Neutral Citation Number: [2014] EWCA Civ 452

Case Nos: A3/2013/0207 & A3/2013/0231

**IN THE COURT OF APPEAL (CIVIL DIVISION)**
**ON APPEAL FROM THE UPPER TRIBUNAL**
**(TAX AND CHANCERY CHAMBER)**
**Mr Justice Henderson and Mr Charles Hellier**
**Appeal Nos: FTC/15/2011 & FTC/46/2011**

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 16/04/2014

**Before :**

**LORD JUSTICE RIMER**
**LORD JUSTICE KITCHIN**
and
**LORD JUSTICE CHRISTOPHER CLARKE**

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**Between :**

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| **DB GROUP SERVICES (UK) LIMITED** | **Appellant** |
| **- and -** | |
| **THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS** | **Respondents** |

**And between:**

| | |
|---|---|
| **THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS** | **Appellants** |
| **- and –** | |
| **UBS AG** | **Respondent** |

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**Mr David Goy QC** and **Ms Nicola Shaw QC** (instructed by **Slaughter and May**) for **DB Group Services (UK) Limited**
**Mr Paul Lasok QC, Mr Richard Vallat and Ms Anneliese Blackwood** (instructed by **HM Revenue and Customs Solicitor's Office**) for the **The Commissioners for Her Majesty's Revenue and Customs**
**Mr Kevin Prosser QC** (instructed by **Pinsent Masons LLP**) for **UBS AG**

Hearing dates: 5, 6 and 7 November 2013

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# Approved Judgment

## Lord Justice Rimer :

*Introduction*

1. Two appeals are before us. In one, the appellants are The Commissioners for Her Majesty's Revenue and Customs ('HMRC') and the respondent is UBS AG ('UBS') ('the UBS appeal'). In the other, the appellant is DB Group Services (UK) Limited ('DB') and the respondents are HMRC ('the DB appeal').

2. UBS is a well known bank. DB was at the material time the main employer in the group headed by Deutsche Bank AG, another well known bank. Both banks have traditionally rewarded employees with bonuses. The payment of bonuses by banks, particularly since the financial crisis of 2008, has given rise to considerable public comment, not all of it favourable. These cases relate to a prior period, when both banks adopted what the Upper Tribunal described as a 'carefully planned tax avoidance scheme which was designed to enable the [banks] to provide substantial bonuses to employees in the tax year 2003/04 in a way that would escape liability to both income tax and national insurance contributions.' The top rate of income tax was then 40% and the perceived beauty of the schemes was that, if they worked, both the banks and the employees derived considerable tax benefits from them. The intent of the schemes was that the employees would receive shares in the nature of 'restricted securities', which would in consequence escape income tax under the provisions of the tax regime in Chapter 2 of Part 7 of the Income Tax (Earnings and Pensions) Act 2003 ('ITEPA'); and the banks would pay the bonuses into the schemes without having to account to HMRC for income tax or for NICs for the relevant employees or their own liabilities on their earnings.

3. Both banks appealed to the First-tier Tribunal (Dr David Williams and Mr David Earle, 'the FTT') against HMRC's determinations that the sums allocated to the employees as bonuses at the start of each scheme were liable to income tax under Part 7 of ITEPA as earnings from their employment and to Class 1 NICs on the same basis. The determinations were against the banks rather than the employees since the banks were in each case liable to deduct and account for any liability to PAYE income tax and Class 1 NICs on behalf of their employees. The FTT heard the appeals successively in February 2010, each appeal occupying five days.

4. In the UBS case, the determinations were both dated 13 October 2008 and were: (a) for £36,863,600 for income tax in respect of bonus payments of around £92m made by UBS in early 2004 to employees; and (b) for £12,717,942 for Class 1 NICs in respect of the same payments. In the DB case, the determinations were both dated 29 April 2008 and were: (a) for £36,520,000 for income tax in respect of bonus payments of around £91m made by DB in early 2004 to employees; and (b) for £12,599,400 for Class 1 NICs in respect of the same payments. The FTT released their decision on the UBS appeal on 6 August 2010 (and then re-issued it with corrections on 15 September 2010); and they released their decision on the DB appeal on 19 January 2011. The FTT dismissed both appeals, although not for identical reasons as there were factual differences between the two schemes.

5. With the permission of the FTT, the banks appealed to the Upper Tribunal (Tax and Chancery Chamber) (Henderson J and Mr Charles Hellier, 'the UT'), which heard the appeals together over five days in February 2012. The outcome of the UT's 212-

paragraph decision released on 17 September 2012 was that they allowed the UBS appeal and dismissed the DB appeal: *UBS AG and DB Group Services (UK) Limited v. The Commissioners for Her Majesty's Revenue and Customs* [2012] UKUT 320 (TCC); [2013] STC 68. So it is that HMRC are now appellants in the UBS case, seeking to overturn the UT's upholding of the UBS scheme; and DB is an appellant seeking to vindicate its own scheme. HMRC in turn seeks to uphold the UT's decision in the DB case for further reasons which differ from those given by the UT.

6. We heard the appeals together over three days. Mr Lasok QC (leading Mr Vallat and Ms Blackwood) opened HMRC's appeal in the UBS case, following which Mr Prosser QC presented UBS's responsive case. Mr Goy QC (leading Ms Shaw QC) for DB then also responded to HMRC's case and opened the DB appeal. Mr Lasok replied generally and Mr Goy had the last word in reply on the DB appeal. I shall deal first with the UBS appeal and then the DB appeal.

*The UBS appeal*

7. Permission for HMRC to appeal in the UBS case was given by the UT on four grounds. HMRC renewed before us their permission application on two further grounds.

*The facts: an overview*

8. UBS does not argue that its scheme was other than a pre-conceived one directed at avoiding income tax and NICs. I need say no more about NICs, upon which we had no separate argument: it is agreed that the position in relation to NICs is the same as in relation to income tax. UBS's position is simple. It says the bonuses are not taxable because the scheme brought them within the highly prescriptive provisions of Chapter 2 of Part 7 of ITEPA, inserted by the Finance Act 2003, being provisions that enabled the bonuses to enjoy the tax exemptions conferred by sections 425 and 429 of ITEPA. HMRC's stance is that the sole reason for the scheme was tax avoidance, and the only reason why an employee would participate in it would be to avoid tax. Mr Lasok described it as a 'cash in, cash out' scheme: UBS would decide upon the intended bonus, which it would pay into the scheme and which the employee could take out a few weeks later. I shall later explain why I regard that as a misdescription of the scheme.

9. The scheme involved UBS subscribing for shares in a company and then awarding the shares to the participating employees. Normally, the award to an employee of shares in a company by reason of his employment would give rise to a charge to income tax in respect of the acquisition on an amount equal to the market value of the shares at the time. But there was no such charge if the shares were 'restricted securities' within the meaning of section 423(2), in which event section 425 conferred a qualified tax exemption. In principle, section 426 would, however, charge income tax on the full value of the shares on a 'chargeable event', which would include when the shares ceased to be 'restricted', as happened in these cases. But Parliament also chose to permit an escape from such charge by section 429, which provided for an exemption from it if the shares were in a company which (amongst other conditions) had not in the previous 12 months been under the employer's 'control' as defined by section 416 of the Income and Corporation Taxes Act 1988 ('ICTA'). Provided the shares fell within these exemptive provisions, there would therefore be no section 426 liability to

income tax, although there would be a potential charge to capital gains tax ('CGT') on the disposal of the shares. For those employees who were non-UK domiciled, there would, however, be no charge to CGT unless gains were remitted to the UK. For those employees who were UK-domiciled, any charge to CGT could be reduced to 10% by business taper relief if the shares were held for two years and the employees continued to be employed by UBS.

*The UBS Scheme*

10. UBS operated performance incentive schemes whereby, in or around February in each year, it made bonus awards to selected employees. The schemes were limited to employees still in UBS's employment at the time of the award and who had not given or received notice of termination. UBS's Executive Share Investment Plan that is now in question ('the scheme') was one such scheme and it was designed to enjoy the tax benefits just summarised. UBS invited selected senior employees to indicate by 12 December 2003 whether they wished to participate in it, and thus to receive a proportion of their bonus award, if any, in shares instead of cash. 426 employees agreed to participate, ten of whom had a contractual right to be paid a minimum cash bonus, whilst for the remaining 416 any bonus was discretionary.

11. UBS engaged Mourant & Co Trustees Limited ('Mourant'), for a fee, to set up a special purpose vehicle for the purposes of the scheme. On 19 January 2004, an offshore special purpose vehicle company called ESIP Limited ('ESIP') was incorporated. Its sole function was to implement the scheme. On the same day, Mourant, in its capacity as the trustee of a pre-existing, unrelated charitable trust, the Sidemore Charitable Trust ('Sidemore'), resolved to subscribe for 200 ordinary £0.01 shares in ESIP for £2.

12. On 23 January 2004, a UBS remuneration committee finalised a list of employees who would receive a bonus award for 2003. This was not communicated to the employees.

13. On 26 January 2004, the share capital of ESIP was reorganised and ESIP adopted a new Memorandum and Articles of Association ('the M&A'). They provided for ESIP to have an authorised share capital of £2.6m voting ordinary shares ('VOS') and 100,000 non-voting redeemable shares ('NVS'). The 200 subscriber ordinary shares already issued were reclassified as VOS.

14. Article 2(7) entitled holders of NVS to receive dividends and surplus assets on a winding up and to redeem all or any of their shares on 22 March 2004, 22 March 2006 or 22 June 2006 for the same amount that the holder would have received if there had been a winding-up on the relevant redemption date.

15. Article 2(14) provided for a forced sale of the legal and beneficial interest in the NVS in certain circumstances. It would take effect if the closing value of an index ('the Index', which was to be specified by the directors) on any date between the first date of issue of the NVS (28 January 2004) and 19 February 2004 (defined as 'the Restricted Period') was greater than the 'Trigger Level' (also to be specified by the directors). In such event, the legal and beneficial interest in each NVS was immediately to be sold to the trustees of a discretionary trust for UBS employees (the UBS Employee Benefits Trust Limited) for a consideration equal to 'the Forfeiture

Price', namely one equal to 90% of their 'Market Value' as defined in the M&A, being their value if no restrictions applied to them. The purpose of the forced sale provision was to make the NVS 'restricted securities' for the purposes of section 423(2). The directors specified the FTSE 100 Index as the Index, and 4,749.15 as the 'Trigger Level'.

16. Article 2(15) provided that at any time when the holder or beneficial owner of any NVS was UBS or any other group company, article 2(7) did not apply, and that the NVS carried no right to dividends or other distributions, were not redeemable and would only carry a right to receive par on a winding-up. The purpose of this provision was to ensure that during the short period from 28 to 29 January 2004, when UBS held all the NVS, it did not have 'control' of ESIP so as to cause a failure of one of the conditions for the enjoyment of the section 429 tax exemption.

17. On 26 January 2004, Sidemore resolved to subscribe for an additional 1,699,800 VOS in ESIP for a total price of £16,998. This brought its total investment in ESIP to £17,000. It held 1,700,000 VOS.

18. On 27 January 2004, UBS subscribed for 900,000 VOS at £9,000. The effect was that whilst Sidemore's holding of VOS gave it shareholder control of ESIP, UBS's holding was sufficient to enable it to block a special resolution (for example, to wind ESIP up).

19. On 28 January 2004, UBS offered to subscribe for 91,880 of the NVS for £1,000 each, a total of £91,880,000. That was the exact equivalent of the cash payments which the UBS employees participating in the ESIP scheme would otherwise together have received as cash bonuses. The UBS offer was, however, conditional on ESIP agreeing to: (i) set the Index and Trigger Level in the manner specified; (ii) purchase call spread options for the NVS, to neutralise the effect of the Trigger Level being reached and of there being a forced sale of the NVS ('the hedging arrangements'); (iii) deposit the subscription price paid by UBS in an interest-bearing account until 20 February 2004; and (iv) use the subscription price paid by UBS to (a) buy shares in UBS in the last five days of February 2004 if the forced sale did not occur, or (b) keep the subscription price paid as cash if it did.

20. The directors of ESIP accepted and implemented those conditions. Pursuant to condition (ii), ESIP applied about 3% of the £91.88m in purchasing call options relating to the Index with an expiry date of 20 February 2004, so that if the Index exceeded the Trigger Level ESIP would make a gain, its net assets thereby increasing by about 10%. The effect of the hedging arrangements was that although the employees would be required to sell their NVS for 90% of their unrestricted value, they would not be materially worse off because the unrestricted market value of the NVS would be equal to approximately 110% of their original subscription price.

21. On 29 January 2004, UBS allocated 91,856 NVS to the relevant employees. On the same day, it transferred 24 NVS to the trustee of a UBS employee- benefit trust. That allocation accounted for UBS's full holding of 91,880 NVS.

22. In the event, the Index did not exceed the Trigger Level, and on 19 February 2004 the NVS ceased to be subject to the forced sale provisions and the call options did not pay

out: in short, the restriction was lifted. In compliance with condition (iv)(a) above, ESIP invested its net assets in the purchase of quoted UBS shares.

23. Articles 2(7)(e) to (g) of the M&A provided for an absolute right to redeem the NVS in March 2004, March 2006 and June 2006 at a price set by a pre-determined formula.

24. On 26 February 2004, UBS emailed the employees reminding them of their right to cash out in March 2004 and of the March deadline for doing so. More than half of the NVS were redeemed on 22 March 2004 at a price of £977.50 per share. Dividends were paid on the NVS in November 2004 (£13 per share) and December 2005 (£20 per share). On 22 March 2006, and once the two years necessary to take advantage of maximum CGT taper relief had ended, further NVS were redeemed for about £1,519 per share, which reflected a large increase in the value of UBS shares. On 22 June 2006, further NVS were redeemed, for £1,429 per share, reflecting a fall in the value of UBS shares. The remaining 44 NVS were redeemed in November 2006 at ESIP's own initiative when a resolution to wind ESIP up was passed.

*The legislation*

25. I shall have to refer to further legislative provisions later, but shall here refer to those at the heart of the issues.

26. I refer first to section 18 of ITEPA, 'Receipt of money earnings'. This is relevant to HMRC's submission that a charge to income tax arose upon the payment by UBS to ESIP of its subscription money for the NVS. Section 18 provides materially:

> '(1) General earnings consisting of money are to be treated for the purposes of this Chapter as received at the earliest of the following times –
>
> *Rule 1*
>
> The time when payment is made of or on account of the earnings.
>
> *Rule 2*
>
> The time when a person becomes entitled to payment of or on account of the earnings. …'

27. Section 19, 'Receipt of non-money earnings', provides materially:

> '(1) General earnings not consisting of money are to be treated for the purposes of this Chapter as received at the following times.
>
> (2) If an amount is treated as earnings for a particular tax year under any of the following provisions, the earnings are to be treated as received in that year – …
>
> (3) If an amount is treated as earnings under section 87 (taxable benefits: non-cash vouchers), the earnings are to be treated as received in the tax year mentioned in section 88.
>
> (4) If subsection (2) or (3) does not apply, the earnings are to be treated as received at the time when the benefit is provided.'

28. I turn next to the provisions of Chapter 2 of Part 7 of ITEPA. The UT, in [11] to [19] of their judgment, provided a valuable explanation of the historical context in which Chapter 2 came to be enacted. I shall also summarise the background, but relatively shortly, and for this purpose I have gratefully drawn, in part verbatim, on the UT's much fuller explanation. In *Abbott v. Philbin* [1961] AC 352, the majority of the House of Lords held that where an employee is granted a share option by reason of his employment, income tax is charged on the realisable monetary value of the option at the time of its acquisition. This was so even if the option was hedged around with conditions, provided it was capable of being turned to monetary account. As the value of such option rights was usually small, section 25 of the Finance Act 1966 reversed *Abbott* by imposing a charge to income tax on the exercise, assignment or release of employees' share options, on an amount equal to the gain thus realised, whilst removing any charge to tax on the grant of the option. Section 25 was consolidated as section 186 of the Income and Corporation Taxes Act 1970. Further refinements were added by the Finance Act 1972.

29. The legislation so far mentioned applied only to share options. It did not apply to a share incentive scheme, under which an employee subscribed for, or was awarded, shares to which restrictions were attached for a prescribed period (for example, in relation to voting rights or dividend receipts) and which would become more valuable on the lifting of the restrictions. By section 79 of the Finance Act 1972, a charge to income tax was imposed on the appreciation in value of the shares at the end of a period defined by the earliest to happen of the lifting of the restrictions, the time when the employee ceased to have any beneficial interest in the shares and the expiry of seven years from their acquisition. There were several exceptions to this charge.

30. The Finance Act 1998 inserted new sections 140A to 140C into ICTA. Their effect was to remove the charge to tax in respect of the acquisition of the conditional interests in shares and to impose a new charge to tax on the market value of the shares when the condition fell away. Sections 140A to 140C were re-enacted without amendment as the original Chapter 2 of Part 7 of ITEPA, Part 7 being headed 'Employment income: share-related income and exemptions'. Within a few months of the coming into force of ITEPA, the Finance Act 2003 substituted a new and more complex Chapter 2, with which these appeals are concerned. Chapters 1 and 2, as so substituted, contain the provisions central to the issues before us.

31. Chapter 1 comprises sections 417 to 421L. Section 417(1) explains that Part 7 'contains special rules about cases where securities, interests in securities or securities options are acquired in connection with an employment', and that the rules are contained in various Chapters in Part 7, including Chapter 2 (restricted securities). Section 417(3) explains that Chapter 2 makes provision for amounts 'to count as employment income' and section 417(4) explains that Chapter 2 also provides 'for exemptions and reliefs from income tax'. Section 420(1) defines 'securities' for the purposes of (inter alia) Chapter 2, as including:

> '(a) shares in any body corporate (wherever incorporated) or in any unincorporated body constituted under the law of a country or territory outside the United Kingdom,
>
> (b) debentures, debenture stock, loan stock, bonds, certificates of deposit and other instruments creating or acknowledging indebtedness …'

32. Section 421 explains that in (inter alia) Chapters 1 and 2, 'market value' has the same meaning as it has for the purposes of the Taxation of Chargeable Gains Act 1992 by virtue of Part 8 of that Act; and that 'where consideration for anything is given in the form of an asset (as opposed to a payment), any reference in [inter alia, Chapters 1 and 2] to the amount of the consideration is to the market value of the asset'. Section 421B provides materially:

> '(1) Subject as follows (and to any provision contained in Chapters 2 to 4) those Chapters apply to securities, or an interest in securities, acquired by a person where the right or opportunity to acquire the securities or interest is available by reason of an employment of that person or any other person.
>
> (2) For the purposes of subsection (1) –
>
> (a) securities are, or an interest in securities is, acquired at the time when the person acquiring the securities or interest becomes beneficially entitled to those securities or that interest (and not, if different, the time when the securities are, or interest is, conveyed or transferred), and
>
> (b) employment includes a former or prospective employment.
>
> (3) A right or opportunity to acquire securities or an interest in securities made available by a person's employer, or by a person connected with a person's employer, is to be regarded for the purposes of subsection (1) as available by reason of an employment of that person unless –
>
> (a) the person by whom the right or opportunity is made available is an individual, and
>
> (b) the right or opportunity is made available in the normal course of the domestic, family or personal relationships of that person. …'.

33. Chapter 2, 'Restricted Securities', comprises sections 422 to 432. Section 422 explains that Chapter 2 applies to 'employment-related securities' if they are either 'restricted securities' or 'a restricted interest in securities' at the time of the acquisition. Section 423, 'Restricted securities and restricted interest in securities', provides:

> '(1) For the purposes of this Chapter employment-related securities are restricted securities or a restricted interest in securities if –
>
> (a) there is any contract, agreement, arrangement or condition which makes provision to which any of subsections (2) to (4) applies, and
>
> (b) the market value of the employment-related securities is less than it would be but for that provision.
>
> (2) This subsection applies to provision under which –
>
> (a) there will be a transfer, reversion or forfeiture of the employment-related securities, or (if the employment-related securities are an interest in

securities) of the interest or the securities, if certain circumstances arise or do not arise,

(b) as a result of the transfer, reversion or forfeiture the person by whom the employment-related securities are held will cease to be beneficially entitled to the employment-related securities, and

(c) that person will not be entitled on the transfer, reversion or forfeiture to receive in respect of the employment-related securities an amount of at least their market value (determined as if there were no provision for transfer, reversion or forfeiture) at the time of the transfer, reversion or forfeiture.

(3) This subsection applies to provision under which there is a restriction on –

(a) the freedom of the person by whom the employment-related securities are held to dispose of the employment-related securities or the proceeds of their sale,

(b) the right of that person to retain the employment-related securities or proceeds of their sale, or

(c) any other right conferred by the employment-related securities,

(not being provision to which subsection (2) applies).

(4) This subsection applies to provision under which the disposal or retention of the employment-related securities, or the exercise of a right conferred by the employment-related securities, may result in a disadvantage to –

(a) the person by whom the employment-related securities are held,

(b) the employee (if not the person by whom they are held), or

(c) any person connected with the person by whom they are held or with the employee,

(not being provision to which subsection (2) or (3) applies).'

34. Section 425, under the heading 'Tax exemption on acquisition', provides:

'425. No charge in respect of acquisition in certain shares

(1) Subsection (2) applies if the employment-related securities –

(a) are restricted securities, or a restricted interest in securities, by virtue of subsection (2) of section 423 (provision for transfer, reversion or forfeiture) at the time of the acquisition, and

(b) will cease to be restricted securities, or a restricted interest in securities, by virtue of that subsection within 5 years after the acquisition (whether or not they remain restricted securities or a restricted interest in

> securities by virtue of the application of subsection (3) or (4) of that section).
>
> (2) No liability to income tax arises in respect of the acquisition, except as provided by –
>
> [various inapplicable provisions in other Chapters]
>
> (3) But the employer and the employee may elect that subsection (2) is not to apply to the employment-related securities.
>
> (4) An election under subsection (3) –
>
> (a) is to be made by agreement by the employer and the employee, and
>
> (b) is irrevocable.
>
> (5) Such an agreement –
>
> (a) must be made in a form approved by the Board of Inland Revenue, and
>
> (b) may not be made more than 14 days after the acquisition.'

35. Section 425 therefore provides for an exemption from tax upon the acquisition of restricted securities. But section 426, under the heading 'Tax charge on post-acquisition chargeable events', provides for a charge to tax on the occurrence of a 'chargeable event'. Section 427 explains what a 'chargeable event' is and section 428 explains the amount of the tax charge. There is no need to set those provisions out in full, but I should set out section 427(3):

> '(3) The [chargeable] events are –
>
> (a) the employment-related securities ceasing to be restricted securities, or a restricted interest in securities, in circumstances in which an associated person is beneficially entitled to the employment-related securities after the event,
>
> (b) the variation of any restriction relating to the employment-related securities in such circumstances (without the employment-related securities ceasing to be restricted securities or a restricted interest in securities), and
>
> (c) the disposal for consideration of the employment-related securities, or any interest in them, by an associated person otherwise than to another associated person (at a time when they are still restricted securities or a restricted interest in securities).'

36. The section at the heart of these appeals is section 429, 'Case outside charge under section 426'. Its essence is that section 426 does *not* apply to cases covered by section 429. It is section 429 that enables the scheme to enjoy its claimed tax advantages. From the perspective of the scheme's architects, it was a generous piece of legislation. Mr Lasok tried, but in my view failed, to explain the legislative rationale for such

generosity; and Mr Prosser and Mr Goy were equally baffled by it. Section 429 provides:

> '429 Case outside charge under section 426
>
> (1) Section 426 (charge on occurrence of chargeable event) does not apply if –
>
> (a) the employment-related securities are shares (or an interest in shares) in a company of a class,
>
> (b) the provision by virtue of which the employment-related securities are restricted securities, or a restricted interest in securities, applies to all the company's shares of the class,
>
> (c) all the company's shares of the class (other than the employment-related securities) are affected by an event similar to that which is a chargeable event in relation to the employment-related securities, and
>
> (d) subsection (3) or (4) is satisfied.
>
> (2) For the purposes of subsection (1)(c) shares are affected by an event similar to that which is a chargeable event in relation to the employment-related securities –
>
> (a) in the case of a chargeable event within section 427(3)(a) (lifting of restrictions), if the provision mentioned in subsection (1)(b) ceases to apply to them,
>
> (b) in the case of a chargeable event within section 427(3)(b) (variation of restrictions), if that provision is varied in relation to them in the same way as in relation to the employment-related securities, or
>
> (c) in the case of a chargeable event within section 427(3)(c) (disposal), if they are disposed of.
>
> (3) This subsection is satisfied if, immediately before the event that would be a chargeable event, the company is employee-controlled by virtue of holdings of shares of the class,
>
> (4) This subsection is satisfied if, immediately before that event, the majority of the company's shares of the class are not held by or for the benefit of any of the following –
>
> (a) employees of the company,
>
> (b) persons who are related to an employee of the company,
>
> (c) associated companies of the company,
>
> (d) employees of any associated company of the company, or

(e) persons who are related to an employee of any such associated company.

(5) For the purposes of subsection (4) a person is related to an employee if –

(a) the person acquired the shares pursuant to a right or opportunity available by reason of the employee's employment, or

(b) the person is connected with a person who so acquired the shares or with the employee and acquired the shares otherwise than by or under a disposal made by way of a bargain at arm's length from the employee or another person who is related to the employee.'

*The decision of the tribunals below*

37. The UT described the issues in both the UBS and the DB cases as having raised issues under three headings: (1) did the employees become entitled to be paid their bonuses in money before the sums allocated to them were applied in acquiring scheme shares? If yes, the bonuses were subject to tax; (2) if no, did any charge to tax arise under the provisions of Chapter 2? That raised the questions of whether the scheme shares were 'restricted securities' within section 423 and, if so, whether the employees were entitled to the tax exemption provided by section 429; (3) applying the *Ramsay* principle (*WT Ramsay Ltd v. Inland Revenue Commissioners* [1982] AC 300), and on a realistic appraisal of the facts, did the schemes fall outside Chapter 2 altogether?

38. In the UBS appeal, the FTT answered question (1) in favour of HMRC as regards the 10 participants who had a contractual entitlement to a bonus, but in favour of UBS as regards the other 416 participants who had no such entitlement. In answer to question (2), they held that the scheme shares were not 'restricted securities' (so that the scheme failed) but that, if wrong on that, the section 429 exemption was available. In answer to question (3), they held that the scheme anyway failed on *Ramsay* grounds. Thus the FTT found against the scheme both on technical and *Ramsay* grounds. The UT allowed UBS's appeal and upheld the scheme.

*The appeal*

39. The structure of Chapter 2 is therefore broadly, and so far as material, as follows. Chapter 2 applies to 'employment-related securities' if they are 'restricted securities' acquired by a person where the opportunity to acquire them was by reason of an employment of that person. They will be 'restricted securities' if they are subject to such a condition as is explained in section 423, as a result of which they may be subject to a 'transfer, reversion or forfeiture' in consequence of which the holder will receive less than their market value were they not subject to such a condition. Section 425 provides for a qualified exemption from tax on the acquisition of restricted securities to which subsection (1) applies. Section 426, however, provides for a charge to tax on the occurrence of a post-acquisition 'chargeable event' in relation to the restricted securities; and section 427 explains what the 'chargeable events' are, and they include 'the employment-related securities ceasing to be restricted securities …'. Section 428 explains the calculation of the tax in such event. Section 429 explains that cases that fall within its provisions are 'outside the charge under section 426'.

40. HMRC questions whether the scheme satisfies the technical requirements of Chapter 2 so as to fall within it. But even if it does, they say that the scheme is not entitled to the benefit of the tax exemptions to which it might then be thought to be entitled. That is because it is simply a tax avoidance scheme and it was not the intention of the legislature to extend the benefit of the provisions of Chapter 2 to artificial arrangements, such as the scheme, that are said to have no commercial purpose. That is HMRC's *Ramsay* point. I come to each of the six grounds argued by HMRC.

*1. The 'broad' Ramsay point*

41. Mr Lasok developed first his 'broad' *Ramsay* proposition (although no counsel actually referred us to *Ramsay*), and it was to the effect that the UT erred in its application to the scheme of the *Ramsay* doctrine. If right in this submission, the fiscal consequence was said to be that UBS would be treated as making an award of cash bonuses to the employees.

42. For what Mr Lasok said was the basic approach to the consideration of whether the scheme fell within the intent of Chapter 2, he cited *The Collector of Stamp Revenue v. Arrowtown Assets Limited* [2003] HKCFA 46, a decision of the Court of Final Appeal of the Hong Kong Special Administrative Region. The facts were miles from ours, but Mr Lasok referred us to some observations of Lord Millett, as well as to the following statement of Ribeiro PJ as to the driving principle in the *Ramsay* line of cases:

> '35. … The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction viewed realistically. Where schemes involve intermediate transactions having no commercial purpose inserted for the sole purpose of tax-avoidance, it is quite likely that a purposive interpretation will result in such steps being disregarded for fiscal purposes. But not always. *MacNiven* [*MacNiven v. Westmoreland Investments Ltd* [2003] 1 AC 311] is a good example of a case where a purposive interpretation of the statute and its application to the facts did not dictate excluding the taxpayer's payment of interest from the statutory provision treating such payments as deductible charges on income. On the true construction of the statute (for the reasons stated by Lord Nicholls at paras 14-17), it mattered not that there had been a circular movement of money between the debtor and the tax exempt creditor to fund the relevant interest payment having no commercial purpose other than to avail themselves of an allowable tax loss.'

43. Mr Lasok also referred to the judgment of Arden LJ in *Astall and another v. Revenue and Customs Commissioners* [2010] STC 137, where she said:

> '34. Both [*Barclays Mercantile Business Finance Ltd v. Mawson (Inspector of Taxes)* [2005] 1 AC 684] and [*IRC v. Scottish Provident Institution* [2005] STC 15] emphasise the need to interpret the statute in question purposively, unless it is clear that that is not intended by Parliament. The court has to apply that interpretation to the actual transaction in issue, evaluated as a commercial unity, and not be distracted by any peripheral steps inserted by the actors that are in fact irrelevant to the way the scheme was intended to operate. …

> 41 … Having said that, I would wish to make it clear that the mere fact that the parties intend to obtain a tax advantage is not in itself enough to make a statutory relief inapplicable.
>
> 44. … In my judgment, applying a purposive interpretation involves two distinct steps: first, identifying the purpose of the relevant provision. In doing this, the court should assume that the provision had some purpose and Parliament did not legislate without a purpose. But the purpose must be discernible from the statute: the court must not infer one without a proper foundation for doing so. The second stage is to consider whether the transaction against the actual facts which occurred fulfils the statutory conditions. This does not, as I see it, entitle the court to treat any transaction as having some nature which in law it did not have but it does entitle the court to assess it by reference to reality and not simply to form.'

44. Mr Lasok said the message from these statements is that legislation should be interpreted by reference to the purpose it is intended to achieve, which requires an application of it to the real world rather than to a fictitious one. He referred us to certain findings of the FTT as to the nature of the scheme. The FTT described its significant feature as an arrangement for the payment of bonus sums. They were paid into the scheme rather than directly to the employee but ultimately the employee was to get cash, and once the scheme had served its purpose the arrangement was wound up. The immediate purpose of the scheme was to take steps to remove income tax and NIC liabilities from the bonus received by the employee. The FTT then referred to the hedging arrangements in the scheme that were directed at countering the risk to the employees in case of a forfeiture. They said the aim there was to achieve a complete offset of the loss to an employee if the trigger event occurred, the reality being that the scheme was designed so that employees would not suffer any significant loss in such event. These considerations were part of the FTT's reasoning that led it to the conclusion that the securities were not 'restricted securities' within the meaning of Chapter 2. Their conclusion was that the predominant reason for the scheme was the mitigation of the burden of income tax and both employer and employee NICs.

45. The UT, however, took a different view. They regarded the FTT's explanation of the 'reality' of the scheme as little more than a restatement of its intended fiscal purpose. It was also inaccurate for the FTT to say, as they had, that the scheme provided for employees to receive the 'same sums' on redemption of the NVS as they would have received as earnings, because of the requirement under the scheme for the subscription money to be invested in the purchase of UBS shares. It followed that the amount received on redemption was linked to the value from time to time of the UBS shares; and, the UT pointed out, 'for the substantial number of employees who held their NVS until the second or third redemption dates, the amount received bore no relation to the cash value of the original bonus.'

46. Mr Lasok submitted that that proposition unfairly summarised the FTT's approach and said the UT's point about the potential difference between the original bonus allocation and the actual return to scheme participators on the redemption of their NVS was unsound. The redemption arrangements were a fundamental part of the scheme. He referred to an email sent to scheme employees on 26 February 2004 reminding them in bold that the first optional redemption period would run from 1 March 2004, giving details of how to redeem and explaining that 12 March 2004 was the deadline for redeeming during this period. The focus on redemption for cash

showed that the securities were not intended to function as securities in the normal sense. They were not granted as interests in companies with an independent business: ESIP had no business apart from the function it was performing for the purpose of the scheme. It was simply a vehicle for passing to the employees the cash identified for them at the outset. The scheme had no commercial purpose, only a tax avoidance purpose. Chapter 2 was not intended to apply to such a scheme. It was wrong to regard it as a scheme under which employees were being rewarded by the allocation of shares. Its sole purpose was to reward them in cash. The shares were not, therefore, 'restricted securities' at all, and the scheme fell outside Chapter 2. Mr Lasok did not go so far as to say that the shares issued to the employees did not exist, or were to be regarded as not existing. His point was that they did not perform the function envisaged for 'restricted securities' in Chapter 2. The fact that those employees who redeemed their shares in 2006 and paid CGT, subject to taper relief, was not, it was said, a relevant consideration.

47. Before dealing with the response to this argument, I shall also summarise Mr Lasok's alternative *Ramsay* submission.

*2. The 'narrower' Ramsay point*

48. Mr Lasok's alternative *Ramsay* point, for which he sought permission to appeal, is one he described as a narrower or reduced version of his primary *Ramsay* argument. If right on this alternative argument, but not on his broader one, he said the fiscal conclusion would be that whilst UBS had rewarded the employees with shares, they were not 'restricted shares' and would therefore have been taxed by reference to their market value.

49. The argument centred on UBS's admission that the forfeiture restriction imposed upon the ESIP shares had no commercial purpose. It was, therefore, a commercially irrelevant provision inserted solely for the purpose of achieving the intended tax avoidance. Mr Lasok underlined that by noting that the hedging provisions in the scheme were designed to neutralise any adverse consequences of the forfeiture provision, and so served to render the forfeiture provision substantially meaningless in real terms. In substance, the narrower *Ramsay* argument amounted to focusing not on the alleged artificiality of the scheme as a whole, but on just one key element of it, the forfeiture provision.

50. In response to both *Ramsay* arguments, Mr Prosser explained that there was a good reason why we were not referred to *Ramsay.* That is because the House of Lords in *Barclays Mercantile Business Finance Ltd v. Mawson (Inspector of Taxes)* [2005] 1 AC 684 had since sufficiently explained what the *Ramsay* principle is, as recognised in *Mayes v. Revenue and Customs Commissioners* [2011] STC 1269. It is unnecessary to cite at length from Mummery LJ's illuminating judgment in *Mayes*. The thrust of it is in the following excerpts:

> '71 … I very much doubt whether, since *Mawson,* it really is necessary to return each time to the base camp in *Ramsay* and trek through all the authorities from then on. For practical purposes, it should, in general, be possible to start from the position stated in the unanimous report of the Appellate Committee in *Mawson* at [26]-[42] under the heading "*The Ramsay principle.*" *Mawson* was obviously meant to be a significant judicial stocktaking of the "new approach" to

> the construction of revenue statutes first applied in *Ramsay* and followed [in] subsequent cases on the *Ramsay* principle. …
>
> 73. Basing myself on the key passages in *Mawson* I agree with Proudman J that the special commissioner erred in law. In allowing the appeal by Mr Mayes, Proudman J correctly applied the new approach to construction laid down in *Ramsay* and clarified in *Mawson,* in her construction of the scope of the ICTA provisions and in her analysis of the legal and fiscal effects of STEPS 2.
>
> 74. First, *Ramsay* did not lay down a special doctrine of revenue law striking down tax avoidance schemes on the ground that they are artificial composite transactions and that parts of them can be disregarded for fiscal purposes because they are self-cancelling and were inserted solely for tax avoidance purposes and for no commercial purpose. The *Ramsay* principle is the general principle of purposive and contextual construction of all legislation. ICTA is no exception and is not immune from it. That principle has displaced the more literal, blinkered and formalistic approach to revenue statutes often applied before *Ramsay.* …
>
> 76. Secondly, HMRC are not, in my view, in fact submitting that there is a special doctrine. They were told in *Mawson* (at [34]) that revenue jurisprudence was not "governed by special rules of its own." *Mawson* made it clear that under the *Ramsay* principle there were two stages in the application of the statutory provisions – a purposive construction of the statute to see, on a "close analysis", what transaction will answer to the statutory provision and a realistic analysis of the transaction to see whether it answers to that description – and that it was wrong to elide the two stages by "sweeping generalisations" about disregarding for fiscal purposes elements that were only inserted for fiscal avoidance reasons and had no commercial purpose. …'.

51. We were referred to *Mawson* itself, from which I shall not also cite, but record that Mr Prosser drew our attention to [26] to [42] in the speech of Lord Nicholls of Birkenhead. Mr Prosser's essential submission was that these cases show that the task for the court in a case such as this is to adopt a purposive interpretation of the relevant legislation; and the transaction in question should be looked at as a whole, as opposed to on a step by step basis. There is nothing special about tax cases, to which the approach should be the same as in non-tax cases. The task in this case is to focus on the provisions of Chapter 2, read in the context of Part 7, and identify its requirements. When that is done, Mr Prosser submitted that there is no warrant for a conclusion that Chapter 2 has no application to transactions carried out for tax avoidance purposes only, nor for Mr Lasok's alternative submission that securities that are subjected to restrictions for tax purposes only are not 'restricted securities'.

52. With a view to making this good, Mr Prosser took us on a tour through Part 7. Section 417(1), in Chapter 1, explains that Part 7 contains special rules about cases where securities or interests in them are acquired in connection with an employment. The rules are in 13 separate Chapters. Section 417(4) explains that Chapters 2, 3 and 5 to 10 make provision for 'exemptions and reliefs from income tax'. Tax exemptions are, therefore, part of what Part 7 is about. Securities are defined in section 420(1) under seven sub-paragraphs. Nothing there suggests that the only securities contemplated are those given to an employee by way of an incentive. The definition extends to securities in companies unrelated to the employer and is, apparently deliberately,

spread very wide. Mr Prosser accepted that it is legitimate in a case such as this to ask whether what the employee gets is securities or money. What it is not legitimate to ask is whether he got what he did for tax avoidance reasons, which is the broader question that Mr Lasok submitted should be answered.

53. Section 421B then explains that Chapters 2 to 4 apply to securities acquired by a person 'where the right or opportunity to acquire [them] is available by reason of an employment of that person or any other person'. Section 421(3) shows that, save in specified cases, there is a presumption that such a right or opportunity to acquire securities made available by one's employer 'is available by reason of an employment of that person …'. Again, there is no suggestion there that what counts is whether the securities are made available for incentive purposes. Section 421E explains cases in which Chapters 2, 3 or 4 do not apply: but it does not include in the exclusions the provision of securities for tax avoidance purposes. According to HMRC, that is so obvious that there was no need to say so.

54. Moving to Chapter 2, and assuming that what the employees got were 'securities' acquired by reason of the employees' employment, the question is whether they are in principle governed by Chapter 2. Chapter 2 provides the answer by explaining in section 422 that it applies to 'employment-related securities' if they are 'restricted securities at the time of the acquisition.' There is then a wide definition of 'restricted securities' in section 423. Assuming (contrary to another HMRC argument) that the NVS in ESIP satisfied the conditions of section 423, Mr Prosser's submission was that there is no basis for Mr Lasok's assertion that they nevertheless fell outside the grasp of section 423 because they were designed for tax avoidance purposes. Section 424 sets out the 'Exceptions', namely the cases when employment-related securities will not be restricted securities: again, it does not include cases where they were acquired for tax avoidance purposes. If one negotiates Chapter 2 as far as sections 426 to 429, they show that section 429 excludes restricted securities from the tax charge that would otherwise arise under section 426. Mr Prosser was unable, like Mr Lasok, to explain the rationale for section 429 and said that it 'puzzles everyone … because [it] doesn't make sense'. He could not discern any purpose in it save one aimed at affording an exemption to tax in cases which satisfied its conditions. Even Mr Lasok was reduced to arguing a point of construction in relation to section 429: it was no part of his argument (save as part of his broad *Ramsay* submission) that section 429 is not there to help tax avoiders. In fact, Parliament was quick to recognise that it may have missed a trick there, and section 86 of the Finance Act 2004 amended section 429 so as to exclude its application in tax avoidance cases. That amendment may, on one view, be said to have assumed that Mr Lasok's broad *Ramsay* argument was wrong; but of course, if so, Parliament may in that respect itself have been mistaken.

55. In this last context, Mr Prosser also referred us to Chapter 3A in Part 7, headed 'Securities with artificially depressed market value'. Its provisions were expressly directed to cases 'where the market value of employment-related securities … is reduced by things done otherwise than for genuine commercial purposes.' That again shows that, when Chapter 2 was enacted, Parliament knew perfectly well how to deal with tax avoidance schemes, and did so in Chapter 3A: but it did not do so until a year later in Chapter 2. In like vein, Chapter 3B deals with cases where the market value is artificially enhanced.

56. Turning to HMRC's broad *Ramsay* submission, Mr Prosser said that what it comes down to is that Chapter 2 does not apply to a scheme for paying cash bonuses to employees so as to escape a charge to income tax. Insofar as it is implicit in that submission that Chapter 2 does not apply to schemes that are directed at tax avoidance, he said there is no principled justification. As to whether the UBS scheme was one for paying money to employees, it is obvious that Chapter 2 does not apply to schemes for the payment of money. The question in this case is, however, whether what the employees got was money or securities. Mr Prosser recognised that what the scheme employees got was capable of being converted or realised into money, but so will many of the securities that will qualify as restricted securities for Chapter 2 purposes – they include debentures, loan stock, certificates of deposit and other instruments acknowledging indebtedness. So the fact that the NVS issued to the scheme employees could and would be redeemed for cash in the future does not prevent them being securities.

57. In Mr Prosser's submission, the answer to the 'securities or money' question is a fact-sensitive one. It may be that, even if shares are allocated, they will carry rights which mean in practical terms that they can simply be regarded as a right to money – if, for example, they are redeemable immediately for a fixed sum. Or they might give a right to dividends dependent on the profitability of the company, and to a right of redemption in an amount similarly dependent. It might also be relevant to consider how quickly they can be redeemed. In the UBS case, the circumstances were closer to the latter type of case. The shares did not guarantee the employees a specific, predictable return on redemption. The redemption proceeds, and dividends payable in the meantime, would depend on the performance of the UBS shares held by ESIP: upon redemption, an appropriate number of UBS shares would be sold for their then market value. The employees' securities therefore functioned just as shares normally do.

58. Then it is said by HMRC that, although some scheme members did not redeem their shares for over two years, the scheme should get no credit for that because that too was motivated by tax avoidance. But all that those scheme members were doing was taking advantage of the reduction in capital gains tax that was available if the shares were held for two years. That was legitimate tax mitigation, recognised by Parliament. Mr Prosser's answer to the broad *Ramsay* argument was, therefore, that what has to be looked at is not the intention of the parties to the scheme, but the nature of the securities that were provided under it. If they were covered by Chapter 2, so was the scheme, even though tax avoidance was its driver. The FTT found that these were real shares, and so they were.

59. In the result, the UT were, said Mr Prosser, entirely right to say there was no intellectually coherent way in which HMRC could assert that the scheme was simply about the payment of cash bonuses. No doubt a fixed amount went in; but there was no certainty what would come out on redemption.

60. Mr Lasok's alternative *Ramsay* argument was that if the NVS were securities, they were not 'restricted securities'. That was said to be because there was no commercial rationale for subjecting them to the 'transfer, reversion or forfeiture' restriction. Mr Prosser accepted that the forfeiture event in the scheme had no commercial rationale, but did not accept that that meant that the scheme did not work. Do the 'certain circumstances' that are a condition of section 423 mean what they say, or does section

423 only have in mind 'certain circumstances' other than those included for tax avoidance purposes? Mr Prosser said there was no basis for any such distinction. He accepted there must be a real, genuine possibility of the stated circumstances occurring: if they were never going to happen in the real world, a purposive interpretation of section 423 would exclude them from its contemplation. In this case, the FTT found there was a genuine possibility of a forfeiture happening on the facts of the scheme. The 'certain circumstances' were therefore real ones, even though their inclusion in the scheme was tax motivated.

61. Mr Goy, for DB, adopted Mr Prosser's submissions on the broad *Ramsay* submission in response to the like case levelled against DB on the scheme in that appeal. Whether Chapter 2 applies to the schemes is a question that can only be answered by a close analysis of what it means and what it provides for. He said the *Mayes* case is particularly important because it was one where the mere fact that something was done to avoid tax did not mean that it could be disregarded. In this case, what is required is to look at the schemes as a whole and to take a realistic view of the facts to see whether Chapter 2 applies to them. In DB, the FTT found, in paragraph 61, that the shares were 'real shares', that the holders received 'actual dividends' and that the shares were 'securities'. On the sale of the shares by those domiciled in the United Kingdom, CGT was paid. How can the fact that the employees received such shares therefore be disregarded? Once one arrives at the correct conclusion that the case is one about the issue to the employees of securities, the next question is whether they are 'restricted securities' and whether the criteria of Chapter 2 are satisfied. It would, said Mr Goy, be odd to interpret Chapter 2 as excluding tax avoidance schemes, when tax avoidance is one of the purposes for which Chapter 2 exists.

62. In conclusion on HMRC's broad and narrower *Ramsay* arguments, I would accept the arguments advanced on behalf of UBS and DB in preference to those advanced on behalf of HMRC. There is no dispute that the scheme was a tax-avoidance scheme. It was directed at avoiding the income tax consequences that would follow from the payment to employees of bonuses in cash. Instead, therefore, UBS rewarded their employees with shares, and say that such shares were therefore employment-related securities, indeed 'restricted securities', whose award fell squarely within the prescriptive provisions of Chapter 2; and, to the extent that Chapter 2 afforded exemption from income tax in relation to chargeable events affecting such shares, there is no reason why UBS is not entitled to it.

63. I agree with Mr Prosser and Mr Goy that the first question is whether, under the scheme, what was provided to the employees by UBS was money or shares. If on a fair analysis of the scheme, the correct answer is that it was money, there can be no question of Chapter 2 having any application. Moreover, I also agree with Mr Prosser that there might be cases in which, even though what was nominally awarded were shares, an objective interpretation of the true nature of the arrangements would justify the conclusion that in fact the employee was being paid money: for example, if the shares were required to be redeemed immediately for a pre-ordained cash sum.

64. In this case, however, there is in my view no question of the scheme being one for the payment of money, and I regard HMRC's endeavours to suggest that it was as misconceived. The FTT found that the NVS were real shares, some of which were held by employees for more than two years, and real dividends were paid on them. Moreover, although the employees had the right to redeem their shares for cash over a

period of two years, the redemption money was not pre-ordained, but its amount varied with the fortunes of the UBS shares held by ESIP, which could have risen or fallen. The shares were therefore real shares which functioned as such. It is true that the scheme could, in substance, be regarded as one in which a fixed amount of money was invested in employment-related shares for each scheme employee. But it was not a scheme under which the employee would, upon redeeming his shares, be entitled to a payment of the like sum. What he would receive was the redemption value of his shares, which might well be a very different sum. The scheme was therefore one for the provision of shares to the employees, not for the payment of money to them.

65. As what was provided to the employees was shares, there is in my view no scope for arguing that the shares were other than 'securities … acquired in connection with an employment' within the meaning of section 417(1) and 420 in Chapter 1. They were therefore 'securities' for the purposes of Chapter 2; and, provided that they satisfied the conditions of section 423, they were also 'restricted securities' for Chapter 2 purposes. I do not understand the argument that because, so it is said, the 'transfer, reversion or forfeiture' circumstances had no commercial rationale, the shares could not be restricted securities. That appears simply to be another way of saying that Chapter 2 does not apply to tax-avoidance schemes. But I do not follow on what basis it can be said that the 'certain circumstances' referred to in section 423(2)(a) can only be 'circumstances' included other than for tax avoidance purposes. There appears to me to be no justification for any such distinction. I of course accept, as did Mr Prosser, that there must be a real, genuine possibility of the stated circumstances occurring: if they were never going to happen in the real world, a purposive interpretation of section 423 would exclude them from its contemplation. In this case, however, the FTT found there was a genuine possibility of a forfeiture happening on the facts of the scheme. The 'certain circumstances' were therefore real ones, even though their inclusion in the scheme was tax motivated. If, therefore, as follows, the NVS are 'restricted securities' within the meaning of section 423, from where in Chapter 2 does one derive the conclusion that Chapter 2 as a whole nevertheless cannot apply simply because the scheme is driven by considerations of tax avoidance? As the UT said, Chapter 2 contains a detailed and prescriptive code for dealing with restricted securities. I agree with the UT that the NVS were restricted securities whose taxation fate was governed by that code. I would reject HMRC's submissions that *Ramsay* principles, whether broad or narrow, require these genuine, employment-related NVS to be regarded other than as genuine 'restricted securities' within the meaning of Chapter 2.

66. I would dismiss HMRC's appeal on the broad *Ramsay* ground and would refuse permission to appeal on the narrow *Ramsay* ground.

*3. Section 18 of ITEPA*

67. Mr Lasok's next point, for which he also sought permission to appeal, was based on section 18 of ITEPA, quoted in [26] above. Before both tribunals below, HMRC argued that the application by UBS of the cash equivalent to the bonus allocated to a scheme employee in subscribing for NVS in ESIP marked the time when the employee became 'entitled to payment … of the earnings' within the meaning of Rule 2. That argument failed and was not repeated to us. The argument that Mr Lasok advanced to us in its place was a new one based on Rule 1. It was that, accepting there was no 'entitlement' under the scheme documentation for the purposes of Rule 2,

when UBS applied the amount of bonus earlier allocated to each scheme employee in subscribing for NVS in ESIP, it was making a Rule 1 payment of the employee's money earnings 'on account' of earnings that the employee would become entitled to when the shares were later allocated to him, and so at the point of subscription such earnings were treated as received by the employee. Mr Lasok specifically did not submit that at the moment of subscription UBS was making a 'payment … of … earnings' for the purposes of Rule 1.

68. Mr Prosser pointed out that section 18 of ITEPA is in Chapter 4 of Part 2, 'Employment Income: Charge to Tax'. Chapter 2 is headed 'Tax on Employment Income' and section 6(1) provides that 'The charge to tax on employment income under this Part is a charge to tax – (a) general earnings, …'. 'General earnings' are defined by section 7(3) as meaning 'earnings within Chapter 1 of Part 3 …'. Section 62, in Chapter 1 of Part 3, defines earnings materially as follows:

> '(1) This section explains what is meant by "earnings" in the employment income Parts.
>
> (2) In these Parts "earnings", in relation to an employment, means –
>
> (a) any salary, wages or fee,
>
> (b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or
>
> (c) anything else that constitutes an emolument of the employment.'

69. This case concerns bonuses, not salary, wages or fees, although a bonus is a 'profit' within section 62(2)(b), but Mr Prosser said they all refer to what the employee obtains. He did not suggest that this means the employee must himself actually receive the money; it will, for example, be sufficient if it is paid to someone at his direction, or if he is in control of it. In this case, however, there can be no suggestion that when UBS paid its money to ESIP in subscribing for shares, it was doing so at the direction of the employees who had agreed to take part in the scheme, or that the employees had any control over the money so paid. Moreover, when UBS asked the employees whether they would like to take part in the scheme, it expressly reserved the right not to go ahead with the scheme.

70. In particular, as for 416 of the employees who agreed to take part in the scheme, they had no contractual right to any bonus and could not have acquired any such right when UBS subscribed for shares in ESIP. The other 10 scheme applicants had a right to a bonus of a specified amount if they were still in employment in February 2004 and no notice to terminate their employment had been given or received. The section 18, Rule 2, argument succeeded in relation to the 10 in the FTT, but failed in the UT and was not repeated to us. Mr Prosser accepted, as I understood it, that as regards the 10, if they had received nothing by the February 2004 pay date, they would have been entitled to shares when they were subscribed for, because that is what they had signed up for. They would not, however, have been entitled to cash. In the event, the February pay date post-dated the declaration of trust in respect of the NVS.

71. As regards the 10, it appears to me that they had a contractual right to a particular cash bonus payment in February 2004. In the meantime, however, they agreed that their right would be satisfied by an award of shares under the scheme. That happened in January 2004, when UBS made its declaration of trust in respect of the NVS. I regard that as the beginning and the end of the story as regards the 10 for the purposes of the present submission, subject only to Mr Lasok's point that when UBS paid the money to ESIP by way of subscription for the NVS, it was making an 'on account' payment of earnings to the 10 – as well of course as to the 416.

72. Mr Prosser accepted that when the declaration of trust was made, all scheme employees became entitled to 'earnings' within the meaning of section 62. He said, however, that section 18, Rules 1 and 2, were not in point, because they apply exclusively to 'earnings consisting of money', whereas the earnings that the scheme employees received were not money: they were non-money earnings of a money's worth nature, and so were earnings to which section 19 applied; and section 19(4) explains that they were treated as received by the scheme members when 'the benefit is provided', which can only mean when the declaration of trust in relation to the NVS was made. Mr Prosser accepted that, in principle, such a benefit is taxable, the basic rule being that it is taxable on the amount that the scheme members could have got for their money's worth. But the answer to that charge on the present facts is that the shares were 'restricted securities' within Chapter 2 of Part 7 and, for reasons explained, escaped a charge to income tax altogether.

73. In short, Mr Prosser's answer to Mr Lasok's section 18, Rule 1, submission is that the only relevant earnings in this case were not 'money' earnings at all, but were 'money's worth' earnings, to which Rule 1 has no application. He also disclaimed any understanding of why HMRC favoured the 'on account' limb of Rule 1 rather than the 'payment is made of … earnings' limb, although I suspect that the answer is that the latter alternative is more obviously misconceived than the former. He also said that in any event HMRC ought not to be entitled to run the new Rule 1 point at the stage of this second appeal. There was, he said, no evidence adduced before the FTT as to whether, when it made the subscription payment, UBS was intending in any manner to discharge its liability to the scheme employees. It is also too late to remit the matter to the FTT for further evidence. HMRC are entitled to only one bite of the cherry.

74. The same point under Rule 1 of section 18 was also raised in HMRC's respondent's notice in the DB appeal, although that appeal is shorn of the minor complication that might be said to arise in respect of the UBS 10. Mr Goy adopted and supported Mr Prosser's submissions.

75. In my view, there is nothing in HMRC's section 18, Rule 1 argument. I have held in relation to the *Ramsay* arguments that the employees were rewarded with real shares, not money, and so I agree with Mr Prosser and Mr Goy that section 18 is irrelevant since it applies only to money earnings. In reply, Mr Lasok said that no-one seemed to have understood that he was advancing his Rule 1 argument on the assumption that he was correct on his broad *Ramsay* argument and that therefore the employees were to be regarded as receiving money, not shares. I admit to being one of those who had failed to understand that. However, I am satisfied that what the scheme employees received was shares, not money, and so I regard section 18 as inapplicable. I would refuse HMRC permission to appeal on this ground.

*4. Were the scheme shares 'restricted securities'?*

76. Mr Lasok advanced various submissions to the effect that the scheme anyway did not satisfy the requirements of Chapter 2 and so was not entitled to its tax exemption benefits. The first submission arose in relation to section 423, which defines 'restricted securities'. For the shares so to qualify, they had to satisfy section 423(2)(c), which requires a comparison of two amounts. The first is what the employee is entitled to receive on a transfer, reversion or forfeiture ('the receivable amount'). The second is the hypothetical market value of the shares at the time of the transfer, reversion or forfeiture as if there were no provision for such ('the market value'). Mr Lasok's argument required a focus on the bracketed words in section 423(2)(c), reading '(determined as if there were no provision for transfer, reversion or forfeiture) …'. Section 423(2)(c) shows that the receivable amount has to be lower than the market value, otherwise section 423(2) will not be satisfied: more accurately, it is a condition that its recipient '*will not be entitled* to [a receivable] amount of at least [the securities'] market value'. Under ESIP's M&A, the forfeiture price was 90% of the market value estimated to be obtainable for the shares if no restrictions applied.

77. I should refer to certain provisions of ESIP's M&A. Article 1.1 provided that:

> '**Forfeiture Price'** means 90 per cent of the Market Value of a Non-Voting Share on the Forced Sale Date …
>
> **'Market Value'** means the price estimated in good faith by the Directors to be obtainable for the share or shares concerned on a sale in the open market between a willing seller and a willing buyer on the relevant date, if no restrictions (including for the avoidance of doubt under Articles 2(14) or 2(15) applied to those shares …
>
> **'NAV'** means the excess of the value of the assets of the Company over its liabilities …
>
> **'Purchaser'** means UBS Employee Benefits Trust Limited …
>
> **'Restricted Period'** means, in relation to the Non-Voting Shares, the period from the date of first issue of any Non-Voting Shares to 19 February 2004 inclusive.'

Article 2(14) provided:

> '… if the closing value of the Index on any date during the Restricted Period is greater than the Trigger Level, the legal and beneficial interest in each Non-Voting Share in issue shall be immediately and automatically sold to the Purchaser for a consideration equal to the Forfeiture Price.'

78. The essence of Mr Lasok's submission was that the sense of the bracketed words is that the market value to be determined for the purpose of the second calculation must be assessed on the basis that not only is there no provision for a transfer, reversion or forfeiture, but *also* that there is no hedging provision such as in the UBS scheme, since that provision was said to be inextricably bound up with the transfer, reversion or forfeiture provision. The effect of the hedging arrangements was that their

implementation would result in the net assets of ESIP increasing by about 10%. The intention behind them was that although the employees would, upon a triggering event, be required to sell their NVS for 90% of their market value, they would not be materially worse off because the market value of the NVS would be equal to approximately 110% of the original subscription price.

79. The way that might translate into practical considerations was the subject of findings by the FTT. They found that the employees would be likely to receive 99.2% of their bonus entitlements in respect of the NVS if the trigger event occurred, the NVS were forfeited *and* the payment to ESIP under the hedging arrangements was made. The FTT also found that there was a possibility that, because of the hedging arrangements, the employees might even receive more than 100% of their bonus entitlements. By contrast, the market value of the NVS on the same date if the NVS were unrestricted, and there were no hedging arrangements, would be likely to be less than 100% of the bonus entitlements. Thus, on the latter facts, the market value was likely to be less than 100% of the bonus entitlements, whilst the possible receivable amount on the occasion of a transfer, reversion or forfeiture ranged from 99.2% to over 100% of the bonus entitlements. As a result, on the facts, and if the hedging arrangements were left out of account in the market value calculation, there was a risk that the receivable amount would be greater than the market value. Even if the lowest value for the receivable amount were to be taken, the difference between the receivable amount and the market value would be likely to be so small that it could be ignored as *de minimis.* It follows, said Mr Lasok, that section 423(2)(c) is not satisfied because it could not be said at the outset that the receivable amount 'will not be' at least the market value.

80. Mr Lasok supported his submission that in calculating the market value the hedging arrangements must also be left out of account by citing *East End Dwellings Co v. Finsbury Borough Council* [1952] AC 109, in which Lord Asquith said, at 132:

> 'If you are bidden to treat an imaginary state of affairs as real, you must surely, unless prohibited from doing do, also imagine as real the consequences and incidents which, if the putative state of affairs had in fact existed, must inevitably have flowed from or accompanied it.'

81. Second, he said the purpose of section 423(2)(c) was to reflect the depressing effect on the market value which would be caused by the restriction and to ensure that, if the employee was only entitled to receive the depressed value of the securities, they would still be 'restricted securities'. The purpose of the hedging arrangements was to negate such depressing effect and to ensure that the employees did not in reality receive the depressed market value of their shares. So the hedging arrangements rectified the very problem that section 423(2)(c) was intended to address.

82. Third, he said that the language of section 423(2)(c) did not require only that the forfeiture provision be ignored in calculating the market value. That might perhaps, read in isolation, be regarded as the limit of the sense of the bracketed phrase. But the hedging provisions were, for the purposes of section 423(1), part of the 'contract, agreement, arrangement or condition' that made 'provision' to which any of subsections (2) to (4) applied, and it was therefore appropriate to look at all parts of the contract etc to decide what 'provision' was made; and, in particular, in construing section 423(2)(c) to have regard to the hedging arrangements in considering whether the condition there prescribed was satisfied.

83. If Mr Lasok was correct on this submission, it would follow that the shares were not 'restricted securities' for the purpose of Chapter 2 with the consequence that the scheme could not enjoy the benefits of Chapter 2.

84. The UT disagreed with the FTT's approach, and also with Mr Lasok's submission. They held that what section 423(2)(c) requires is to compare (a) what the employees will get on a forced sale with (b) the market value at that time ignoring the restriction. Mr Prosser submitted that the UT was correct.

85. The UT gave elaborate reasons for their conclusion that, contrary to the view of the FTT, the section 423(2)(c) condition was here satisfied; and Mr Prosser also advanced full reasons in support of that conclusion, which were in their essentials as follows. 'Market value' in section 423(2)(c) is explained in section 421, which gives it the meaning it has for the purposes of the Taxation of Chargeable Gains Act 1992 by virtue of Part 8 of that Act: that is 'the price which those assets might reasonably be expected to fetch on a sale in the open market.' In a case where, as here, the hypothetical sale would be subject to the restrictions, the definition would ordinarily require an assumption that the purchaser would take subject to the restrictions, which would have a depressing effect on the price the purchaser would pay and thus on the market value. The purpose of the bracketed words in section 423(2)(c) was to negate the depressing effect on the market value which would be caused by making the assumption that the purchaser would take subject to the restrictions, and so ensure that, if the employee were to receive only the reduced market value of the securities, they would remain restricted securities for the purpose of Chapter 2. In other words, in order to ensure that the securities are 'restricted securities', if the amount the employee will be entitled to receive on a forced sale will be less than their unrestricted market value, an adjustment has to be made to 'market value' as defined; and it is the bracketed words that perform that function.

86. I would accept that argument as a correct explanation of the function of section 423(2)(c). As to what the bracketed words mean, I regard it as plain that their ordinary and natural sense is that they require no more than that 'the provision for transfer, reversion or forfeiture' is to be ignored. There is no warrant for interpreting the words as if they extended also to the hedging arrangements, which as a matter of language they do not; and, as the UT said, those arrangements were anyway purely collateral and served a different purpose of ensuring that the employees would not end up significantly out of pocket if a forced sale occurred. The only purpose of the bracketed words is to negate the depressing effect of the assumption, implicit in the definition of 'market value', that the purchaser will take subject to the restriction. Whatever the notional market value of the securities, the employees still only get 90% of it in the event of a forced sale. As the UT said, and I agree, the conclusion that they would *not* be entitled to receive at least the market value of their shares is inescapable.

87. I would dismiss this ground of HMRC's appeal.

*5. The 'control' point: section 429*

88. Mr Lasok's point here was that the scheme shares did not satisfy the requirements of section 429. They had to do so if the claimed exemption was to be justified, since the shares ceased to be 'restricted securities' on 19 February 2004, when the restricted period ended and (subject to section 429) became subject to a charge to tax under

sections 426 to 428. The FTT held that section 429 would have applied if, contrary to their prior holding, the shares were 'restricted securities'. The UT also held that section 429 applied.

89. As the UT noted in [113], section 429 applies if four conditions are satisfied. It is agreed that the following three are. First, that the NVS must be 'shares … in a company of a class' (section 429(1)(a)). Second, the transfer, reversion or forfeiture provision must apply to all the shares of the class (section 429(1)(b)). Third, all the shares of the class (other than the employment-related securities) must be 'affected by an event similar to that which is a chargeable event' (section 429(1)(c) and (2)(a)).

90. The fourth, and controversial, condition is that, immediately before the termination of the forced sale provision, the majority of the shares of the class were not held by or for the benefit of certain specified persons, including in particular 'associated companies of' ESIP or 'employees of any associated company' of ESIP (section 429(1)(d) and (4)(c) and (d)). The critical question is whether UBS was an 'associated company' of ESIP on 19 February 2004. If it was, section 429(4) was not satisfied.

91. Section 432(6) explains that, in Chapter 2, 'associated company' has the meaning indicated in section 421H, which in turn explains that 'associated company' has the same meaning as, by virtue of section 416 of ICTA, it has for the purposes of Part 11 of ICTA. Section 416 provides:

> '416. Meaning of "associated company" and "control"
>
> (1) For the purposes of this Part …, a company is to be treated as another's "associated company" at a given time if, at the time or at any other time within one year previously, one of the two has control of the other, or both are under the control of the same person or persons.
>
> (2) For the purposes of this Part, a person shall be taken to have control of a company if he exercises, or is able to exercise or is entitled to acquire, direct or indirect control over the company's affairs, and in particular, but without prejudice to the generality of the preceding words, if he possesses or is entitled to acquire –
>
> > (a) the greater part of the share capital or issued share capital of the company or of the voting power in the company; or
> >
> > (b) such part of issued share capital of the company as would, if the whole of the income of the company were in fact distributed among the participators (without regard to any rights which he or any other person has as a loan creditor), entitle him to receive the greater part of the amount so distributed; or
> >
> > (c) such rights as would, in the event of the winding-up of the company or in any other circumstances, entitle him to receive the greater part of the assets of the company which would then be available for distribution among the participators.

> (3) Where two or more persons together satisfy any of the conditions of subsection (2) above, they shall be taken to have control of the company.
>
> (4) For the purposes of subsection (2) above a person shall be treated as entitled to acquire anything which he is entitled to acquire at a future date, or will at a future date be entitled to acquire.
>
> (5) For the purposes of subsections (2) and (3) above, there shall be attributed to any person any rights or powers of a nominee for him, that is to say, any rights or powers which another person possesses on his behalf or may be required to exercise on his direction or behalf.
>
> (6) For the purposes of subsections (2) and (3) above, there may also be attributed to any person all the rights and powers of any company of which he has, or he and associates of his have, control or any two or more such companies, or of any associate of his or of any two or more associates of his, including those attributed to a company or associate under subsection (5) above, but not those attributed to an associate under this subsection; and such attributions shall be made under this subsection as will result in the company being treated as under the control of five or fewer participants if it can be so treated.'

92. HMRC's submission was that Mourant, as trustee of Sidemore, held the controlling VOS in ESIP; and that UBS was therefore able to exercise indirect control over ESIP through its control over Mourant. Whilst HMRC accepts that 'control' in section 416(2) means control at shareholder level (see *Steele (Inspector of Taxes) v. EVC International NV (formerly European Vinyls Corp (Holdings) BV)* [1996] STC 785, at 794, per Morritt LJ), Mr Lasok submitted that that did not preclude the conclusion that relevant control was in UBS.

93. The proposition that ESIP did what it was told by UBS was advanced to and rejected by the FTT, which concluded that the evidence did not show that UBS and ESIP were associated companies. I interpret them as having regarded ESIP as independent. The FTT noted in paragraph 120 of their reasons that:

> '… The evidence showed that two of its three directors were not appointed by UBS or associated with it, but were appointed by the independent company, Mourant, who by its nominees held the other voting shares in ESIP Ltd. They had held real meetings and made real decisions.'

And, in paragraph 122, they said that they 'saw no evidence to suggest that there was control of the kind envisaged by section 416.'

94. The UT recorded that it had not been said that the FTT had 'expressly misdirected itself' on the law; and the FTT had heard evidence from witnesses of fact, including from Mr Ferrara, who had supported the view that ESIP was independent of UBS. Nor, before the UT, did HMRC refer to the transcripts of the oral evidence or the witness statements. The UT therefore wondered, at [127], how in those circumstances they could conclude that the FTT had erred in law in holding that UBS did not within the relevant one-year period satisfy the section 416(2) test of control, at shareholder level, of the affairs of ESIP.

95. Mr Lasok, in his criticism of the FTT's approach, focused on the word 'expressly' included in the opening sentence of my preceding paragraph and said that the FTT did err in their apparent conclusion that section 416 control required a 'necessary degree of compulsion'. In fact, the FTT said no such thing. They did, however, use such language in their separate decision in the like 'control' issue in the DB case, delivered five months later. As I shall explain, the UT considered in the DB case that the FTT had misdirected themselves in adopting such a 'compulsion' test and concluded that, on the facts (and contrary to the decision of the FTT), the relevant 'control' did exist. Both limbs of that approach by the UT are challenged by DB in its own appeal. Mr Lasok nevertheless submitted that the inference must be that the FTT had implicitly made the same self-misdirection in the UBS case, with the consequence that their 'control' decision in UBS was similarly flawed.

96. As for the UT's observation that there had been no evidence from any Mourant witnesses, Mr Lasok explained that this was not because it had not been sought by UBS, but because one potential Mourant witness refused to give evidence altogether, and two others were prepared only to provide witness statements and refused to give oral evidence.

97. To understand the nature of Mr Lasok's submissions under this head, I should first set out the following paragraphs of the UT's decision:

> '128. Counsel for HMRC sought to persuade us to do so [viz, to conclude that UBS controlled ESIP at shareholder level] by deploying in their skeleton argument a lengthy, but selective, array of documents designed to establish that:
>
> (a) the actions of ESIP were predetermined by UBS, and were carried out "on auto-pilot";
>
> (b) the decisions ostensibly taken by ESIP were in fact taken by UBS;
>
> (c) the directors of ESIP exercised no independence, but simply complied with the wishes of UBS; and
>
> (d) Mourant (the holder of the majority of the voting ordinary shares in ESIP) viewed UBS as being in charge of ESIP.
>
> 129. So, for example, under heading (a) reference was made to documents at the planning stage between August and October 2003 which showed that UBS expected the special purpose vehicle ("SPV") company to "effectively run on auto-pilot", or to operate as a "clockwork" SPV whose activities would be predetermined by its articles. Under heading (b), reference was made to written records of meetings which took place between representatives of UBS and Mourant on 11 December 2003 and 9 January 2004 at which the future activities of ESIP were agreed and mapped out, before it had even been incorporated. Under heading (c), reference was made to concerns expressed by Mr Ferrera's line manager about his proposed appointment as a director of ESIP, and whether he would be able to engage properly in his role without assuming a significant workload. Rebecca Jackson sought to allay these concerns by saying that most of ESIP's activities would have been "set out in the Articles and associated legal documentation", and "we do not anticipate that the workload would be of great

> significance …". Again, reference was made to evidence suggesting that the decisions taken at the key board meetings of ESIP on 27 and 28 January 2004 were preordained, were not the subject of any independent consideration by the directors, and were mere formalities. Under heading (d), reference was made to an email sent on 22 January 2004 by Mourant to UBS, enquiring whether UBS would like Mourant to submit its invoice for legal work "to ESIP Limited or to UBS". On 10 February 2004, Mourant sent UBS an invoice for work done to date which amounted to £100,762.86, and in a letter of the same date Mourant explained the fees that it would be charging ESIP and sent UBS a copy of ESIP's invoice. Such behaviour would not have been appropriate, submitted counsel, if UBS and ESIP were not associated companies.
>
> 130. Quite apart from the selective nature of this material, there are at least two other reasons why it is in our view inadequate for its intended purpose. First, a great deal of it relates to the activities of ESIP at board level, whereas what needs to be established is control at shareholder level. Secondly, much of it is aimed at establishing that the activities of ESIP were for all practical purposes preordained, in the sense that there was no reasonable likelihood that ESIP would not play its planned role in the scheme. But in the present context that is not the issue or could only be part of the test, and an affirmative answer to it is an answer to the wrong question, or at the very least is not in itself conclusive.'

98. Mr Lasok said the fact that the material may have been selective was irrelevant if there was no other material inviting a different inference. The fact that much of the material may have related to Mourant's activities at board level was also irrelevant. He said the evidence that the UT summarised in [128] and [129] showed that UBS was directing Mourant how to exercise its shareholder control, and he sought to make that good in his oral submissions by referring us to, inter alia, minutes of an ESIP board meeting held on 28 January 2004, although it was not apparent to me how that showed that Mourant was acting in accordance with instructions from UBS.

99. The UT rejected the argument that the FTT had made an error of law in concluding that UBS exercised no relevant control over Mourant. They said:

> '131. It needs to be remembered that Mourant was a Jersey-based company, part of the well-known Mourant group, which the FTT found in paragraph 66 of its decision to be "unrelated to UBS". Mourant held the majority of the voting shares in ESIP, as trustee of the charitable Sidemore Trust. On the face of it, shareholder control of ESIP clearly resided with Mourant, not with the minority voting shareholder UBS. Equally, it would on the face of it have been a serious breach of Mourant's fiduciary duties as a charity trustee to cede that control to its unrelated minority co-shareholder. Unfortunately, such things can and do happen in the sometimes murky world of offshore tax avoidance, and the FTT was in our view quite right to recognise that HMRC were justified in raising the question and thoroughly testing the evidence. But the result of that exercise was the FTT's findings of fact which we have recited, including (via its acceptance of Mr Prosser's submissions) that the board of ESIP "had held real meetings and made real decisions'; that there was nothing unusual or untoward about the relationship between UBS and ESIP; and that it had seen "no evidence to suggest there was control of the kind envisaged by section 416". We find it impossible to conclude, on the material placed before us, that to quote Lord Radcliffe in [*Edwards*

> (*Inspectors of Taxes*) *v. Bairstow* [1956] AC 14], at 36 "no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal". Whether we would ourselves have reached the same conclusions is irrelevant. The FTT was the sole tribunal of fact, and in the absence of any demonstrable error of law we are not entitled to interfere with its findings.'

100. Mr Prosser acknowledged that there were no Mourant witnesses before the FTT, but said there was evidence from UBS witnesses who had set the scheme up and had held meetings and discussions with the Mourant people, including evidence as to whether Mourant was simply doing what it was told. Those witnesses were cross-examined at length. HMRC's closing case was that the evidence showed that UBS was exercising relevant control. The FTT rejected that case. HMRC's stance before the UT, and now this court, was a different one, to the effect that in order to decide this question it was necessary merely to look at the documentary evidence, evidence which the UT had described as selective: and Mr Lasok had specifically, but perhaps understandably, not sought to support his case by reference to the oral evidence adduced before the FTT. The UT also rejected the case after merely being shown a selection of documents. This court is now being asked to say that the UT was wrong in law not to find that the FTT erred in law in its conclusion.

101. In my judgment, Mr Lasok's proposition that the FTT impliedly misdirected themselves in law because they were tacitly applying a test for control that had to be underpinned by a 'necessary degree of compulsion' is mistaken. First, there is no warrant from anything that the FTT said in the UBS decision that they were applying any sort of 'compulsion' test. Secondly, as I shall explain when I come to the DB appeal, I consider, with respect, that the UT misunderstood the sense in which the FTT used the 'compulsion' phrase in the DB decision, and that Mr Lasok was, in consequence, seeking to build his castle on a foundation that is, in this respect, based on sand. In my judgment, the FTT made no self-misdirection in their disposition of the control issue.

102. There remains HMRC's proposition that this court should find, contrary to the finding of fact by the FTT after hearing oral evidence on the issue, that the FTT erred in law in failing to hold that Mourant was merely dancing to UBS's tune in its exercise of control at shareholder level. I regard the proposition as hopeless. What UBS wanted was clear enough. It was, however, in no position to dictate to Mourant to do its bidding and the FTT found that it did not and that Mourant exercised its shareholder powers in respect of ESIP independently. I would dismiss this ground of HMRC's appeal.

*6. Should article 2(15) of ESIP's M&A be disregarded as artificial?*

103. This was Mr Lasok's final point as to whether the scheme satisfied the technical requirements of Chapter 2. I summarised the nature and purpose of article 2(15) in [16] above. It is agreed that, were article 2(15) to be disregarded, UBS would have had control over ESIP for the purposes of section 416(2) of ICTA. Mr Lasok's submission was that the provision was artificial and so should be disregarded. Article 2(15) provided:

> '(15) Notwithstanding the preceding provisions of these Articles and anything else expressed or implied in these Articles, at any time at which the Holder or beneficial owner of any Non-Voting Share is a Group Company [meaning any of UBS and its subsidiaries], that Non-Voting Share shall, except to the extent that such Group Company is the Purchaser and has acquired the Non-Voting Share pursuant to Article 2(14), confer the following rights and for the avoidance of doubt the provisions set out in Articles 2(7) to 2(14) (other than Article 2(13)) shall not apply to the Non-Voting Share.'

There followed provisions removing all rights to substantial dividends and distributions, together with the right to receive notices of or to vote at any meetings save those affecting the NVS; entitling the holders of the NVS to recover only the nominal value of the shares in a winding-up; and prohibiting any transfer or redemption of the NVS.

104. Mr Lasok said that article 2(15) had no basis in commercial reality. It stripped the NVS of key rights whilst they were held by UBS. That carried with it the risk that UBS could thereby lose £60m, a risk it admitted would be commercially unacceptable if it happened, but which it was content to run because it considered the prospect of article 2(15) actually being implemented as so small. UBS's explanation of this was that the risk applied only during the brief window during which UBS held the NVS shares, its holding of VOS was anyway sufficient to prevent a special resolution in Jersey to wind ESIP up and there was only a negligible prospect of a winding up on other grounds.

105. Mr Lasok's submission to us, as to the UT, was that the courts will disregard artificial provisions in contracts that are directed at circumventing legislative provisions and which disguise the nature of the true arrangement between the parties. He invoked *Street v. Mountford* [1985] AC 809 and *Antoniades v. Villiers* [1990] 1 AC 417.

106. The problem with this argument is that, unlike the arrangements under scrutiny in those cases, the FTT found article 2(15) to be a genuine provision, in the sense that it represented the true arrangement to which UBS intended to submit, even though it carried the minuscule commercial risk referred to. The language of article 2(15) did not, therefore, contradict the reality of the parties' intentions. The UT also rejected HMRC's 'sham' argument, and although in [149] to [151] they placed a slightly different focus on it, they also rejected the argument as so focused. In short, they saw no basis for construing article 2(15) as meaning other than what it said. Mr Lasok repeated to us the essence of the arguments that he had advanced to the UT. Article 2(15) was, he said, a pretence included for tax avoidance purposes and should be disregarded.

107. This argument is also hopeless. There was no finding that the participants did not intend article 2(15) to take effect according to its terms and so the argument that it was a sham was rightly rejected. Once this point is reached, I am at a loss to know on what basis article 2(15) can be airbrushed out of the scheme.

108. I would also dismiss HMRC's appeal on this ground.

*Disposition of the UBS appeal*

109. I would refuse permission to HMRC to appeal on the two grounds for which it sought permission, and dismiss their appeal on the other four grounds. I would, therefore, dismiss HMRC's appeal against the decision of the UT.

*The DB Appeal*

*The facts*

110. In what follows I have gratefully drawn from the judgment of the UT. The DB group was headed by Deutsche Bank AG. DB was the main employer in the UK of staff working for the group. DB had a policy of paying certain employees annual bonuses in various forms, including cash bonuses. For the tax year 2003/2004, DB implemented a tax avoidance scheme that had been devised by Deloitte and Touche LLP ('Deloitte'). Deloitte was involved at all stages of its implementation. The scheme was considered and accepted by DB's compensation committee in December 2003. Like the UBS scheme, it sought to take advantage of Chapter 2 in Part 7 of ITEPA. In either December 2003 or January 2004, DB's employees were informed of the scheme and were offered the opportunity to be considered for participation in it. Those interested had to complete and return an application form by 26 January 2004. The minimum level of participation was £50,000 and the maximum was 90% of any discretionary bonus that might be awarded. The one-page summary of the scheme stated that it was one 'that allows your non DB equity-based year-end discretionary award to be delivered to you in the form of EDSA shares' (the scheme was then known as 'the EDSA plan').

111. On an uncertain date in late January 2004, the DB compensation committee decided on the bonus sums to be allocated to named employees. By 26 January 2004, the closing date for applications, some 300 employees had returned the necessary forms. On 27 January, Investec Bank (UK) Limited ('Investec'), whose role broadly corresponded to that of Mourant in the UBS scheme – and which the FTT found to be independent of DB – incorporated a company in the Cayman Islands called Dark Blue Investments Limited ('Dark Blue'), whose role broadly corresponded with that of ESIP in the UBS scheme. On 27 January, a Guernsey company, Walbrook Nominees (No 6) Limited ('Walbrook'), agreed with DB to act as nominee for the scheme. On 28 January, Investec appointed two directors to Dark Blue.

112. On 29 January, DB informed Walbrook of the names of the employees for whom shares were to be beneficially held under the scheme, and told Walbrook that it would shortly receive 91,300 C1 shares in Dark Blue to be held for those employees (they were to be the 'restricted shares'). Walbrook then executed a declaration of trust. On 29 January, Deloitte notified DB that the final funding figure for Dark Blue would be £91.3m.

113. On 2 February, Dark Blue's Memorandum and Articles of Association ('DB M&A') were amended by special resolution. The new share structure was as follows:

(i) A single share of US$1, upon which nothing turns;

(ii) 38,042 ordinary shares of 35p each. The shares had voting rights and rights to dividends.

(iii) 91,300 C1 redeemable shares of 35p each. They had voting rights and rights to dividends. They were redeemable by Dark Blue as provided by article 7. The effect of the terms of the DB M&A and the fact of the large premium at which the shares were issued, meant that most of the dividends were payable in respect of these shares. These were the intended 'restricted securities'.

(iv) 91,300 C2 redeemable shares of 35p each. These shares had no voting rights, but did have a right to dividends.

(v) 91,300 D shares of 35p each. These shares had no voting rights and no rights to dividends.

(vi) 251,078 E shares of 35p each. These shares had voting rights to dividends, and article 7 also provided that they were redeemable by Dark Blue in certain circumstances.

114. The effect of article 33 of the DB M&A was that the C1 and C2 shares could not be transferred between 7 February and 1 April 2004 inclusive. The C1 shares were intended to be 'restricted securities' for the purposes of Chapter 2 of Part 7. The UT described the nature of the restriction as simpler, and less artificial, than in the UBS scheme: article 34 provided that if, before 2 April 2004, any individual who held, or was beneficially entitled to, C1 shares ceased to be employed by any DB company, or notice of termination was given to an employee ('the Terminating Employee') for any reason other than redundancy, death, disability or without cause, then:

(i) The C1 shares held by the Terminating Employee would be converted into and redesignated as C2 shares and the conversion and redesignation of such shares would be deemed to be an issue of the C2 shares at that time, and

(ii) The Terminating Employee would be deemed to have irrevocably agreed and be bound to transfer, or be bound to instruct any nominee to transfer, the C2 to the holders of the ordinary shares for nil consideration.

These provisions were set out in articles 34(a)(ii) and (b) of the DB M&A and constituted the mechanism of forfeiture in the scheme.

115. On 2 February 2004, the following events also occurred:

(i) Investec subscribed £91.3m in cash for the C1 shares and £87,000 for the E shares;

(ii) Dark Blue entered into a Portfolio Management Agreement ('the PMA') with Investec under which Dark Blue appointed Investec to be investment manager until 31 July 2006. The PMA restricted the investment of Dark Blue's assets to a narrow range of low risk investments such as UK gilts and triple A corporate bonds;

(iii) Dark Blue entered into a Security Over Cash Agreement ('SOCA') with Investec under which Dark Blue granted Investec a charge over its funds to secure all obligations owed at any time to Investec.

116. On 5 February, DB subscribed for 38,042 ordinary shares in Dark Blue for the subscription price of £13,314.70 and appointed John Mooney a director of Dark Blue. On the same day, DB entered into a Shareholders' Agreement with Investec under which it was agreed, inter alia, that:

(i) Investec would transfer the C1 shares it held to Walbrook on 6 February for no consideration but on the condition that DB paid Investec a fee of £92.6m. The UT held that the primary purpose of this payment must have been to reimburse Investec the £91.3m it had earlier subscribed for the C1 shares, and only the balance of £1.3m could in the UT's view properly be described as a fee for Investec's participation in the scheme;

(ii) Investec would ensure that Dark Blue opened and operated a bank account, and opened and operated a custodian arrangement for securities owned by Dark Blue, with a company in the DB group;

(iii) DB would provide Investec with monthly valuations of Dark Blue's assets on the basis of which Investec would provide DB and Walbrook with indicative figures for the redemption of the C1 shares in certain specified months; and

(iv) Investec was obliged to purchase C1 and C2 shares from Walbrook in certain specified months if Walbrook requested it to do so.

117. On 6 February, the arrangements set out in the shareholders' agreement were completed. DB paid £92.6m to Investec and Investec transferred the C1 shares to Walbrook. On the same day, Walbrook informed the relevant employees of their award of C1 shares and that it held them on bare trust for them as their nominee. The restriction on the transfer of the C1 shares was lifted on 2 April 2004; and 42% of the C1 share capital was redeemed at the first opportunity on 8 July 2004, at a price of £1,003.73 per share. The opportunities for regular redemption continued until December 2006, and all the employees had redeemed their shares by 8 December 2006, with only five of them redeeming them on that date.

*The decisions of the tribunals below*

118. I summarised in [37] above the three main questions that arose before the FTT. They answered question (1) in favour of DB. In answer to question (2), they concluded that the shares were 'restricted securities' and that, on a technical analysis, the section 429 exemption was available. So far so good for DB, but it then fell at the question (3) fence, in respect of which the FTT held that the *Ramsay* argument succeeded and so the scheme failed.

119. The UT disagreed with the FTT on the *Ramsay* argument but still dismissed the appeal since they took the view that the FTT were in error on the section 429 control argument.

120. I shall deal first with DB's appeal against the UT's decision on the 'control' issue, and then with the issues raised by HMRC's respondent's notice seeking to support the UT's decision on other grounds.

*The DB appeal*

*The section 429 'control' issue*

121. The question is whether Dark Blue was ever an associated company of DB. If it was, section 429(4) of Chapter 2 was not satisfied, and a charge to tax would have arisen on the removal of the restrictions affecting the C1 shares. More particularly, the question is whether DB had control over the affairs of Dark Blue in the sense of the opening words of section 416(2) of ICTA, meaning control over its affairs at the level of general meetings. The FTT found that DB did not so control Dark Blue. The UT concluded that in this respect the FTT erred in law.

122. The UT explained, at [201] and [202], what it called the complex shareholding structure of Dark Blue. It is sufficient to quote [202]:

> 'The total number of shares in issue was therefore 380,420, all of which had equal voting rights. DB held 10% of the shares, in the form of the ordinary shares, while Investec held 66% in the form of the E shares. The C1 shares accounted for the remaining 24%, and were beneficially held by Investec during the short period between their issue on 2 February 2004 and their transfer to Walbrook as nominee for the employees on 6 February. The effect of the provision relating to dividends and distributions of assets on a winding-up was, of course, that the C1 shares in practice represented almost the entire economic value of the company. In terms of voting control, however, at shareholder level, Investec prima facie had a controlling interest throughout. Nor was there ever any formal agreement between Investec and any DB company as to how Investec should exercise the votes it held in respect of the C1 and E shares. Similarly, there was no such agreement between Walbrook and any DB company in respect of the C1 shares after 6 February 2004.'

123. The UT said the FTT were right to find that DB at no time had control of Dark Blue in the formal sense of being a controlling shareholder. The UT also agreed that the FTT were right to say that the 'carefully engineered share structure' of Dark Blue was at the heart of the 'control' argument. But the UT said that was not the end of the matter: it was necessary also to consider whether DB in fact exercised control at shareholder level over Dark Blue, despite the fact that it was only a minority shareholder.

124. In dealing with this issue, the UT quoted paragraphs 90 to 97 of the FTT's decision. I shall do likewise:

> '90. It is clear to the tribunal that Investec and [Dark Blue] (initially in the guise of Newco) were written into the planning and implementation of the Scheme in a detailed, indeed prescriptive, way. Investec was to take certain actions at certain times and [Dark Blue] was to take other actions at certain times. Why? Because this was required to implement the Scheme. The evidence of the planning clearly points to both Investec and [Dark Blue] being guided closely about what they had to do and when they had to do it. Was that guidance – the tribunal's term – enough to constitute control ahead of any formal agreement? The tribunal has in mind the evidence showing that the timing of, and the order in which, events occurred, including the order in which the agreements between DB and both [Dark Blue] and Investec occurred, was a preordained order.

> 91. That is the factual situation, the tribunal finds, to which it must apply the test in section 416: "a person shall be taken to have control of a company if he exercises, or is able to exercise or is entitled to acquire, direct or indirect control over the company's affairs".
>
> 92. [The UT noted that the FTT then quoted from the decision of the Special Commissioner, Dr John Avery Jones, in *Foulser v. MacDougall* [2005] STC (SCD) 374 at [26], where he concluded that the actions of Mr Foulser on behalf of himself and his wife "went far beyond just acting as a director negotiating a sale and making a recommendation to the shareholder of the underlying companies", and that Mr Foulser "made all the decisions relating to the sale".]
>
> 93. That form of wording reflects the facts of that case, which the tribunal does not need to elaborate here. And, of course, this is not binding guidance. But the Special Commissioners had had the case law mentioned above cited to him: *Arrowtown*, *Gascoigne* and *Newfields.* This tribunal adopts that approach as a practical test on the facts with which to approach the features of this appeal just rehearsed. Standing back, did those go beyond mere negotiation and recommendation? Did DB make all the decisions relating to the Scheme to the extent that it controlled [Dark Blue] either alone or in co-operation with Investec?
>
> 94. The tribunal finds that the evidence shows close co-ordination, but does not, in the section 416 sense, show control.
>
> 95. The tribunal has indicated in the findings made above its view about the levels of agreement and co-ordination occurring between those involved in establishing the Scheme. It is clear that Investec knew that to earn the full fee the Scheme had to proceed in a particular way and to a particular timetable. And it is clear that [Dark Blue], controlled by Investec, emerged from this process and conducted itself as required by the process.
>
> 96. The tribunal also observes that the evidence produced to it of the involvement of Investec is limited. It saw notes of the meetings of 15 and 19 January. But it did not see evidence of any email exchanges equivalent to those it saw between DB and Deloitte. For example, the tribunal has set out above evidence of a request by Christine Chen of Deloitte that John Berry of DB ask Investec to ask Walbrook to take certain actions. This suggests ongoing email exchanges. But the tribunal does not consider that it can read into that evidence – or absence of evidence – the necessary degree of compulsion as between DB and [Dark Blue] that would amount to control for these purposes. It does not show that DB's actions went "far beyond" those of a commercial entity dealing with another commercial entity to the extent that in reality [Dark Blue], and therefore Investec, was not in control of its own decisions.
>
> 97. Accordingly, the tribunal finds that there was no control in the section 416 meaning of the phrase and that this aspect of Mr Lasok QC's argument fails.'

125. The UT then explained why they considered that the FTT had erred in law. They said that, in referring to 'the necessary degree of compulsion' in paragraph 96, the FTT had set the bar for the test of control significantly too high. I should also set out the remainder of the UT's reasoning, since it was the focus of the arguments before us:

'205. … A person can in our judgment exercise control over another, without being in a position to *enforce* compliance. If the other can in practice be relied upon always to act in accordance with his wishes and without giving any independent thought to it. This is the kind of control that "shadow" directors are accustomed to exercise at board level, and we see no reason why similar principles should not apply at shareholder level too. Moreover, the point is perhaps even clearer when two or more persons together exercise or are able to exercise direct or indirect control over a company's affairs. Such combined activity or ability to exercise control is brought within the scope of section 416 by subsection (3). We have already quoted from the judgment of Chadwick LJ in *Foulser v. MacDougall* [2007] STC 973 … where, in relation to the similar test in section 839(7) of ICTA 1988 of acting together to exercise control of a company, he said that "the concept is sufficiently wide to include cases where one person (who has shareholder or voting control) agrees to exercise that control in accordance with the wishes of another". In our view, therefore, two central questions which the FTT should have asked itself were (a) whether Investec (as the shareholder with voting control of Dark Blue) had agreed to exercise that control in accordance with the wishes of DB, and (b) whether at shareholder level DB was in practice always able to rely upon Investec to act unthinkingly in accordance with its wishes. In either case, the correct conclusion of law would have been that the test of control in section 416(3) was satisfied. It is also necessary to remember that it would have been enough for the test to be satisfied *at any time* after Investec first acquired shareholder control of Dark Blue by its subscription for the C1 and E shares on 2 February 2004.

206. On 5 February 2004 Investec and DB entered into the Shareholders' Agreement. We have already referred to some of its main provisions in paragraphs 179 to 180 above. As the name of the agreement itself indicates, this was an agreement entered into between two companies as shareholders: so it was clearly the kind of agreement to which section 416 could apply. Furthermore, the obligations undertaken by Investec under the agreement all formed part of the preordained scheme which Deloitte had masterminded for DB. There was no independent input from Investec at all. We have already referred in paragraph 184 to the FTT's important findings that Investec had no interest in the scheme apart from the cash fee paid for its involvement, and that it never exercised any independent discretion with regard to the scheme. In other words, in return for a handsome fee Investec agreed to play a preordained role in a tax avoidance scheme devised for DB by Deloitte. That the scheme was indeed preordained in all material respects appears not only from paragraph [90] of the decision but also from numerous other findings, notably in paragraphs [108] to [112]. So, for example, the FTT said in paragraph [111]:

> "Further, although the Scheme was undertaken through the medium of independent entities, the tribunal finds as fact that in reality the whole was a coordinated scheme in which all those involved in providing bonus payments to the employees played assigned roles undertaken either to achieve the desired reduction in taxation or to receive a fee for facilitating that aim."

> 207. In the light of these findings, the conclusion appears to us inevitable. The activities of Investec as majority shareholder of Dark Blue, including in particular its entry into the Shareholders' Agreement, were dictated to it by DB, not as a matter of legal compulsion, but simply because this was what Investec in practice had to do in order to earn its fee, and because Investec never brought any independent thought or judgment to bear in the fulfilment of its preordained role. Investec acted throughout in accordance with the wishes of DB, and there was never any realistic possibility that it would do otherwise. In those circumstances, it seems to us to follow that DB and Investec together both exercised, and were able to exercise, direct control of Dark Blue within the first limb of section 416(2) read with subsection (3). For the same reasons, we consider that DB alone in practice had the ability to exercise direct or indirect control over Dark Blue at shareholder level.
>
> 208. If the FTT had not misdirected itself by importing a requirement of compulsion as between DB and Dark Blue, we think that the only answer it could properly have given to the question which it asked itself at the end of paragraph [95] was an affirmative one. DB did indeed make all the decisions relating to the scheme, whether directly or through the agency of Deloitte, who devised the scheme on DB's behalf; and it controlled Dark Blue, either alone or in conjunction with Investec, because (as the FTT in effect found) Investec was a mere cipher which unthinkingly did whatever it was asked to do in order to earn its fee. The crucial distinction between the findings of fact which the FTT made in relation to the role of Mourant in *UBS* and those which it made in relation to Investec in DB is that in the UBS case the FTT did not make findings similar to those we quote in paragraphs 2014 and 184 from which it was plain that Investec would do what was expected of it in order to earn its fee without exercising any independent discretion. In the absence of such findings the presumption must be that Mourant as trustee of a charitable trust would not have ceded control to a co-shareholder (see paragraph 131). Another distinction is that the Shareholders' Agreement had no parallel in *UBS*, and most of the activities of ESIP relied on by HMRC as showing control by UBS were activities at board level.
>
> 209. On behalf of DB, Mr Goy QC submitted that shareholder control of Dark Blue by DB, or by DB in conjunction with Investec, was not established merely because Investec predictably decided to act in accordance with its own financial self-interest. But it seems to us that the FTT's findings of fact go considerably further than that, and negate any true independence on the part of Investec at all.
>
> 210. In our respectful opinion, the FTT erred in law in finding that the test of control in section 416 was not satisfied, and its decision on the point cannot stand. It follows that the exemption under section 429 of ITEPA was not available, the scheme failed in its object, and DB's appeal must be dismissed.'

126. The sole question, said Mr Goy, is whether DB controlled Dark Blue at shareholder level; and the answer lies in whether the case falls within the type of control identified in the opening words of section 416(2) of ICTA. Mr Goy referred us to *Steele's* case, supra, in which Morritt LJ said, at 794:

> '… In my view control of the affairs of the company in s. 416 means control at the level of general meetings of the company in the sense explained in the cases

> to which I have referred. Those cases recognise that control at that level carries with it the power to make the ultimate decisions as to the business of the company and in that sense to control its affairs.'

Mr Goy said that what Morritt LJ was there referring to was the ability to secure the passing of an ordinary resolution at a general meeting. The essence of Mr Goy's submission was that, on a proper reading of the FTT's decision, they did not apply the wrong test of control; but even if they did, the UT were themselves in error in drawing the conclusion as to control that they did. In addition, although the UT referred to section 416(3) as being relevant, he submitted that it was plainly irrelevant.

127. Mr Goy referred us first to what the FTT said at paragraphs 90 to 94, quoted in [124] above. He said the UT made no criticism of those findings. They showed that, after hearing the evidence, the FTT concluded that Investec and Dark Blue were guided closely about what they had to do and when they had to do it, but the FTT then asked themselves whether what Dark Blue did went beyond mere negotiation and recommendation so that DB alone made all the decisions. In paragraph 94, they answered that question in the negative: whilst there was close co-operation and co-ordination, there was not control.

128. The FTT then, in paragraphs 95 and 96, considered the involvement of Investec. It was as to this, the relationship between DB and Investec, that the UT said the FTT had, in referring to 'the necessary degree of compulsion', set the bar too high. Mr Goy did not suggest that, for there to be relevant control, it is necessary to have a legal right of compulsion, although he did submit that it was necessary at least to have some form of ability to require someone to do something. At the very least, he said, it will be necessary for the case to be one in which someone simply goes along with the wishes of another and does not exercise any independent thought as to whether what is to be done is in its own best interests. But that, by itself, will still not be enough, nor will mere co-operation or co-ordination be enough. Mr Goy submitted that when the FTT referred in its paragraph 96 to 'the necessary degree of compulsion as between DB and [Dark Blue]', they were simply attempting to identify that elusive 'something more' that is required in addition to merely going on with the wishes of another. The FTT were *not* saying that there will only be control if compliance can be enforced; and, if that had been the FTT's view, their discussion as to a practical test on the facts at paragraphs 90 to 94 made little sense. Moreover, the phrase 'degree of compulsion' shows that they did not in fact mean that compulsive powers were necessary. There is either a power of compulsion or there is not; there are not degrees of compulsive powers. What the FTT said was that the evidence did not show that DB's powers went 'far beyond' those of a commercial entity dealing with another commercial entity such that, in reality, Investec, and therefore Dark Blue, was not in control of its own decisions.

129. Mr Goy emphasised that the control in question is that as to the casting of votes at a general meeting. There may well in many cases be circumstances in which A will expect shareholder B to vote in a particular way, and B does so; but there may also come a point when B will say that it is not prepared so to vote in relation to a particular matter and will point out that it is not a nominee for A and must consider its own interests. Investec, said Mr Goy, was no stooge for anybody. It of course wanted its fee and would vote in a way which was in its own interests to vote. It would not, however, have voted in a particular way because DB asked it to. Insofar as the UT

regarded the shareholders' agreement as relevant, it was not: it had nothing to do with the casting of votes at general meetings. The issue is whether, in relation to the decisions of Dark Blue in general meeting, DB could be said to have done more than proposed, advised or influenced. The FTT's answer on the facts was what it said in paragraphs 93 and 94, namely that whilst the evidence showed close co-ordination, it did not, in the section 416 sense, show control. The FTT so found after hearing all the evidence and knowing full well that it was concerned with the implementation of a scheme in respect of which Deloitte had planned that certain steps would take place at certain times. They accepted that Dark Blue and Investec were closely guided, but concluded that such guidance did not go beyond negotiation and recommendation.

130. In the alternative, Mr Goy submitted that, if this court were to conclude that the FTT *had* misdirected themselves with regard to 'the necessary degree of compulsion', the UT nevertheless then also misdirected themselves by holding that the only conclusion open to the FTT was that DB controlled Dark Blue. The UT, in [205], identified the two central questions, (a) and (b), that the FTT should have asked themselves. Mr Goy submitted that the findings of the FTT showed that neither question could be answered in the affirmative. He referred us to the FTT's findings at paragraph 42, where, looking at the position before the shareholders' agreement was entered into, the FTT found that while 'there was no direct agreement in place in any formal sense between DB and Investec, clearly some arrangement was in place. The order of events was not coincidental; it was a deliberate order of events.'

131. Mr Goy did not deny that, as the FTT found, there must have been some arrangement in place between DB and Investec. It did not, however, follow that DB controlled what Investec did as regards Dark Blue. Investec had no rights against DB, and it invested £91.3m in subscribing for C1 shares in Dark Blue on 2 February 2004 before it entered into the shareholders' agreement with DB on 5 February. Mr Goy said the notion that, when it invested in Dark Blue, Investec was simply responding to a controlling direction from DB flew in the face of reality: it had no agreement with DB, and it could rationally only be regarded as doing what it did by consulting its own interests in doing so. In that context, Mr Goy recognised that Investec saw the prospect of earning a fee and would have been willing to implement the arrangement as it thought fit, and in its own interests. But it simply does not follow that in doing so, it was acting unthinkingly in accordance with DB's wishes. Both DB and Investec were substantial, independent companies; and whilst they were together working towards a common goal, the suggestion that one was controlling the decisions of the other makes no commercial sense. Moreover, it is clear from the FTT's findings in paragraphs 90 to 94 that DB had no such control over Investec. Pre-ordained it may all have been; but that did not mean that Investec was in the pocket of DB. The UT did not themselves hear the evidence, and were in no position to second-guess the FTT on this point. In particular, it was never put to Mr Beddows (of Investec) that Investec would simply do DB's bidding.

132. Mr Goy also criticised the UT's statement in [207] that Investec's entry into the shareholders' agreement was 'dictated to it by DB'. Mr Goy said that proposition was contrary to common sense. There was no finding to that effect by the FTT, nor had the UT heard any evidence enabling it to substitute their own views and make such a finding. Investec entered into that agreement at a time when it had no binding commitment with DB, and it is obvious that its decision to do so would have been one

made in its own interests. Nor is there anything in the agreement relating to the exercise of Investec by its voting rights at a general meeting of Dark Blue. In [208], the UT said that the FTT had 'in effect found' Investec to be a mere cipher. The FTT had, however, not said that, either 'in effect' or at all.

133. Finally, Mr Goy submitted that the UT fell into error in relation to section 416(3). The UT's view, in [205], appears to have been that if DB controlled Investec in relation to the latter's voting at general meetings of Dark Blue, then 'the test of control in section 416(3) was satisfied'. Mr Goy submitted, and I agree, that section 416(3) is irrelevant to our facts. Investec, by virtue of its holding in Dark Blue, was formally in control of Dark Blue within the meaning of section 416(1). The relevant question for our purposes, however, is whether Investec was, vis-à-vis its role as a Dark Blue shareholder, itself in the control of DB. If it was, the opening words of section 416(2) are satisfied and DB and Dark Blue are associated companies. If it was not, those words are not satisfied. I do not understand what section 416(3) is thought to have to do with it. It is contemplating a case in which, for example, DB and X Ltd together had relevant control of Dark Blue via their combined control of Investec. On no footing is that this case. Mr Goy did not, however, go so far as to say that the UT's error in relation to section 416(3) undermined their conclusions on the 'control' point to which they had otherwise anyway come.

134. Mr Lasok rightly did not seek to defend what the UT had said about section 416(3). He opened his substantive response by suggesting that in a simple case where A and B agree that B will do what A wants in furtherance of a tax avoidance scheme, and B then acts as a majority shareholder in C Ltd in furtherance of the scheme, A controls C for the purposes of section 416. That, he said, is essentially the scenario with which we are concerned. As to whether the UT were right to come to the conclusion they did, that requires a consideration of the decision of the FTT. Insofar as Mr Goy submitted that Investec was following recommendations, and that DB's role did not go beyond negotiation and recommendation, Mr Lasok said the FTT made no such findings; Mr Goy's assertions were, he said, no more than inferences from the FTT's findings.

135. As to the assertion that there was no agreement between Investec and DB before the shareholders' agreement, Mr Lasok referred to the FTT's finding in paragraph 41 that 'the order of events as between DB and Investec took place in accordance with coordinated plans' and to their observation that 'it must ask why would Investec set up [Dark Blue] in the way it did unless there was some arrangement in place as to Investec's role in the Scheme.' And, in paragraph 42, the FTT wrote that:

> '… While it accepts that it has seen no agreement in writing, or written evidence of an agreement between DB and Investec, it is clear to the tribunal that events took place in a preordained order with a mechanism in place to ensure that the order was as intended and that the reasons for that order was [sic] as indicated by Christine Chen. While the tribunal is prepared to accept that there was no direct agreement in place in any formal sense between DB and Investec, clearly some arrangement was in place. The order of events was not coincidental; it was a deliberate order of events.'

136. In Mr Lasok's submission the argument on the 'control' issue was not capable of much elaboration. He said it was simply a question of looking at the FTT's decision to

see whether their findings support the conclusion that the control test was satisfied. Of course, the FTT found that it was not, but the implication is that the UT were entitled to conclude, on the basis of the FTT's findings, that it was. Mr Lasok referred us, without reading them, to several paragraphs of the FTT's decision, which he said supported the 'control' conclusion. I do not propose to refer to them. Their thrust is directed to the pre-ordained, regimented nature of the scheme, as to which there is no dispute.

137. In my judgment, and with respect, the UT went wrong on this issue. First, I consider that there was no warrant for the UT's conclusion that the FTT, in their paragraph 96 reference to a requirement of the 'necessary degree of compulsion', were raising the bar too high. The UT interpreted those words as meaning an ability to 'enforce' compliance with (in this case) DB's views. But the FTT plainly cannot have meant that. It is obvious that DB could not compel Investec to vote in any particular way; and if the FTT *did* regard the test as requiring an element of compulsion, they could have considerably reduced their discussion by simply making a finding that such element was missing.

138. The FTT did not, however, do that. They carefully examined the facts to see whether the case was one in which DB had relevant control and concluded, in summary, that whilst the evidence showed close co-ordination, it did not 'in the section 416 sense, show control'. In my view, Mr Goy was right that in the phrase 'the necessary degree of compulsion' the FTT was doing no more than attempting, perhaps not with an ideal choice of phrase, to identify the elusive extra ingredient that needs to be found before A Ltd can be said to be in control of voting powers of a majority shareholder of B Ltd. Ultimately, whether there is such control is a fact-sensitive matter; and here the FTT found against HMRC's control case on the facts.

139. I consider therefore that the UT were wrong to hold that it was open to them to consider afresh whether DB controlled Investec's voting powers as a shareholder of Dark Blue. That was a question of fact for the FTT, and the FTT had given rational reasons for their answer to that question. Moreover, and with respect, I regard the UT's conclusion that the only answer to the control question was that DB was relevantly in control of Investec a remarkable one, which I regard as obviously wrong. Yes, the scheme was pre-ordained and involved a co-ordinated course of action between the participants, with Investec and DB, two wholly independent companies, playing pre-ordained and co-ordinated roles, with each having its own commercial interests in bringing the scheme to fruition. It does not, however, begin to follow from this that DB was in relevant control of Investec. If A Ltd proposes to B Ltd, an unconnected and independent company, a co-ordinated course of action with a view to achieving a commercial end to the benefit of both, and B Ltd agrees to the proposal and co-operates in its implementation, it is beyond my comprehension why such a state of affairs should be thought to justify the inference that, in playing its own part in the operation, B Ltd is to be regarded as being 'controlled' in what it does by A Ltd. The proposition is wrong. B Ltd will, by inference, want to take part, and will do so. But there will ordinarily be no basis for an inference that the decisions it makes *en route* to the ultimate goal will be decisions it makes other than independently, and in its own interests, in achieving the proposed end.

140. The FTT understood this. The UT appear not to have done so. In my judgment, the UT fell into error in setting aside this part of the FTT's reasoning. I would allow DB's appeal on the 'control' issue. I turn to HMRC's points on their respondents' notice.

*HMRC's respondents' notice*

*1. The 'broad' Ramsay point*

141. HMRC's argument under this head was the same as in the UBS appeal. There were no separate features relating to DB that require additional comment. I would reject the argument for the same reasons that I consider it fails in the UBS appeal.

*2. The 'narrower' Ramsay point*

142. This is a semi-new point. It was raised in HMRC's skeleton argument before the FTT. It was not, however, argued before the UT, where HMRC apparently confined themselves to seeking to uphold the FTT's acceptance of their broad *Ramsay* argument. Mr Lasok said, however, and I agree, that for HMRC to raise it before this court will cause no prejudice to DB, as it is a question of law turning on decided facts. It is, in substance, the like alternative line of argument as that advanced in the UBS case, namely that the shares issued to the DB employees were no more 'restricted securities' than HMRC said the shares in the UBS scheme were. It turns, however, on the terms of the restrictions in the DB scheme. Mr Lasok advanced two reasons in support of the argument.

143. Article 34(a) of the DB M&A, in a part headed 'Compulsory Transfer of C1 and C2 Shares', provided as follows:

> '34. (a) If before 2 April 2004 any individual who holds or who is beneficially entitled to C1 shares which are held on his behalf by a nominee ("a Nominee") ceases to be employed by any DB Company or notice is given to or by that individual of termination for any reason other than termination by the relevant DB Company without cause, redundancy, death or disability (such a person being referred to in this Article as a "Terminating Employee") then:
>
> > (i) if, immediately prior to the occurrence of that event, the C1 Shares held by or on behalf of that Terminating Employee, when aggregated with any shares held by any Relevant Holders (in aggregate) hold more than the Relevant Limit (as defined in Article 35) then each C1 Share held by or on behalf of such Terminating Employee, that would result in the Relevant Holders in aggregate holding more than the Relevant Limit, shall with effect from the moment immediately prior to the occurrence of that event have the same rights for all purposes under these Articles as if it was a D Share and shall, on whichever is the later of the occurrence of that event and notification under Article 34(e), be converted into and redesignated as a D Share; and
> >
> > (ii) if, on the basis referred to in (i), the Relevant Limit would not be so exceeded, each C1 Share held by or on behalf of the Terminating Employee shall be converted into and redesignated as a C2 Share and except where these Articles otherwise provide such conversion and redesignation shall be

> deemed to be an issue of the relevant C2 Share at the time of such conversion and redesignation.'

144. Mr Lasok said the only circumstances in which the triggering of the clause 34(a) condition might occur were, for practical purposes, where the employee chooses to hand in his own notice or is dismissed for misconduct, in either case within a window of about six weeks; and in both instances the condition could therefore only be satisfied by the employee doing something within his own control – either resigning, or committing misconduct. I comment that the relevant misconduct could have occurred earlier, and only been discovered by DB during the six week period, and so the suggestion that that element of the provision is entirely within the employee's control during that period may be an overstatement. Mr Lasok said, however, that the 'risk' associated with the restriction of the C1 shares could be considerably minimised, or reduced to a negligible level, by an employee simply determining to remain in employment and so within the scheme.

145. Secondly, DB's evidence was that the article 34 restriction on the C1 shares would result in their market value being reduced by at most 2 to 3 per cent, which HMRC submitted was *de minimis* and should accordingly be ignored. The result was that the restriction was said to turn on a commercially irrelevant contingency, which at most created an acceptable risk that the scheme might not achieve its tax avoidance aim. In those circumstances, article 34 should be disregarded in the assessment of whether the C1 shares were 'restricted securities'. That would leave the scheme as a vehicle for conferring an unrestricted interest in securities upon the employees, and so would fall outside Chapter 2.

146. Although the first point was not argued before the UT, it is one with which the UT would have disagreed. The UT said:

> '196. In our judgment there is no error of law in the conclusion of the FTT on these issues. The FTT was plainly entitled to find that the provisions in articles 33 and 34 were genuine and intended to take effect in accordance with their terms; and Mr Lasok did not seek to argue the contrary before us. The FTT also had well in mind the fact that the only restrictions which applied on 6 February were those in article 34, because the prohibition on transfer in article 33 did not come into operation until the following day. While that is true, we would comment that the existence of the restriction in article 33 was still clearly relevant to the market value of the shares on the previous day. The FTT assessed the likelihood of a forfeiture taking place, and concluded that it could not be ignored as of no significance, despite the obvious limitations in time and scope of the triggering events. The FTT might have added (as counsel for DB submitted to us in their skeleton argument) that restrictions of this nature are clearly within the contemplation of section 423, because section 424(b) provides an express exception to the effect that employment-related securities are not restricted securities by reason only that the holder may be required to offer them for sale or transfer "on the employee ceasing, as a result of misconduct, to be employed by the employer or a person connected with the employer". There would be no need for the exception, so the argument runs, unless provisions for forfeiture of the shares on cessation of employment were within the scope of section 423. Equally, the exception shows that it does not matter if the triggering event is one within the control of the employee.'

147. Mr Goy, in response to the first head of HMRC's argument, advanced essentially the same points. He added that there is no stress in sections 423 to 425 of Chapter 2 on why the restrictions are in place, that is whether they are there for commercial reasons or otherwise, nor whether the employee can ensure that they do not apply. The stress is simply on whether the restrictions reduce value, nothing more. I agree and would not accept HMRC's first line of argument.

148. As to HMRC's second, *de minimis* point, the UT was similarly unimpressed that there was anything in it. They said:

> '199. The question whether the reduction in value brought about by the forfeiture provision in article 34, and the restriction on transfer in article 33, was so small as to be insignificant was in our judgment one of fact and degree for the FTT to determine. The FTT was entitled to prefer the expert evidence of Mr Eamer to that of Mr Croft, and to accept that the reduction in value was not negligible. Mr Lasok sought to persuade us to the contrary, by reference to the transcript of Mr Eamer's cross-examination, but we remain wholly unpersuaded that this conclusion was an impossible one for the FTT to reach. Whether we would have reached the same conclusion ourselves is beside the point. Furthermore, common sense suggests that even a very remote chance of forfeiture is likely to have a depressing effect on market value, given that the shares would in effect then have to be transferred for a nil consideration. In some contexts a reduction in market value of the order of 2 to 3 per cent might well be negligible, but we do not think the present context can be so categorised. After all, as Mr Goy pointed out, even 2% of the unrestricted market value of the C1 shares would be about £1.8 million, and some of the largest share awards to individual employees were in excess of £2 million (where a 2% reduction in value would amount to £40,000). Even at the minimum award level of £50,000, the reduction would be £1,000. These are not negligible amounts, and in our view the FTT was entitled to find that the CI shares were restricted securities within the meaning of Chapter 2.'

149. Mr Goy submitted that we should, in answer to this submission, adopt the approach of the UT. I agree. It was in my view a sound and correct approach. I would reject this argument too.

*3. The section 18, Rule 1 argument*

150. Mr Lasok also advanced this argument in relation to the DB scheme. I would reject it for the same reasons I have given in relation to the like point in the UBS appeal.

*4. Were the C1 shares 'restricted securities' within the meaning of section 423(1)?*

151. Mr Lasok submitted that, in the case of the DB scheme, there was in fact no provision under which there would a 'transfer, reversion or forfeiture' of the C1 shares within the meaning of section 423(2)(a), with the consequence that the C1 shares were not 'restricted securities' within the meaning of section 423(1). The point was that article 34(a)(ii) provided that on the occurrence of the relevant 'circumstances' the C1 shares will be *converted* into C2 shares. There is, however, no provision for their 'transfer, reversion or forfeiture', and instead article 34(b) provides that the C2 shares so created shall be transferred to the holders of the ordinary shares for nil consideration.

Whilst therefore there is a provision in relation to the C2 shares so created for their 'transfer, reversion or forfeiture', there is none in relation to the C1 shares.

152. HMRC did not argue this in the tribunals below, but the UT raised the point themselves in [197], and disposed of it shortly. They said:

> '197. Section [423(2)(a)] applies to the securities only if there is a provision under which there will "transfer, reversion or forfeiture". The mechanism by which the employees were to lose their C1 shares consisted of their conversion to C2 shares and the immediate transfer of those shares for no consideration. The C1 shares were different from the C2 shares and there is no provision in Chapter 2 which equates them on conversion. Thus the transfer of the C2 shares would not be a transfer of the securities for the purposes of section [423(2)(a)]. It plainly would not be a reversion. But in our judgement the process by which the employees were to be stripped of the C1 shares if they gave notice to terminate their employment is within the meaning of "forfeiture" in section [423(2)(a)].'

153. Mr Goy supported the reasoning of the UT, and I also agree with it. The consequence of the happening of the relevant 'circumstances' is that the C1 shares are converted to C2 shares and become subject to an immediate transfer for no consideration. I agree with the UT that that amounted to the 'forfeiture' of the C1 shares. That, I consider, is how the reasonable employee would regard it. Mr Lasok accepted that his contrary argument was what he called 'an arid Chancery point'. I regard it as wrong and would reject it.

154. The result is that I would reject all HMRC's submissions directed at upholding the UT's dismissal of DB's appeal against the decision of the FTT.

*Disposition of the DB appeal*

155. I would allow DB's appeal against the decision of the UT. I presume that will result in an order setting aside the two determinations dated 29 April 2008 referred to in [4] above.

*Overall disposition*

156. I would dismiss HMRC's appeal in the UBS case. I would allow DB's appeal in the way just described.

**Lord Justice Kitchin :**

157. I agree.

**Lord Justice Christopher Clarke :**

158. I also agree.