lord Nicholls referred to the principles of construction which had been first applied by the House of Lords in *Ramsay* and said at [32]:

> The essence of the new approach was to give a statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straightjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found.

20. Lord Nicholls also approved (at [36]) the statement of Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 (‘*Arrowtown*’) at [35]:-

> [T]he driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.

21. In *Berry v HMRC* [2011] STC 1057 at [31], Lewison J (as he then was) set out a very helpful summary of the *Ramsay* principle, as derived from cases decided up to the time of that decision, summarised as follows:

> (i) The *Ramsay* principle is a general principle of statutory construction (*Arrowtown* (§35); *BMBF at* (§36)).
>
> (ii) The principle is two-fold; and it applies to the interpretation of *any* statutory provision:
>
> > (a) To decide on a purposive construction exactly what transaction will answer to the statutory description; and
> >
> > (b) To decide whether the transaction in question does so (*BMBF* (§36)).
>
> (iii) It does not matter in which order these two steps are taken; and it may be that the whole process is an iterative process (*BMBF* (§ 32); *Astall v HMRC* [2010] STC 137 (§ 44)).
>
> (iv) Although the interpreter should assume that a statutory provision has some purpose, the purpose must be found in the words of the statute itself. The court must not infer a purpose without a proper foundation for doing so (*Astall v HMRC* (§ 44)).
>
> (v) In seeking the purpose of a statutory provision, the interpreter is not confined to a literal interpretation of the words, but must have regard to the context and scheme of the relevant Act as a whole (*Ramsay*, 184; *BMBF* (§ 29)).
>
> (vi) However, the more comprehensively Parliament sets out the scope of a statutory provision or description, the less room there will be for an appeal to a purpose which is not the literal meaning of the words. (This, I think, is what Arden LJ meant in *Astall v HMRC* (§ 34). As Lord Hoffmann put it in an article on 'Tax Avoidance': 'It is one thing to give a statute a purposive construction. It is another to rectify the terms of highly prescriptive legislation in order to include provisions which might have been included but are not actually there': See *Mayes v HMRC* [2010] STC 1 (§ 30)).
>
> (vii) In looking at particular words that Parliament uses what the interpreter is looking for is the relevant fiscal concept: (*MacNiven v Westmoreland Investments Ltd* [2001] STC 237 (§§ 48, 49)).
>
> (viii) Although one cannot classify all concepts a priori as 'commercial' or 'legal', it is not an unreasonable generalisation to say that if Parliament refers to some commercial concept such as a gain or loss it is likely to mean a real gain or a real loss rather than one that is illusory in the sense of not changing the overall economic position of the parties to a transaction: *Ramsay,* 187; *Inland Revenue Commissioners v Burmah Oil Co Ltd* (1981) 54 TC 200, 221; *Ensign*

> *Tankers Ltd v Stokes* [1992] 1 AC 655, 673, 676, 683; *MacNiven v Westmoreland Investments Ltd* (§§ 5, 32); *BMBF* (§ 38).
>
> (ix) A provision granting relief from tax is generally (though not universally) to be taken to refer to transactions undertaken for a commercial purpose and not solely for the purpose of complying with the statutory requirements of tax relief: (*Arrowtown* (§ 149)). However, even if a transaction is carried out in order to avoid tax it may still be one that answers the statutory description: (*BMBF* (§ 37)). In other words, tax avoidance schemes sometimes work.
>
> (x) In approaching the factual question whether the transaction in question answers the statutory description the facts must be viewed realistically: (*BMBF* (§ 36)).
>
> (xi) A realistic view of the facts includes looking at the overall effect of a composite transaction, rather than considering each step individually: (*Ramsay*, 185; *Carreras Group Ltd v Stamp Commissioner* [2004] STC 1377 (§ 8); *BMBF* (§ 35)).
>
> (xii) A series of transactions may be viewed as a composite transaction where the series of transactions is expected to be carried through as a whole, either because there is an obligation to do so, or because there is an expectation that they will be carried through as a whole and no likelihood in practice that they will not: (*Ramsay* , 185).
>
> (xiii) In considering the facts the fact-finding tribunal should not be distracted by any peripheral steps inserted by the actors that are in fact irrelevant to the way in which the scheme was intended to operate: (*Astall v HMRC* (§ 34)).
>
> (xiv) In considering whether there is no practical likelihood that the whole series of transactions will be carried out, it is legitimate to ignore commercially irrelevant contingencies and to consider it without regard to the possibility that, contrary to the intention and expectation of the parties it might not work as planned: (*Commissioners of Inland Revenue v Scottish Provident Institution* (2004) 76 TC 538, 558 § 23). Even if the contingency is a real commercial possibility it may be disregarded if the parties proceeded on the basis that it should be disregarded: (*Astall v HMRC* (§ 34)).'

22. Following *Berry* there was a further decision on the *Ramsay* principle in the Supreme Court: *HMRC v Tower MCashback LLP 1 and another* [2011] UKSC 19, [2011] STC 1143. Two points may be noted: first, in giving a judgment with which five other members of the court agreed, Lord Walker at [49] described Lord Nicholls' judgment in [38] of *BMBF* as representing a strategic withdrawal from Lord Hoffmann's distinction between 'legal' and 'commercial' concepts in *MacNiven*. Secondly, Lord Walker made clear that 'one of the lessons of *BMBF* is that it is not enough for HMRC, in attacking a scheme of this sort, to point to the money going round in a circle. Closer analysis is required', see [77].

23. In *Schofield v HMRC* [2011] UKUT 306 (TCC), [2011] STC 1920 at [51] the Upper Tribunal (Warren J (P) and Judge Clark) suggested a further description of the type of transaction which the *Ramsay* principle may expose.

> The position can be summarised in this way: first, there must be a pre-ordained series of transactions (or, to use different language which has emerged from the case, there must be a composite transaction). Secondly, there must be steps inserted which have no commercial (business) *purpose* apart from the avoidance of liability to tax – not 'no business effect'. The inserted steps are then disregarded for fiscal purposes meaning, as interpreted by Lord Hoffmann, disregarded for the purpose of applying the relevant fiscal concept.

24. At [57] the Upper Tribunal added, quoting *Carreras Group Ltd v Stamp Commissioner* [2004] UKPC 16, [2004] STC 1377 at [8]:

> [T]his approach does not deny the existence or legality of the individual steps but may deprive them of significance for the purposes of the characterisation required by the statute.

The FTT's conclusions

25. Although it is unnecessary to go into the detail of the evidence before the FTT, it is convenient to summarise some of its factual conclusions.

(1) Mr Chappell knew (at any rate in rough terms) the amount of the MODs he would be required to make, because it was equal (or roughly equal) to the amount of the income he wanted to shelter from income tax - which was £300,000. He also understood that the £300,000 required to make the MODs would come from 'within the scheme'. He expected only to be liable for the contracted-for fees (the fixed fee of £18,000 plus a contingent fee if the scheme 'worked'), [71].

(2) He did not understand at the time of the transaction that the MODs of approximately £300,000 were funded by the difference between the consideration received on the sale of the Loan Notes to BLL and the consideration required to be paid for the purchase of the equivalent Loan Notes from QL, [72].

(3) Mr Chappell's participation in the 'Highlands' scheme represented a pre-planned series of 'transactions' which took place over 8 days. They began on 29 July 2005 when he entered into the GMSLA with Barsbury, pursuant to which SCL Redeemable 2005-02 Loan Notes to a nominal value of £6,377,280 were 'transferred' for same-day settlement to SGH as custodian for Mr Chappell against Collateral to be 'transferred' on behalf of Mr Chappell to Barsbury of a letter of credit for £6,680,403. They ended on 5 August 2005 when QL 'sold' to Mr Chappell SCL Redeemable 2005-02 Loan Notes to a nominal value of £6,377,280 for a consideration of £6,037,588 in cash, payable at completion, enabling the 'loan' of Loan Notes from Barsbury to be 'repaid'. The arrangements involved certain matters that were uncertain when Mr Chappell signed the documents – the entities to which Mr Chappell would 'sell' the Loan Notes cum div and from which he would 'purchase' the Loan Notes ex div (BLL and QL respectively), and the prices at which those 'transactions' would take place. Those uncertainties (and the continued existence of the Loan Notes after they had been 'repaid' to Barsbury) were incorporated into the arrangements specifically as 'anti-*Ramsay* devices' (see: *Inland Revenue v Scottish Provident Institution* (2004) 76 TC 538 at [23]). They were commercially irrelevant uncertainties since there was no realistic possibility that the scheme would not work

as planned, the identities of the entities 'purchasing' from and 'selling' to Mr Chappell were immaterial and the prices were contrived and did not reflect the market value of the 'securities', having regard to the fact that SCL was a BVI company with share capital of £1 and redeemable Loan Notes of £1.5 billion and the lack of security for the Loan Notes, [184-186].

(4) The arrangements involved little more than signing pieces of paper and entries being made in accounts, [187].

(5) The evidence was overwhelming (and was accepted as showing) that the arrangements had no commercial purpose and their only objective was to obtain a tax advantage, [188].

(6) The loan stock and the obligations under the GMSLA were created solely for the purposes of the scheme – there was no other reason for their existence, [189].

(7) The quantum of the loan stock that was issued was dictated by the tax relief desired, [190].

(8) The Loan Notes were never at Mr Chappell's disposal for any purpose other than that of the scheme, being held over the weekend by SG Hambros Bank & Trust (Jersey) Ltd, [198].

(9) The 'sale' of the Loan Notes to BLL and the 'purchase' from QL were both at wholly contrived prices, sufficient to ensure that the arrangements fulfilled their purpose. The difference between the price at which the loan notes were 'sold' and the price at which they were 'bought' by Mr Chappell was crucial to the scheme and was determined by the quantum of the MODs 'paid', which in turn was dictated by the amount of income sought to be sheltered, [191].

(10) Realistically, Mr Chappell ran no risk apart from paying the fee for participation in the scheme, [192].

(11) If the movements of the moneys involved had been real they would have been 'quite staggering', but in reality the money went round in a circle from start to finish. In the view of the FTT this underlined the lack of commerciality of the 'transactions', [193].

(12) The sole purpose of all the entities involved in the scheme was to participate in the scheme, [194].

(13) The structuring of the interest payment dates on the SCL Loan Notes, by their 'eccentricity or idiosyncrasy', prevented Mr Chappell from becoming liable to tax on the interest accrued on the Loan Notes which he sold to BLL on 1 August 2005 cu*m div*, [195].

26. In the light of these findings, the FTT considered the central question.

> [196] We ask ourselves again with regard to this factual matrix whether there was realistically a 'transfer' of 'overseas securities' (Loan Notes) by Barsbury to Mr Chappell and whether Mr Chappell made 'payments' (MODs) to Barsbury in the context of paragraphs 1(1) and 4(1) of Schedule 23A ICTA and regulation 2B(3) of the Regulations, purposively construed.

27. The FTT accepted that the transactions in quotation marks were not shams and that the interest ‘payments’ were in fact made [197] and that words and phrases used in the statutory provisions carried the same single meaning whether in a commercial context or in a tax avoidance context. In each case the meaning was to be arrived at by way of a purposive construction [199].

28. At [202], the FTT expressed its view that the question in issue was:

> ... whether the commercial nature of a transfer or a payment is a necessary qualitative ingredient in a transaction whose legal effect is a transfer or payment, to enable such a transaction to be recognised, as a matter of fact, as one which answers to the statutory description.

29. In [206]-[212] of the Decision, the FTT set out its conclusions as follows:

> 206. In this case, the movements of funds which Mr Chappell claims to be ‘payments’ of MODs for the purposes of paragraph 4(1), Schedule 23A ICTA did not discharge what we regard as a commercial obligation to pay the MODs. We accept that such an obligation derived from the GMSLA, but we reject the proposition that the obligation was commercial. It was part and parcel of the self-cancelling scheme designed (as if by magic) to create a tax deduction and no corresponding tax charge. As Mr Goy submitted ... the series of pre-determined transactions in this case both created and satisfied the apparent obligation to pay the MODs.
>
> 207. Further, we discern ... a context which is contrary to the submission that we should regard the relevant movements of funds as payment of MODs and an apparent policy that we should not do so. As we have already said, we consider that paragraph 4 of Schedule 23A ICTA and regulation 2B of the Regulations are intended to apply to MODs which are compensatory payments in respect of income receipts which the borrower receives or to which the borrower becomes entitled, and, importantly, on which the borrower may expect to be taxed.
>
> 208. We regard the citations from *Scottish Provident* to which Mr Goy referred us ... as providing further authority for our approach, which is to regard all the transactions entered into by Mr Chappell, and the structuring of the interest payment dates on the SCL LNs as being artificial steps which should be ignored (see per Lord Hope in *MacNiven*, *ibid.* at [77]) and having the composite effect that there was no ‘transfer’ of ‘overseas securities’ (Loan Notes) by Barsbury to Mr Chappell or ‘payment’ (MOD) made by Mr Chappell to Barsbury for the purposes of paragraph 4(1), Schedule 23A ICTA or regulation 2B(3) of the Regulations. This approach is also consistent with the analysis in *Barclays Mercantile* of *Burmah*, *Furniss* and *Carreras*, where Lord Nicholls observed that ‘the elements inserted into the transactions without any commercial purpose were treated as having no significance’ (*ibid.* [35]) ... The transactions entered into in this case achieved nothing as a matter of fact for the purposes of paragraph 4(1), Schedule 23A ICTA or regulation 2B(3) of the Regulations.

> 209. Turning to the necessary purposive construction of those provisions, we have already indicated that we construe them as having been enacted for the purpose of applying to MODs which are compensatory payments in respect of income receipts which the borrower of overseas securities receives, or to which he becomes entitled and on which he may expect to be taxed.
>
> 210. [Counsel for Mr Chappell] would have had us construe them literally, and as applying to individual steps in a series of transactions on the authority of *Mayes*. However, as Mummery LJ said in *Mayes*, the statutory provisions under consideration in that case '[did] not readily lend themselves to a purposive commercial construction' at [78]). We have concluded that the provisions relevant in this case do readily lend themselves to such a construction. As in the legislation in issue in *Berry*, so here, '[Parliament] has used words which have a recognised commercial meaning; and it is to be expected that Parliament intended to tax (or relieve) real commercial outcomes' (per Lewison J at [52]).
>
> 211. Finally, on this aspect of the case, we refer to *Moodie* which provides direct and clear House of Lords authority for a conclusion that there need not be a payment within the meaning of a taxing provision requiring one when steps are taken (including the relevant movement of funds) which are self-cancelling. The more recent case of *Schofield* also provides authority for an approach of ignoring the taxation effect of an individual transaction carried out as part of a larger preordained series of transactions (or single composite transaction).
>
> 212. For these reasons we conclude that HMRC's *Ramsay* attack succeeds and that for that reason Mr Chappell's appeal must be dismissed ...

The Appellant's challenge to the FTT's analysis and conclusions

30. The Appellant's case before us was, as it had been before the FTT, that:

(1) The Loan Notes borrowed by Mr Chappell from Barsbury were 'overseas securities' within the meaning of §1(1) of Schedule 23A to ICTA.

(2) The loan of the borrowed Loan Notes was a 'transfer' of those 'overseas securities' within the meaning of §4(1) of Schedule 23A to ICTA, being a disposal other than a sale.

(3) It followed that the amounts of interest paid by SCL on the borrowed Loan Notes were 'overseas dividends' within the meaning of §1(1) of the Schedule; and the amounts of £4,164 and £298,959 paid by Mr Chappell to Barsbury on 2 August and 4 August 2005 were MODs and that he was the relevant 'overseas dividend manufacturer'; and Mr Chappell was the 'overseas dividend manufacturer' within the meaning of §1(1) of Schedule 23A to ICTA.

31. Mr Ewart's argument focussed on what was said by members of the House of Lords in *MacNiven* and, in particular, what was said about the nature of a payment.

32. *MacNiven* concerned a circular movement of funds from a pension scheme to its subsidiary company and then back to the pension scheme in discharge of a debt owed by the company to the pension scheme. The question was whether the company had made a 'payment' of interest within the meaning of s.338 of ICTA 1988, so as to be entitled to a tax loss.

33. Lord Nicholls, at [1]-[8], and Lord Hoffmann, at [28]-[32], considered the application of the *Ramsay* principle. In *MacNiven*, as in the present case, there was no question of a sham. There were however circular payments which were made for no commercial purpose other than gaining a tax advantage, see Lord Nicholls at [13]. At [15], Lord Nicholls accepted that it did not matter that there was no business purpose other than gaining a tax advantage.

> A genuine discharge of a genuine debt cannot cease to qualify as a payment for the purpose of s.338 by reason only that it was made solely to secure a tax advantage. There is nothing in the language or context of s.338 to suggest that the purpose for which a payment of interest is made is material.

34. Lord Hoffmann at [67] concluded that 'payment' must be given its ordinary meaning and the findings of fact by the Special Commissioners, that the loan and the payment had actually occurred, were dispositive.

> ... payment of a debt such as interest ordinarily means an act, such as the transfer of money, which discharges the debt. It is accepted that in this case the interest debt was indeed discharged. So why did this not count as payment for the purposes of the 1988 Act? ... The Crown's real complaint is that the scheme, as an exempt fund, was able to reclaim the tax. But this cannot be remedied by giving the word 'paid' a different meaning in the case of a payment to an exempt lender. The word must mean the same, whatever the status of the lender.

35. Lord Hope and Lord Hobhouse agreed with Lord Hoffmann. The former adding at [81]:

> On this approach the case does not seem to me, in the end, to give rise to any real difficulty. The words 'paid' and 'payment' are to be construed according to their ordinary meaning. The question whether a payment has been made is a question of fact. ... a loan was in fact made by the pension scheme to [the taxpayer] and [the taxpayer] used that loan to pay interest to the pension scheme. The interest was a charge on income because it was a payment of a description mentioned in s.338(3) of the 1988 Act. That point having been established, the rule in s.338(1) determines the fiscal effectiveness of the transaction for the purposes of [the taxpayer's] liability to corporation tax.

36. Mr Ewart submitted that the speeches in *MacNiven* threw light on the analysis in the present case. Even in a case where the Court was considering an artificial tax scheme, the question is whether there was a payment by Mr Chappell to Barsbury to discharge a debt. If there was then it constitutes a payment for the purposes of paragraph 4(1) of Schedule 23A to ICTA and regulation 2B(3) of the Regulations.

On a similar basis, there was a 'transfer' of the overseas securities by Barsbury to Mr Chappell.

37. No parts of the transaction were elements inserted into the transactions without any commercial purpose so as to be treated as having no significance. These were transactions which had actually taken place, and the legislation applied to transactions whether or not those transactions had a commercial purpose.

The Respondents' response

38. The starting point, Mr Goy QC submitted, was the approval given in the opinion of the House of Lords in *BMBF* (Lord Nicholls at [36]) to what was said by Ribeiro PJ in *Arrowtown* at [35]:

> [T]he driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.

39. On the assumption that the Regulations provided a relief from tax, the legislative intent was that the rules should apply in the context of 'real world' transactions and not in circumstances existing solely for the purpose that relief would apply. The transactions upon which reliance was placed were never capable of having economic consequences for the parties to them. Mr Goy submitted that the 13 findings of fact to which we have referred above were crucial to the FTT's conclusions and fatal to this appeal. Having made those findings the FTT adopted the approach set out in the cases: viewing the transactions realistically and construing the statutory provisions purposively, and having considered the facts, concluded that the provisions did not apply, see FTT [208].

Conclusion on issue 1

40. It is clear that the FTT viewed the overall effect of the transactions realistically and with a view to determining their overall effect.

41. It is apparent from the full and clear findings of fact that there were neither payments nor Loan Notes in a real or practical sense. Their purpose was not a commercial purpose, but exclusively a tax avoidance purpose. Nor was there a transfer in the sense contemplated by the Regulations. Mr Chappell never had the securities available to him for any commercial purpose. All the transactions were organised in advance, and consisted of movements of funds in a circle, with the payments being recorded in writing. Loan Notes to the value of £1.5 billion were created, but they had no substance, no money was ever made available and the sale price had nothing to do with the intrinsic value of the loan stock. These were not overseas securities for the purpose of the Regulations. The obligation to pay the MODs arose out of the obligation to pay interest under the Loan Notes, which were created solely to enable the MODs to be paid for the purposes of the scheme; and the MODs were met by funds generated internally by the scheme with no commercial risk

involved. The transactions were self-cancelling; and no one was either better or worse off. The payments, the Loan Notes and the transfers were all, in that sense, artificial. They had no commercial purpose and no practical significance beyond enabling the taxpayer to claim that the requirements of the legislative provisions had been complied with.

42. In our judgment these features were sufficient to deprive them of their essential characteristics for the purposes of the statutory provisions.

43. Three further points from the cases may be noted.

44. First, it is clear from *BMBF* that not all circular self-cancelling transactions are to be disregarded, see Lord Nicholls in *BMBF* at [38] and Lord Walker in *Tower MCashback* at [77].

45. Secondly, a test of artificiality will not by itself provide the key. The word 'artificial' was used by Lord Hutton in *MacNiven* at [93]:

> I consider that an essential element of a transaction to which the *Ramsay* principle is applicable is that it should be artificial. The requirement that there must be artificiality, and the importance between distinguishing between the real world and the world of make-believe, between real gain (or loss) and a contrived or unrealistic gain (or loss) have been stressed in a number of judgments of the House where the application of the *Ramsay* principle has been considered.

46. In the course of argument, Mr Ewart took issue with a test of artificiality. We do not understand Lord Hutton to be describing an independent test of 'artificiality'; his reference to the cases makes it clear that he was not. However, it seems to us that having an eye to the artificiality of a scheme is inherent in viewing the transactions realistically. Indeed Lord Hope in *MacNiven*, at [79] referred to the possibility of steps in a transaction being ignored because they were artificial, see also *Moodie v Commissioners of Inland Revenue* (1993) 65 TC 556, Hoffmann J at 639A-C and I, and the Court of Appeal at 658 F-G. As in *Schofield* (see at [61]), the taxpayer started and ended with nothing, and was correctly taxed on the basis that nothing had occurred. In the present case, artifice in the means led to unreality in the result.

47. Thirdly, although Mr Ewart placed great emphasis on the *MacNiven* case, there was an important distinction between the facts of that case and the facts of the present case. In *MacNiven* there was a genuine obligation to pay interest on a real loan which arose outside any scheme, see also *Customs & Excise Commissioners v Faith Construction Ltd* [1990] 1 QB 905. In the present case the obligation to pay was created as part of the scheme and made for no other reason than that it could be used to make a claim for tax relief. The distinction was pointed out by Lord Millet (sitting as a Non-Permanent Judge of the Court of Appeal in Hong Kong) in *Arrowtown* (see above) at [141]:

> ... as Lord Hutton's speech indicates, it is unlikely that the same conclusion would have followed if the scheme had included the creation of the company's liability in the first place

48. For these reasons we have concluded that the FTT were correct in their conclusion and it follows that the appeal fails on the first issue.

Issue 2: the technical annual payment issue

49. We have already set out the terms of regulation 2B(2) and (3) of the Regulations.

50. It was common ground that a MOD was not an 'annual payment' on general principles. The issue was whether Mr Chappell could deduct the MODs because regulation 2B(2) and (3) of the Regulations treated the MODs as if they were annual payments within section 349(1) of ICTA. Regulation 2B(3) of the Regulations provides that, in the case of a payer of a MOD, the MOD is treated for the purposes of the charge to tax under Schedule D and, so far as the payer is concerned, as an annual payment within section 349(1) but no amount is required to be deducted from the payment on account of income tax or accounted for under section 350. Regulation 2B(4) of the Regulations provides that the recipient of a MOD is to be treated as having received income chargeable to tax under Schedule D of an amount equal to the amount of the MOD 'but not so as to entitle the recipient to claim relief under Part XVIII of the Taxes Act [Double Taxation Relief] in respect of any tax attributable to the [MOD] received.'

51. The FTT considered this issue on the basis that, contrary to their conclusion on issue 1, Mr Chappell had paid MODs to Barsbury for the purposes of paragraph 4(1) of Schedule 23A to ICTA. Having quoted extensively from *Earl Howe v Commissioners for Inland Revenue* (1919) 7 TC 289, *Bingham v Commissioners for Inland Revenue* (1955) 36 TC 254 and *Commissioners for Inland Revenue v Frere* (1964) 42 TC 125 , the FTT reached the following conclusions on this issue.

> [251]. We have however concluded that we must follow the explicit statements of the law in *Earl Howe*, *Bingham* and *Frere*, which we have set out at paragraphs 231, 232, 234 and 235 above and hold that only annual payments which are payable under deduction and retention of tax as between the payer and the payee can be allowed as deductions from the income of the payer for income tax purposes.
>
> [252]. Contrary to [Counsel for Mr Chappell's] submission, we consider that it would be wrong to assume that the draftsman of regulation 2B of the Regulations intended to shape that provision otherwise than wholly consistently with the law on the deductibility of annual payments clearly laid down in *Earl Howe*, *Bingham* and *Frere*. But we consider that the legislative language inferentially denies a right of deduction in respect of an MOD to which regulation 2B(3) of the Regulations applies – in contrast, for example to the express denial in the language used in section 125(1) (the anti-*Plummer* provision) ...

52. Mr Ewart submitted that the FTT fell into error. A MOD is not an 'annual payment' as generally understood: it is not in fact 'annual' as it is not recurrent nor is it pure income profit in the hands of the recipient. It was therefore apparent that

regulation 2B(3) deemed the MOD to be an annual payment so as to give rise to a deduction in computing the total income of the payer of the MOD. This gives an individual payer similar treatment to a trader and a company within the loan relationship provisions.

53. He pointed out that the FTT (at [249]) regarded this submission as an 'attractive proposition' which had the advantage of providing symmetry; and that it was consistent with the purpose which it identified behind paragraph 4(1) and regulation 2B(3).

54. He further submitted that the principle to be derived from the three cases referred to by the FTT was that the payment was not deductible unless it was an annual payment and so was the pure income profit of the recipient. It was an inevitable characteristic of an annual payment that it was paid under deduction of income tax, and the Courts had identified an annual payment as having that characteristic. If it was not required to be paid under deduction of income tax, it was not an 'annual payment' within the relevant legislation. The distinction between the three cases and regulation 2B(3) were the words 'shall be treated ... <u>as if</u> the amount paid was an annual payment.' It was a clear deeming provision whose effect was that the payment was to be treated as if it were an annual payment.

55. Mr Goy's response was that regulation 2B(3) does not by its terms give tax relief unlike, for example, paragraph 2A(1) of Schedule 23A to ICTA which expressly provides for tax relief. He submitted that, since Parliament clearly knows how to provide tax relief in terms, it would be odd if it intended that result by means of a reference to 'annual payment'. At the time, only annual payments which were, or could be, made under deduction of tax were allowable and the *Earl Howe*, *Bingham* and *Frere* cases made clear that the law did not give an automatic right to relief for any annual payments made. A payment could only be deducted if it was, or could be, paid under deduction of tax pursuant to specific statutory provisions, see the *Earl Howe* case, Warrington LJ at p.300 and Scrutton LJ at p.303; the *Bingham* case, Harman J at p.256-7 and 259-60; and the *Frere* case, Wilberforce J at p.131, and Viscount Radcliffe at p.149-150.

Conclusion on issue 2

56. In our view, the argument of HMRC is correct and for the reasons Mr Goy gave.

57. In enacting the Regulations, Parliament must be assumed to have understood the then state of the law by which only annual payments that were, or could be, made under deduction of tax were allowable. Viscount Radcliffe in the *Frere* case at p.149, in referring to the *Earl Howe* case, said this:

> It was also the basis of the Court's decision in that case, that in arriving at the figure of total income, only those annual payments could be allowed as deductions which were themselves payable under deduction and retention of tax as between payer and payee. The decision is very well known, and I must say until this case I had never heard it

> questioned that the principle the court had proceeded upon was the correct one.

58. Whatever else may have been intended by the Regulations, it was plainly not intended to provide relief directly under the terms of regulation 2B(3); and we do not accept that the same effect was achieved by treating the amount paid as if it were an annual payment. In our judgment the FTT were correct in their conclusion that only annual payments which are payable under deduction and retention of tax as between the payer and the payee can be allowed as deductions from the income of the payer for income tax purposes; and that regulation 2B(3) must be read with this principle in mind.

59. It follows that we also dismiss Mr Chappell's appeal on the alternative grounds under issue 2.

Issue 3: section 3 ICTA tax relief issue

60. This issue only arises if Mr Chappell succeeds in his appeal against the FTT's conclusion in relation to both of the other issues. In those circumstances, HMRC contended that section 3 of ICTA provides that Mr Chappell was chargeable to income tax at the basic rate on the amount of the MODs so that he was only entitled to tax relief at the higher rate in respect of the MODs.

61. Section 3 of ICTA stated:

> Where a person is required to be assessed and charged with income tax in respect of any property, profits or gains out of which he makes any payment in respect of –
>
> (a) any annuity or other annual payment (not being interest); or
>
> (b) any royalty or other sum in respect of the user of a patent;
>
> he shall, in respect of so much of the property, profits or gains as is equal to the payment and may be deducted in computing his total income, be charged at the basic rate.

62. The FTT summarised their reasons and set out their conclusion on this issue in [266] and [270] as follows:

> 266. Section 3 ICTA applies in terms to a person who makes an annual payment out of profits or gains chargeable with income tax. This suggests that annual payments within section 348, rather than section 349, are being referred to. The requirement that the payer be assessed and charged with income tax is directly provided for in section 348(1)(a). If section 3 were also to be applicable to section 349 payments which are, anomalously, paid out of profits or gains chargeable to income tax, that would, we consider, be merely as a result of the wording of section 3, which is intended to apply to annual payments within section 348 and not section 349, fortuitously covering such a payment. In the context of this tightly drawn series of statutory provisions we regard that as an unlikely and forced construction not in accordance with the purpose of the provisions as we discern it, which we describe in the following paragraphs 267 to 271.

…

270. Because of these differences in the treatment of annual payments payable wholly out of profits or gains charge [sic] to income tax (section 348) and annual payments not so payable (section 349), we conclude, against Mr Goy, that section 3 ICTA does not apply to a payment within section 349, but only applies to a payment within section 348 which may be deducted in computing the payer's total income. The fact that Mr Chappell paid the MODs in issue out of profits or gains charged to income tax makes no difference."

63. Section 348 ICTA provides as follows:

(1) Subject to any provision to the contrary in the Income Tax Acts, where any annuity or other annual payment to which this subsection applies is payable wholly out of profits or gains brought into charge to income tax -

(a) The whole of the profits or gains shall be assessed and charged with income tax on the person liable to the annuity or other annual payment without distinguishing the annuity or other annual payment; and

(b) The person liable to make the payment, whether out of the profits or gains charged with income tax or out of any annual payment liable to deduction, or from which a deduction has been made, shall be entitled on making the payment to deduct and retain out of it a sum representing the amount of income tax thereon; and

(c) The person to whom the payment is made shall allow the deduction on receipt of the residue of the payment, and the person making the deduction shall be acquitted and discharged of so much money as is represented by the deduction, as if that sum had been actually paid; and

(d) The deduction shall be treated as income tax paid by the person to whom the payment is made.

(1A) Subsection (1) applies to any annuity or other annual payment, not being interest -

(a) which is charged with tax under Case III of Schedule D,

(aa) which -

(i) is charged with tax under Chapter 7 of Part 4 of ITTOIA 2005 (purchased life annuity payments), Chapter 10 of that Part (distributions from unauthorised unit trusts), section 579 of that Act (royalties etc. from intellectual property), Chapter 4 of Part 5 of that Act (certain telecommunication rights: non-trading income) or Chapter 7 of Part 5 of that Act (annual payments not otherwise charged), and

(ii) is not relevant foreign income,

(b) which is charged with tax under Part 9 of ITEPA 20034 (pension income) because section 605 of that Act applies to it (retirement annuity contracts: annuities), or

(c) which arises from a source in the United Kingdom and is charged with tax under Part 9 of ITEPA 2003 because section 609, 610 or 611 of that Act applies to it (certain employment-related annuities).

…

64. Section 349 of ICTA relevantly provides as follows:

(1) Where -

(a) Any annuity or other annual payment to which this paragraph applies; or

(b) ...

(c) ...

is not payable or not wholly payable out of profits or gains brought into charge to income tax, the person by or through whom any payment thereof is made shall, on making the payment, deduct out of it a sum representing the income tax thereon.

(1A) Paragraph (a) of subsection (1) applies to any annuity or other annual payment, not being interest

(a) which is charged with tax under Case III of Schedule D,

(aa) which -

(i) is charged with tax under Chapter 7 of Part 4 of ITTOIA 2005 (purchased life annuity payments), Chapter 10 of that Part (distributions from unauthorised unit trusts), section 579 of that Act (royalties etc. from intellectual property), Chapter 4 of Part 5 of that Act (certain telecommunication rights: non-trading income) or Chapter 7 of Part 5 of that Act (annual payments not otherwise charged), and

(ii) is not relevant foreign income,

(b) which is charged with tax under Part 9 of ITEPA 20034 (pension income) because section 605 of that Act applies to it (retirement annuity contracts: annuities), or

(c) which arises from a source in the United Kingdom and is charged with tax under Part 9 of ITEPA 2003 because section 609, 610 or 611 of that Act applies to it.

65. Section 350(1) ICTA provides as follows:

Where any payment within section 349 is made by or through any person, that person shall forthwith deliver to the inspector an account of the payment, and shall be assessable and chargeable with income tax at the applicable rate [see: section 350(1A) and section 4 ICTA – in these circumstances, the basic rate] on the payment, or on so much thereof as is not made out of profits or gains brought into charge to income tax.

The argument on issue 3

66. Regulation 2B(3) of the Regulations provides that, although the MOD is treated as an annual payment under section 349(1), the payer is not required to deduct any amount from the payment on account of income tax or account for it under section 350.

67. The FTT concluded at [270] that section 3 ICTA does not apply to a payment within section 349 but only applies to a payment within section 348, which may be deducted in computing the payer's total income. The FTT reached this conclusion because of the differences that the FTT perceived between the treatment of annual payments payable wholly out of profits or gains chargeable to income tax under section 348 and annual payments not so payable under section 349. The FTT stated that the fact that Mr Chappell had paid the MODs in issue out of profits or gains charged to income tax made no difference. The analysis that led the FTT to this conclusion is contained in [266] – [269] of the Decision. It was based on the premiss that section 3 referred to payments in section 348 and not to payments in section 349, see [266] of the Decision.

68. At [267], the FTT described, in terms that are uncontroversial, how section 348 operated. In [268], the FTT stated that the position of 'the usual sort of payment' within section 349 (i.e. not MODs) is different, because such payment was not made out of profits or gains on which the payer would be chargeable to income tax. The FTT stated in [269] that the charge to tax on payments under section 349 is not imposed on the payer but on the person through whom the payment is made which led the FTT to conclude that the tax was imposed on the payment itself. In reaching that conclusion, the FTT stated '*ex hypothesi* the payer does not make the payment out of his profits or gains'.

69. Mr Goy submitted that the FTT had erred in concluding that payments within section 348 are subject to section 3 whereas payments within section 349 are not. He argued that the FTT was wrong to refer, in [266], to annual payments within section 349 that were paid out of profits or gains chargeable to income tax as anomalous and the application of section 3 to such payments as fortuitous. Mr Goy contended that section 3 applies to all payments made out of income chargeable to income tax and, therefore, applies equally to a payment within section 348 and a payment within section 349 to the extent that such payment is made out of property, profits or gains chargeable to tax, as in Mr Chappell's case. There is nothing in the words of section 3 that leads to any other conclusion and nothing anomalous in the result. Mr Goy submitted, by reference to a worked example, that treating section 3 as not applying to annual payments made out of profits or gains chargeable to income tax that also fell within section 349 would lead to anomalous results.

70. In his skeleton argument, Mr Ewart was content to adopt the reasoning of the FTT at [265]-[271] of the Decision in its entirety. Before us, he submitted that the reason for the charge to tax under section 3 ICTA is to prevent the payer obtaining two deductions, ie when deducting the annual payment for the purposes of calculating liability to income tax and, again, when deducting an amount equal to basic rate tax from the payment to the payee. Mr Ewart submitted that, as regulation 2B(3)

provides that no amount is required to be deducted from a payment within section 349 on account of income tax or accounted for under section 350, there is no need for section 3 to apply. He contended that section 3 was intended to refer to a situation where the payer was able to deduct an amount as tax and keep it but it was not intended to apply to a situation where regulation 2B(3) applied and a person was not required to deduct tax and account to HMRC for it under section 349.

71. In summary, Mr Ewart's case was that section 3 was intended to prevent a payer of an annual payment obtaining two deductions. Regulation 2B(3) prevented that happening in the case of payments within section 349. He accepted that, read literally, section 3 could apply to annual payments within section 349 made out of profits or gains chargeable to income tax; however he submitted that, in order to make it work sensibly, section 3 should be read as only referring to situations where the payer can deduct and withhold an amount equal to the tax.

72. As the FTT observed, at [260], both section 348(1) and section 349(1) apply to the same types of payment, namely annual payments with a UK (not a foreign) source. In our opinion, the FTT erred when it concluded that section 3 ICTA only applies to a payment within section 348 and cannot apply to a payment within section 349. We consider that the FTT failed to have sufficient regard to the fact that:

(1) section 349 requires the payer of an annual payment which is "not wholly payable out of profits or gains brought into charge to income tax" to deduct a sum representing the income tax from the payment; and

(2) section 350 requires the payer to account to HMRC on that part of the payment that is not made out of profits or gains brought into charge to income tax.

73. The effect of those provisions is that, to the extent that annual payments are made out of profits or gains chargeable to income tax, the payer is entitled to deduct tax from a payment and retain the tax deducted. We consider that the fact that similar consequences follow under section 349 and section 350 in relation to payments made out of profits or gains chargeable to tax as follow when section 348 applies, indicates that section 3 should also apply to annual payments within section 349 made out of profits or gains chargeable to income tax. Although the FTT may be correct in stating, at [268], that the usual sort of payment within section 349 is one made other than out of profits or gains chargeable to income tax, that does not mean that, where a payment within section 349 is made out of such profits or gains, section 3 should not apply.

74. In our view, the fact that regulation 2B(3) removes the requirement to deduct and account for tax under sections 349 and 350 does not lead to the conclusion that section 3 does not apply to payments that fall within section 349 by virtue of regulation 2B of the Regulations. We consider that the words of section 3 are clear. On its terms, section 3 applies where a person makes an annual payment out of any property, profits or gains in respect of which he is required to be assessed and charged with income tax. We cannot discern any purpose in section 3 which would lead us to

interpret it so as to limit its operation to annual payments subject to deduction of tax at source. Nor can we find such a purpose in sections 348, 349 and 350.

75. For the reasons discussed above, we allow HMRC's appeal in relation to the section 3 of ICTA tax charge issue.

Disposition

76. Mr Chappell's appeal against the FTT's decision in relation to issues 1 and 2 is dismissed and HMRC's appeal in relation to issue 3 is allowed.

Mr Justice Simon

Greg Sinfield
Judge of the Upper Tribunal

Release date: 28 July 2014