[2015] UKUT 0066 (TCC)

Appeal number:FTC/86 & 87/2013

Corporation Tax: (1) Sch 24 FA 2003 – whether the deduction which would arise under a scheme which included a transfer of value occasioned by the grant of an option was "in respect of" an employee benefit contribution; (ii) section 74 TA 88: whether expense of contributions under the scheme was wholly and exclusively for the trade – had the FTT treated an incidental effect as a purpose.

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

SCOTTS ATLANTIC MANAGEMENT LIMITIED **Appellants**
(in members voluntary liquidation)
SCOTTS FILM MANAGEMENT LIMITED

- and -

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

TRIBUNAL: MR JUSTICE WARREN, Chamber President
Judge CHARLES HELIER

Sitting in public at the Rolls Building, London EC4A on 14 &15 October 2014

Andrew Thornhill QC and Edward Waldegrave, counsel for the Appellants

Richard Coleman QC and David Yates, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. When a trader incurs the cost of the provision of benefits to employees wholly and exclusively for the purposes of his trade, the cost (determined in accordance with generally accepted accounting practice) of so doing is usually deductible in computing his taxable profits in the period in which the cost is recognised in his accounts. But if the related benefit does not vest in an employee until later then it may not be taxed in the hands of the employee until sometime after, perhaps many years after, the Exchequer's income has been diminished by the effect of the deduction from the employer's taxable profits.

2. Schedule 24 FA 2003 addresses the adverse effect of such timing differences on the Exchequer by denying the employer a deduction for such a cost in an accounting period generally unless it gives rise to income taxable in the hands of the employee in the period or within 9 months of its end.

3. Between 2003 and 2004 each of the Appellants took part in arrangements which it was hoped would circumvent the provisions of Schedule 24 and enable them to claim deductions relating to the cost of rewarding their directors and certain employees without those directors and employees having become liable to income tax and national insurance contributions on the benefits in the relevant period or within nine months thereafter.

4. HMRC decided that the arrangements were ineffective and amended the companies' tax returns. An assessment was also raised on one of the directors, Mr Dryburgh. The appellant companies and Mr Dryburgh appealed. The First-tier Tribunal (the "FTT") allowed the appeal against the assessment on Mr Dryburgh, but dismissed the companies' appeals. The Appellant companies, Scotts Atlantic Management Limited ("SAML") and Scotts Film Management Limited ("SFML") appeal against that decision. HMRC do not appeal against that part of the decision which relates to Mr Dryburgh.

Schedule 24

5. Paragraph 1(1), (2) and (3) Schedule 24 as applicable at the relevant times read as follows:

> "1. Restriction on deductions
>
> (1) This Schedule applies where –
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> (a) a calculation is required to be made for tax purposes of a person's profits for any period, and
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> (b) a deduction would (but for this Schedule) be allowed for that period in respect of employee benefit contributions made, or to be made, by that person ("the employer").

But it does not apply to a deduction of a kind mentioned in paragraph 8.

(2) For the purposes of this Schedule an employer makes an "employee benefit contribution" if –

(a) he pays money or transfers an asset to another person ("the third party"), and

(b) the third party is entitled or required, under the terms of an employee benefit scheme, to hold or use the money or asset for or in connection with the provision of benefits to employees of the employer.

(3) The deduction in respect of employee benefit contributions mentioned in sub-paragraph (1) is allowed only to the extent that –

(a) during the period in question or within nine months from the end of it -

(i) qualifying benefits are provided out of the contributions, or

(ii) qualifying expenses are paid out of the contributions, or

(b) where the making of the contributions is itself the provision of qualifying benefits, the contributions are made during that period or within those nine months."

6. Subparagraph (4) permitted a deduction which had been disallowed by (3) to come back into account in a subsequent period if it was received by an employee as a qualifying benefit or a qualifying expense in that period or within 9 months of its end.

7. Paragraph 2 provided

(1) For the purposes of this Schedule qualifying benefits are provided where there is a payment of money or transfer of assets, otherwise than by way of loan, that-

(a) gives rise to both an employment income tax charge and to an NIC charge [or would do so if certain conditions relating to place of work were fulfilled], or

(b) is made in connection with the termination of the recipient's employment with the employer…

and paragraph 9 provided that:

…"employee benefit contribution" shall be read in accordance with paragraph 1(2);

"employee benefit scheme" means a trust, scheme or other arrangement for the benefit of persons who are or who include, employees of the employer;…

8. Many employee benefit schemes take the form of Employee Benefit Trusts ("EBTs") – trusts under which assets are held for the benefit of employees. Not all "employee benefit schemes" as defined by para 9 however need take such form.

The Scheme

9. In his skeleton argument Andrew Thornhill QC, who appears for the Appellants before us as he did before the FTT, explained how it was hoped that the scheme would work - adopting the example figures used by the FTT:

> "8. As conceived, the arrangements were to work in the following way:
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> (1) A new company would be incorporated [a "Newco"], and an EBT established. The EBT would be for the benefit of the directors and employees of the implementing company.
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> (2) The company implementing the arrangements (i.e. either SAML or SFML) would subscribe for 100 £0.01 shares in the new company at a large premium of, for example, £999,999, so that the new company would have £1,000,000.
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> (3) The new company would then grant an option to the trustees of the EBT to subscribe for, for example, 10,000 £0.01 shares at par. That would have the effect of diminishing the value of the original 100 shares held by the implementing company, and the value would move into the EBT."
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> [Mr Thornhill adds: " It is this step which gives rise to the deductions which are the subject of the dispute between the Appellants and HMRC in this case"]
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> (4) The implementing company could then sell the original 100 shares to a third party for their proper (i.e. reduced) value (which, on these figures, would be £10,000). [The FTT referred to these shares as the "trivial shares".]
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> (5) The trustees of the EBT could then exercise their option to subscribe for a large number of shares in the new company, and proceed to liquidate it. Following liquidation, they could use the funds to make distributions and loans to the beneficiaries of the EBT (for example).

10. We refer to (1) to (5) above as the steps in the arrangement or scheme. We note that the third party was, for SAML, the trustees of the SFML EBT and, for SFML, the trustees of the SAML EBT. The beneficiaries of each EBT included common employees of the two companies.

11. Mr Thornhill explained that this approach was developed because Schedule 24

> "only applied *when* an employer "pays money or transfers an asset to another person". The arrangements outlined above were designed to achieve a movement of value from the implementing company to the EBT without a payment of money or the transfer of an asset occurring; rather the value moved on the granting of an option (which, it is contended, is neither a payment nor the transfer of an asset)".

We have italicised "when" because it will be seen that paragraph 1(2) uses the word "if".

12. We observe that after step (3) the holder of the original shares could theoretically have exercised its rights as shareholder to compel the issue to it of further shares in the new company which swamped the option shares. In the scheme as implemented this theoretical possibility was addressed in relation to times after step (4) by procuring that the third party gave a commitment to ensure that the new company did not issue shares or make a distribution which would dilute the value of the option. Theoretically there may have been a possibility that there could have been such a share issue or distribution between step (3) and step (4), but the FTT regarded such a possibility as "ridiculously far fetched" and no argument relying on such a possibility was raised before us or the FTT.

13. Arrangements which incorporated the steps in paragraph 9 above were implemented once by SAML and twice by SFML. The steps actually undertaken were somewhat more complicated than those in paragraph 9. For the purposes of this decision nothing turns on the detail of implementation and it may be taken that the steps outlined in paragraph [9(1)] to [9(5)] were taken as part of a single plan, although the liquidation of the Newcos took place some time after the exercises of the options by the EBTs.

The FTT's decision

14. The FTT accepted that Schedule 24 would not apply to deny a deduction to the companies, but it held:

> (1) that, in the case of both SAML and SFML, all the claimed expense had the purpose, alongside any purpose of remunerating directors and employees, of ousting the application of Schedule 24, and that that dual "all pervading objective of achieving an employee tax deduction" meant that none of the claimed expense was incurred wholly and exclusively for the purposes of the trade, so that none of it was allowable;
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> (2) that, if its decision at (1) was wrong, then in the case of SAML part (£2,765,000) of the subscription price (of £7,136,000) for the shares in the new company was not "wholly and exclusively a revenue expense of remunerating" the directors, and was therefore not deductible. The FTT reached this conclusion because the consideration given for the subscription comprised in part charged deposits of £2,765,500, and it held that the liabilities of SAML secured by the charge meant that the £2,765,500 was not immediately available to the Newco because it secured liabilities of SAML; and
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> (3) again, if its decision at (1) was wrong, and again in the case of SAML only, that, because part of the purpose for the transfer of the money to the new company was to strip SAML of the assets it would need to pay its corporation tax bill if the scheme did not succeed, the payment was to that

> extent not made wholly and exclusively for the purposes of its trade, and was to that extent therefore not deductible.

15. The appellants appeal against the conclusions (1) to (3). HMRC appeals against the FTT's decision in relation to Schedule 24.

16. The FTT also held that because there was some doubt as to the validity or enforceability of the certain of the options said to be granted at step (3), some small disallowance of the expense claimed to have been incurred by virtue of the scheme might be required because the trivial shares may have been, as a result, worth slightly more than the amount for which they were sold. The FTT made no assessment of the amount which would be so disallowable.

17. HMRC assert that the FTT erred in relation to paragraph 16 above by failing to find that the options were unenforceable with the consequence that the transfer of the shares at step (4) was at undervalue and triggered the operation of Schedule 24 even if it were found that the scheme worked in relation to the other options. The Appellants do not contest the FTT's finding that a small amount of the deduction attributable to the scheme should be reduced, but take issue with HMRC's contention that the options were unenforceable, and to that extent take issue with the tribunal's doubts.

18. The FTT also held that an element of the contributions destined for a Mr Charles should be disallowed. There is no appeal against this finding.

The Schedule 24 Scheme

19. The FTT dealt with this issue without regard to the claimed errors in the implementation of the schemes. It said:

> 152. …. In deciding whether the scheme, properly implemented, succeeded in achieving its objectives, we take it to be common ground between the parties that we should interpret paragraph 1 Schedule 24 purposively. In this context it is manifest that Parliament would not have intended the obvious statutory purpose of the provisions to be circumvented by the value shifting type operation. As Mr. Thornhill said, had the draftsman noted how it might be claimed that the provisions might be circumvented, he would have said "oops". He might indeed then have noted that the [subsequent] rapidly introduced provision, preceded by a "Treasury announcement" of a future law change, had failed to note a point precisely noted in 1965 by the draftsman of the Finance Act 1965 that for capital gains purposes, grants of options, grants of leases and value shifting operations between one category of shares in a company and other shares or rights in the company were not disposals or "transfers of assets" (i.e. transfers of existing assets or strictly speaking – in the case of value shifting – transfers at all), such that in 1965 specific provisions deemed all three "non-disposal" situation, to constitute disposals.

153. Whilst thus it is obvious that in strict technical terms the drafting of paragraph 1 Schedule 24 was deficient, and that it occasioned the chance that the present scheme might evade the perfectly obvious intention that Parliament would have had, had the value shifting scheme been contemplated, the question for us is whether it is possible to interpret the provisions broadly so as to achieve a result in conformity with common sense and the result that Parliament would have intended, had the present scheme been contemplated.

154. Our decision is that the Newco scheme, operated without errors, would have succeeded in avoiding the application of paragraph 1 Schedule 24 (to no avail of course if our decision in paragraph 147 above is correct). We agree with Mr. Thornhill that the deduction was not allowed *"in respect of employee benefit contributions"*, i.e. in respect of any *"[payment] of money or transfers [of assets made by an employer to another person]"*. The step for which the deduction was claimed, namely the grant of the option, involved no payment of cash or transfer of any asset. The grant of the option by Newco was not a transfer of a pre-existing asset (the natural meaning of "transfer"), but was furthermore not made by the employer company at all. Mr. Coleman, for HMRC, claimed that the intended result under paragraph 1 Schedule 24 might have been achieved by the scheme had the wording referred to *"obtaining a deduction for payments of cash or transfers of assets by the employer to another person"*, but that when the words *"in respect of"* in fact appeared rather than the word *"for"*, this enabled the provision to be interpreted more broadly. Mr. Thornhill said that the meaning of the phrase was identical to the meaning of the word "for".

155. It is a very fine point of interpretation, but we incline to the view that Mr. Thornhill is right. We consider that Mr. Coleman is construing the words *"in respect of"* wrongly. The correct paraphrase of the events in the Newco scheme is not that *"the deduction is claimed for or in respect of a step* (the value shifting step) that is either a payment of cash to a third person, or a transfer of assets by the employer to another person. Instead, the deduction is claimed *"in respect of a step that is itself implemented in respect of contributions to an employee benefit scheme in a broad manner."* The words *"in respect of"* appear in the wrong place for Mr. Coleman's interpretation to be correct, and we consider that on any permissible basis of interpretation, the statutory wording cannot be interpreted to undermine the present scheme.

[original italics]

20. Mr Thornhill's argument before the FTT and before us is that the deduction was not in respect of an employment benefit contribution. He identifies the deduction with the value shift occasioned by the grant of the option at step (3), and says that step (3) was not an employment benefit contribution because there was no payment and no transfer of any asset at that time within paragraph 1(2)(a). As a result Schedule 24 does not apply.

21. The accounts of the companies identify the loss as arising on disposal of the Newco shares. That disposal was a transfer of assets by the employer to the SFML EBT (in the case of the SAML Newco) and the SAML EBT (in the case of the SFML Newco). As the beneficiaries of the SAML EBT included employees of SFML and *vice versa,* Mr Thornhill would accept that this transfer was the making of an employee benefit contribution but says that it occasioned no, or nugatory, expense since those shares were not worth anything significant and in any case were sold for their reduced value.

22. Mr Coleman argues for a number of alternatives:

> (1) the deduction was in respect of the scheme to reward employees; when considering that scheme in its totality there was an employment benefit contribution and the deduction sought was claimed in respect of the various transactions which, taken as a whole, constituted such contributions;
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> (2) alternatively, the deduction arose from the share subscription payment at step (2). That payment would eventually be received by the relevant EBT. The deduction was thus in respect of an employment benefit contribution;
>
> (3) alternatively, the FTT said at [4] of its decision that the companies had "contributed… indirectly into the EBT"s. "Payment" in paragraph 1(2) should be construed widely in this context to mean, as was held in *Aberdeen Asset Management v HMRC* [2014] STC 438, the making of money available to another person over which that person had control. After step (3) the EBTs had practical control of the Newcos and the subscription monies. Payment had been made to them and they held the monies for employees. Step (3) was thus an employee benefit contribution;
>
> (4) finally and alternatively again, in relation to SAML the option granted was unenforceable. As a result the trivial shares held by SAML did not have a trivial value and the loss in respect of which the deduction was claimed arose at the time of, and was thus in respect of, their transfer.

23. Mr Coleman also argued in the alternative that the grant of the option at step (3) was the transfer of an asset within paragraph 1(2)(a). Thus step (3) was an employment benefit contribution, and if the deduction was in respect of step (3), it was in respect of an employment benefit contribution. We should say at the outset that we reject that argument because, even if the grant of the option were the transfer of an asset, the company which incurred the deduction did not make the transfer since the options were granted by the Newcos; and paragraph 1(2) requires the transfer to be made by the employer.

Discussion

24. For the purpose of this discussion we assume that section 74 Taxes Act 1988 would not deprive the companies of deductions in respect of any employee benefit contribution they made.

25. In cases where Schedule 24 does apply, it is necessary to identify (i) the relevant employee benefit scheme and (ii) a payment or transfer of another asset (within the meaning of paragraph 1(2)(b)) by the employer to a third party to be held under the terms of that scheme. Where a deduction is sought by the employer for the making of an employee benefit contribution, it will be allowed only to the extent permitted under paragraph 1(3). Where a deduction is sought in respect of a transaction which is not an employee benefit contribution, then Schedule 24 is not engaged.

(1) An employee benefit scheme

26. An employee benefit scheme is defined by paragraph 9 to include an "arrangement" for the benefit of persons who include employees of the employer. The EBT in relation to each of SMAL and SFML was, of course, an employee benefit scheme when viewed in isolation. In our view, a series of steps designed and implemented in such a way as to ensure that the EBT received assets which it could realise constitutes an "arrangement" within the definition of employee benefit scheme found in paragraph 1(9). In our judgment, both (i) steps (1) to (4) and the relevant EBT and (ii) steps (1) to (5) and the relevant EBTs were "arrangements" constituting employment benefit schemes in relation to each of SAML and SFML. We will refer to these two employment benefit schemes in relation to each of SAML and SMFL respectively as "the First EBS" and "the Second EBS" (or, together, "the EBSs"). There are thus (at least) three candidate employee benefit schemes for each of the Appellants when it comes to considering the impact, of any, of Schedule 24: these are (i) the EBT, the First EBS and the Second EBS.

(2) An employer makes an employee benefit contribution.

27. It may be helpful to set out paragraph 1(2) again

> (2) For the purposes of this Schedule an employer makes an "employee benefit contribution" if –
>
> (a) he pays money or transfers an asset to another person ("the third party"), and
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> (b) the third party is entitled or required, under the terms of an employee benefit scheme, to hold or use the money or asset for or in connection with the provision of benefits to employees of the employer.

28. Paragraph 1(2) sets out conditions to be fulfilled before an employee benefit contribution can be said to be made by an employer. It does not provide a definition of an employee benefit contribution as such but a deduction is denied (or postponed) when it is in respect of a transfer or the making of a payment which falls within paragraph 1(2)(b). We think it is right to call such a payment or transfer an employee benefit contribution.

29. Step (2), the subscription for shares in each Newco at a large premium, clearly, in our view, gave rise to a payment, within the meaning of paragraph 1(2)(a), by SAML

and SFML to the relevant Newco. Step (2) formed part of the arrangements constituting each of the First EBS and the Second EBS: the payment was therefore a payment under or to an employment benefit scheme. Since the arrangements were pre-planned as a means of avoiding, it was thought, the provision of Schedule 24, the reality was that the payment is properly to be seen as one under which Newco was entitled or required, under the terms of an employee benefit scheme (whether one focuses on the First EBS or the Second EBS), to hold or use the money or asset for or in connection with the provision of benefits to employees of the employer (SAML or SFML as the case may be). (The payment would of course be reduced by any expenses incurred by Newco in the exercise. The sums passing, under the eventual liquidation of Newco under step (5), to the owners of the trivial shares pass to the EBTs, so that everything would pass to one or other of the EBTs.)

30. Thus the requirements of paragraph 1(2)(b) were satisfied because the arrangement was an "employee benefit scheme" and Newco was entitled pursuant to that scheme to hold or apply the monies for employees. It was not necessary for the monies to reach the EBTs in order to satisfy paragraph 1(2)(b) since Newco, whose shares were, under the arrangement, to be held by the EBTs, was itself entitled to apply the monies for the benefit of employees.

"In respect of" an employee benefit contribution.

31. It does not necessarily follow from those conclusions, however, that the appeals of SAML and SFML must be dismissed. Mr Thornhill's case is that the deduction which is sought to be made is not in respect of the payment which we have identified as the making of an employee benefit contribution. His case is that a deduction arises only for the diminution of the value of the shares in Newco which took place as a result of step (3), the grant of the option by Newco, because until that point the company has suffered no loss. For ease of reference, we will refer to this as value shifting, although it is not, perhaps, an entirely accurate description. The central issue then is what, within the meaning of paragraph 1, would the deduction have been in respect of. Mr Thornhill says that the deduction is in respect of, and only in respect of step (3). Since step (3) does is not a payment of money or transfer of assets, the employer does not make an employee benefit contribution.

32. We have already noted what the FTT said in [152] of the decision: see at paragraph 19 above. We agree that "it is manifest that Parliament would not have intended the obvious statutory purpose of the provisions to be circumvented by the value shifting type operation" found in the present case. If it is possible to do so without any undue strain on the meaning of the phrase "in respect of", we consider that we should give that phrase a meaning which captures the deduction which Mr Thornhill submits is to be made, as a deduction "in respect of" the payment which we have identified as the making of an employee benefit contribution, that is to say the payment at step (2).

33. We see no difficulty in giving that phrase such a meaning. It is true that the deduction claimed, on Mr Thornhill's approach, is for the amount of the value shifting which results from step (3) and, in that sense, the deduction is "in respect of" that

amount. But that value shifting occurs only as one step in a larger arrangement; and that larger arrangement includes the earlier step which we have identified as the making of an employee benefit contribution. The purpose of step (3) is to move the value of the employee benefit contribution from Newco to the EBT. Clearly, the employee benefit contribution and the value shifting are closely connected: the former is effected to enable the latter to take place and the latter actually takes place as the inevitable practical consequence of the former having been made. In our judgement, it is a perfectly natural and unstrained interpretation to read the words "in respect of" as describing the relationship between, on the one hand, the deduction which is said to arise for the amount of the value shifting at step (3), and, on the other hand, the employee benefit contribution which has enabled that value shifting to take place.

34. Mr Thornhill submits that the words "in respect of" cannot be given this wide meaning in the context of paragraph 1(1)(b). He says that, in effect, "in respect of" is to be read as meaning "for". Thus the deduction, on his interpretation, is not "for" the employee benefit contribution but only "for" the value shifting. The use of words "in respect of" is explained because they are more apposite than the single word "for" in a provision applying not only to payments but also to transfers of assets: the deduction is not "for" the asset itself but is "for" the **value** of the asset and thus "in respect of" the asset.

35. It seems to us that replacing "in respect of" by "for" carries the debate no further. The expense eventually occasioned by step (3) would not have been incurred but for step (2) as part of the scheme, and it is a natural use of language in the circumstances to say that the deduction was "for" the making of the contribution under the scheme.

36. The FTT, in the paragraphs quoted at paragraph 19 above, concluded that "in respect of" did mean "for" in the sense Mr Thornhill accords to it. But even the FTT thought the point was a very fine one. The reason for concluding that HMRC's construction of "in respect of" was wrong is found in the short passage in [155] of the decision:

> "The correct paraphrase of the events in the Newco scheme is not that "*the deduction is claimed for or in respect of a step* (the value shifting step) that is either a payment of cash to a third person, or a transfer of assets by the employer to another person. Instead, the deduction is claimed "*in respect of a step that is itself implemented in respect of contributions to an employee benefit scheme in a broad manner.*" The words "*in respect of*" appear in the wrong place for [HMRC's'] interpretation to be correct, and we consider that on any permissible basis of interpretation, the statutory wording cannot be interpreted to undermine the present scheme."

37. We do not, unfortunately, understand the proposition (found in the first half of the final sentence quoted) that the words "in respect of" appear in the wrong place if it is being suggested that there is a different place where, without a significant recasting of the provision, those words might have appeared which would have made the position clear in favour of HMRC; and the second half of the final sentence is simply an assertion of the conclusion. The reasoning, therefore, is to be found in the first two

sentences quoted. That reasoning is based on an analysis of what is claimed. Paragraph 1(1) does not, however, refer to a claim being made. Rather, it is concerned with what would be the position absent Schedule 24 and with what the deduction, if allowed, would be in respect of. It is true, on Mr Thornhill's approach, that the claim (and thus the deduction) would be for the amount of the value shifting at step (3) so that the deduction can be said to be in respect of step (3). But it does not follow from that truth, however, that the deduction cannot also and at the same time be in respect of something else, in particular in respect of the employee benefit contribution.

38. For the reasons which we have given, we do not agree with Mr Thornhill's submission or with the FTT's reasoning. Our conclusion is that even if it can be said that the deductions sought by SAML and SMFL are properly to be made for the amount of the value shifting at step (3) the deductions nonetheless fall within the scope of Schedule 24 because they were also in respect of the making of the employee benefit contribution.

39. If that is wrong, it leads us to question the premise of Mr Thornhill's argument, namely that the deduction which would, apart from Schedule 24, be allowed is for the amount of the value shifting at step (3). If that premise is incorrect, then any deduction would, as we see it, have to be claimed by reference to the arrangements as a whole and not by reference to an single element step (3), in the course of the implementation of those arrangements: in effect, the deductions would be for such part of the payments at step (2) as becomes available for the provision of relevant benefits. Any such deduction would clearly fall within the provisions of Schedule 24.

40. In our view, it is wholly unrealistic to regard any deduction which might properly be allowed as arising only at, or only because of, or being only for or in respect of step (3). The cost of the arrangement as a whole was incurred at step (2) and was in truth in respect not of the subscription, nor of the grant of the option, nor of the disposal of the shares on their own, but arose from, and was in respect of, the implementation of scheme as a whole. Where a set of pre-planned actions are undertaken which together result in a cost to the company, the cost or the deduction is properly regarded for the purpose of paragraph 1(1) as being in respect of those actions as a whole, and those actions constituted the making of an employee benefit contribution.

41. Outside Schedule 24, there is no need to identify in respect of precisely what a deduction is allowed. It would not matter if the deduction was technically to be allowed in relation to the amount subscribed at step (2) (less an amount representing the residual value of the trivial shares) or whether it was calculated by reference to the loss which occurred at step (3). Schedule 24 requires a more nuanced approach. Our conclusion, were we wrong on the first issue (*ie* that any deduction at step (3) is "in respect of" the contribution at step (2)), is that any deduction to which SAML and SFML would, absent Schedule 24, be entitled would not be in respect of step (3) in isolation. It would instead arise in relation to the scheme as a whole. If that approach is correct, as we think it is, there can be no doubt, in our view, that there have been employee benefit contributions to the schemes (namely the subscription amounts at

step (2)) and that the deductions which could properly be sought are, for the purposes of Schedule 24, in respect of those employee benefit contributions.

42. As a result we conclude that the FTT erred in law in its conclusion that Schedule 24 did not apply.

43. That conclusion is sufficient to dispose of the appeal. If Mr Coleman is right and some of the options were unenforceable, then Mr Thornhill does not dispute that paragraph 1 would apply "in respect of" the transfer of the trivial shares and that their transfer would have been an employee benefit contribution. Our analysis is that in those circumstances too the employee benefit contribution in respect of which the deduction would be given may encompass other parts of the scheme, but the conclusion is the same: Schedule 24 applies to deny the deduction.

Wholly and Exclusively

44. Our conclusion in relation to Schedule 24 makes it unnecessary to determine the appeals of SAML and SFML in relation to the application of section 74 Taxes Act 1988. However, in case this matter should go further, and because technically the denial of the deduction by section 74 precludes the operation of Schedule 24, we propose to say something about this topic.

45. The issue addressed by the parties before the FTT and before us was whether there was a duality of purpose in the contributions (we ignore for the moment quite what was contributed and to what entity). This question here is whether the contributions fell within the provision of section 74 Taxes Act 1988 which, at the relevant times, provided as follows:

> "(1) Subject to the provision of the Tax Acts, in computing the amount of the profits to be charged under Case I or Case II of Schedule D, no sum shall be deducted in respect of-
>
> > (a) any disbursements or expenses not being money wholly and exclusively laid out or expended for the purposes of the trade profession or vocation;"

46. It is said by Mr Thornhill that the contributions did not fall to be disallowed by this provision; the purpose, and only purpose, of the contributions was to provide benefits for employees through the EBTs. It is said by Mr Coleman that the FTT correctly held that there was another purpose, namely to secure a tax deduction. He submits that not only was securing this tax deduction a purpose of the scheme (which clearly it was, as is common ground) but it was also a purpose of the expenditure so that the contributions were not wholly and exclusively expended for the purposes of the trade.

47. The effect of the statutory provisions is well known. Expenditure is deductible only if it is incurred wholly and exclusively for the purposes of the trade. The word "exclusively" means that if the expense was also incurred for some other purpose, it is not deductible. The "wholly and exclusively" issue is to be determined by the object of the taxpayer in incurring the expense.

48. The question of what was a taxpayer's object is one of fact to be assessed by the FTT: see *eg* Romer LJ said in *Bentleys, Stokes & Lowless v Beeson* 33 TC 491 at 503 and 504. It is only if its finding is one which no reasonable tribunal could have reached, being properly instructed as to the law and properly applying that law, that it may be disturbed on an appeal on a point of law to this tribunal.

49. However in determining the object of a taxpayer in incurring an expense the FTT must observe a number of principles (and a failure to do so may render its conclusion erroneous in law).

50. First, "as the taxpayer's object in making the expenditure has to be found it inevitably follows that (save in cases which speak for themselves) the [FTT needs] to look into the taxpayer's mind at the moment the expenditure is made" (Lord Brightman *Mallalieu v Drummond* [1983] AC 861 at 870 D-E).

51. Secondly, in so doing, the object of the expenditure must be distinguished from its effect. If the sole object of the expenditure was the promotion of the business, the expenditure is deductible, even though it necessarily involves other consequences. Thus the existence of for example of a private advantage does not *necessarily* mean that the expenditure is disallowable. As Millett LJ said in *Vodafone Cellular v Shaw* 1997 STC 734 at 742g:

> "The object of a taxpayer in making the payment must be distinguished from the effect of the payment. A payment may be made exclusively for the purposes of a trade even if it secures a private benefit. This would be the case if the securing of the private benefit was not the object of the payment but merely a consequential and incidental benefit of the payment."

52. Another way of phrasing this is that a merely incidental effect of expenditure is not necessarily an object of a taxpayer in making it. However, as Lord Brightman's well known example in *Mallalieu* (see at p 870G) of the medical consultant going to the South of France to treat a friend shows, it may be the case that in fact what would be an incidental effect in some circumstances could be an independent object in others. What the FTT must not do is to conclude that merely because there was an effect, that effect was an object.

53. Thirdly, "some results are so inevitably and inextricably involved in particular activities that they cannot but be said to be a purpose of the activity" (Lord Oliver *MacKinlay v Arthur Young* [1990] 2 AC 239) and as a result the conscious motive of the taxpayer is not decisive: "it is of vital significance but is not the only object which the fact finding tribunal is entitled to find to exist" (Lord Brightman in *Mallalieu).* Another way of putting that is that the FTT must take a robust approach to ascertaining the purposes of the taxpayer.

54. There is one point to add: neither the statutory provision nor any of the cases indicate that the way in which an expense is incurred will determine whether the expense is deductible. The question is what is the object of the expense, not what was the object of the means of incurring it. But that is not to say that the means by which

the expenditure is made cannot be one of the circumstances to be taken into account in determining its purpose.

55. A trader may have a choice of the way in which it achieves an end which is exclusively for the benefit of the trade. The choice may be influenced, or indeed wholly determined, by the tax consequences of each choice. A taxpayer is perfectly entitled to order its affairs in a way which incurs the least tax liability. The mere fact that a choice is influenced or dictated by the tax consequences does not necessarily mean that the choice involves a duality of purpose as regards the expense. The words of Millett LJ are just as relevant and applicable where there is a choice as where there is not: in each case, the question is whether the payment is made exclusively for the purposes of the trade, and that is a question of fact for the FTT

56. The FTT found that the companies had more than one purpose in incurring the cost of the contributions. As Moses LJ said in *Interfish Limited v HMRC* [2014] EWCA 876 "You might have thought, therefore, that once it had been found as a fact by the First-tier Tribunal that the payments…had two purposes, that was the end of the matter", but Mr Thornhill has two criticisms of the FTT's conclusion. First, he submits that the FTT's conclusion is inconsistent with the principle stated by Romer LJ in *Bentleys,* and recently approved by the Court of Appeal in *Interfish* that

> "if, in truth, the sole object is business promotion, the expenditure is not disqualified because the nature of the activity necessarily involves some other result or the attainment or furtherance of some other objective, since the latter is necessarily inherent in the act."

He says the FTT accepted that the purpose of the expense was to benefit employees and that this should be a business purpose. He says that the arrangements SAML and SFML adopted to reward their employees had the incidental effect of reducing their tax liabilities: but that did not mean that the costs had not been incurred exclusively for trading purposes. The FTT had wrongly treated an incidental effect as a purpose.

57. His second criticism was that even if there was an element of duality, the expenditure would have been incurred even without a non-trading tax avoidance motive and, relying on *Kilmorie (Aldridge) v Dickinson*, (an appeal heard with the appeals cited as *Ransom v Higgs* 50 TC 1), he says that in such circumstances the expenditure remains deductible.

An Incidental Effect, not a Purpose

58. The determination of a person's purpose is one of fact. Only if the FTT reached a conclusion not available to it on the evidence or at variance with the rules summarised above can it be said to have made an error of law. Mr Thornhill does not argue that the FTT's decision was contrary to the evidence but that it erred in law in treating an incidental result as a purpose

59. The tribunal found that the rule against dual purposes stemming from section 74 prevented the deduction of all of the amount charged in computing the companies'

profits, on the basis that the whole of that expenditure had a dual purpose. It reached its conclusion in [146] to [148] of its decision. In [146] it said:

> "146. It is clear and cannot be disputed that an objective, on the part of a company, of seeking to eliminate its liability for corporation tax, cannot be a legitimate ground for claiming a trading deduction. In the case of ordinary payments of salary and bonus, we accept Mr. Thornhill's contention that when a company ordinarily makes such payments the feature that it expects to secure a trading deduction for the payments does not occasion any "duality of purpose" concern. In the ordinary way, salary and bonuses are obviously tax deductible, they are meant to be tax deductible, and the expectation that this will be so is not an objective of making the payments."

60. In this paragraph it appears to us that, whilst its language is unconventional, the FTT correctly recognises that the expectation – "a consequential or incidental benefit", or something "necessarily involv[ing]…the attainment of another objective" - of obtaining a deduction for employee benefit payments does not necessarily mean that obtaining that deduction was an object of the taxpayer.

61. The FTT went on to say this:

> "147. The provisions of paragraph 1 Schedule 24, however, undermine this ordinary expectation. The reality becomes that if no steps are undertaken to oust the application of paragraph 1 Schedule 24, the corporation tax deductions will obviously be denied by that provision. If, however, a highly contrived scheme is implemented to oust the application of paragraph 1 Schedule 24, the reality then becomes that:
>
> - the highly artificial steps of the scheme focus attention on the fact that those steps, which were central to the whole planning in the present case, were entirely designed to achieve a particular objective;
> - that purpose was obviously to oust the application of paragraph 1 Schedule 24, which can be paraphrased realistically to be a purpose of achieving the precisely opposite corporation tax treatment for the EBT contributions than the result intended by Parliament; and that
> - the deliberate and all-pervading objective of achieving a corporation tax deduction makes it impossible to treat the corporation tax result sought for the contributions as the "ordinary, intended or realistically expected outcome" of making salary, bonus or equivalent payments.
>
> These related factors appear to us wholly to undermine the general argument (in a case such as the present) that when salary or bonuses are paid, the expectation of securing a corporation tax deduction does not constitute any

> sort of "duality of purpose". SA's and FM's intentions were plainly to secure a far from ordinary tax deduction, one that would not ordinarily be expected, and certainly one that was designed to achieve the very opposite of the result intended by Parliament. On this ground we consider that the resultant "duality of purpose" in making the contributions, via the value-draining scheme, is the very factor that occasions the fatal duality of purpose that results in the denial of the entire deductions claimed by both companies."

62. At the end of [147] the FTT came to the conclusion that there was in this case a duality of purpose. It can be seen that the FTT reached that conclusion after considering the manner in which the expense was incurred. Thus, the first bullet point of [147] deals with the objective of the "artificial steps of the scheme" and *their* objective. The second bullet point addresses "that purpose", namely the purpose of those steps. Those two bullet points are not, it is to be noted, on their own a conclusion that the expense had the same purpose as the purpose of the steps in which it was incurred.

63. The third bullet point is a finding that there was an all-pervading object of achieving a deduction. This gives rise to the conclusion at the end of the paragraph ("On this ground…") that there was "'duality of purpose' in making the contributions" in other words in incurring the expense, not simply in undertaking the scheme.

64. The preceding discussion of the reasons for the steps suggests that the FTT may have concluded that it was because the means adopted had a second purpose that the expense also shared that purpose. That could be consistent with what the FTT said in paragraph 148:

> "148. The curious position thus becomes that if no attempt is made to circumvent paragraph 1 Schedule 24, the deduction is denied. If a contrived scheme is effected to achieve the opposite result, it fails simply because that objective becomes the fatal purpose that creates the duality of purpose that itself undermines the deduction."

65. Thus, on one interpretation of its decision, the FTT appears to have found that SAML and SFML had incurred expenditure for the purposes of their trade, but that because those companies then decided to incur that expenditure in a particular way, their objects in incurring it came to include in addition the object of avoiding corporation tax.

66. If that was the FTT's reasoning we do not agree with it. That reasoning would be to confuse the object of the expenditure with the reasons for incurring it in the way in which it was in fact incurred. As we have already noted at paragraph 55 above, a taxpayer is entitled to order its affairs in a way which incurs the least tax liability and the mere fact that a choice is influenced or dictated by the tax consequences does not *necessarily* mean that the choice involves a duality of purpose. It does not, therefore, necessarily follow that the adoption of the scheme by SAML and SAFL results in a duality of purpose (although it may do so as a matter of fact) unless this is one of those cases referred to by Lord Oliver *MacKinlay v Arthur Young* (see paragraph 53

above) where the results (in the present case, the securing of deductions) are so inevitably and inextricably involved in particular activities (in the present case, the making of the contribution and the effecting of the scheme) that they cannot but be said to be a purpose of those activities.

67. However, the FTT did not say in so many words that, because the scheme had one particular object, the expenditure also had that object. Instead, in the third bullet point, it provides a separate finding that the all pervading object (*ie* to achieve a corporation tax deduction) made it impossible to treat the corporation tax result sought for the contributions as the "ordinary, intended or realistically expected outcome" of making salary, bonus or equivalent payments. The words "ordinary, intended or realistically expected outcome" are thus being adopted as the yardstick by reference to which a result can be ignored as a separate object.

68. It seems to us that this gloss on the "wholly and exclusively" test is either (i) putting into other words Millett LJ's description of a "consequential and incidental benefit of the payment", and saying that this was not a situation in which the tax benefit was merely consequential or incidental, or (ii) is stating, in different language, the proposition to be derived from what Lord Oliver said in *MacKinlay v Arthur Young*, so that the securing of the deductions cannot but be said to be a purpose of the contributions.

69. However, taking that gloss on its own terms, the FTT reasoned in the closing paragraph of paragraph 147 that the three bullet points "undermined the general argument (in a case such as the present) that where salary or bonuses are paid the expectation of securing a corporation tax advantage does not constitute any sort of duality of purpose". It seems to us that the FTT's conclusion must therefore have been not simply that the purpose of the scheme was to produce a tax deduction (it clearly was and nobody has ever suggested otherwise) but that the purpose of the contribution was to produce a tax deduction: that is why there was a duality of purpose.

70. That conclusion finds support in what the FTT said in paragraph 149:

> "149. ….HMRC had plainly contended that the objective of securing a tax deduction was a relevant motivation (indeed, as contended, even the dominant motive for making the contributions) we have no hesitation in reaching our decision…."

Here the FTT was addressing the purpose for making the contributions not the purpose for adopting the scheme. It seems to be saying that one, perhaps the dominant, reason why the contributions were made was to obtain a tax deduction. On that approach, there was a duality of purpose in the context of the "wholly and exclusively" test because one purpose of the expenditure (rather than of the steps by which the expenditure was incurred) was to obtain a tax deduction. In other words, this was not a case where the purpose of the expenditure was solely to provide employee benefits with the incidental result that a deduction would be obtained;

rather, one purpose of the contribution was to obtain the deduction (in order, no doubt, on this approach to reduce the corporation tax liability).

71. Thus we conclude that the FTT's decision contains a finding that one of the purposes of the contributions, in contrast with the purpose of the method of effecting the expenditure by way of the scheme, was to obtain a corporation tax deduction which would not have been available if the contribution had been made by more conventional means, and that in these particular circumstances such purpose was not an incidental consequence of the expense. Whatever else, the FTT did not conclude that *because* the tax benefit was a consequence of the contribution, it was a purpose of the expense.

72. The FTT heard the evidence of Mr Dryburgh and would have been entitled to treat its conclusions as to his subjective motives as those of SAML and SAFL. It was not argued that there was no evidence before the FTT on which it could reasonably have held that at the time the companies incurred the expenditure one of the objects was to obtain a tax deduction for the whole of the companies' profits for the year or that the evidence contradicted such a finding. On that basis it was entitled to find that one of its objects in incurring the expenditure was to obtain a tax deduction for it, and that obtaining a deduction was a purpose rather than an incidental or consequential effect of the expense.

73. We therefore do not accept Mr Thornhill's first criticism. In the context of the present case, the important words in the passage quoted from Romer LJ are "if, *in truth*, the sole object is business promotion". The premise of the principle is that the fact finding tribunal has properly found that there is a sole object. The principle is that if such is the case, then an incidental effect does not as a matter of law disturb that conclusion. In this case the FTT did not find that there was a sole object. It found expressly that the companies had another object. In doing so it recognised that an incidental consequence of a tax deduction did not mean that such a deduction was necessarily an object.

74. The point made by Romer LJ in *Bentleys* was that expenditure is not disqualified *because* the nature of the activity necessarily involved some other result, in other words that the mere existence or knowledge of that result is not enough to give a dual purpose. But if the fact finding tribunal concludes that its enquiry into the mind of the taxpayer revealed that the taxpayer actually had that other purpose as an object of the expenditure, then the fact that that result is a natural consequence of the expenditure will not cause that finding to be perverse.

The expenditure would have been incurred in any event.

75. Mr Thornhill's second criticism was that even if there was an element of duality, the expenditure would have been incurred even without a non-trading tax avoidance motive and, relying on *Kilmorie (Aldridge) v Dickinson*, he says that in such circumstances the expenditure remains deductible. He says that *Kilmorie* shows that if the cost of something would have been £10, and its cost with tax benefit is also £10, then £10 remains deductible. He argues that this follows both from an example in

Lord Cross's speech about a retailer, and also from the division between the allowable and unallowable elements of an expense incurred with a dual purpose espoused by Lord Wilberforce in his agreement with Roskill LJ and by Lord Simon in his speech.

76. But in that case none of their Lordships reached a conclusion that part of the payment should be allowed and part disallowed. The closest to that proposition were Lord Reid and Lord Cross. Lord Reid said the relevant section could well be read as meaning that part was a proper deduction but said that the question did not have to be decided, and Lord Cross said that as the Revenue had agreed to allow a deduction for part of the expense it was not necessary to decide whether part was allowable. Further the House was considering the case in which it was possible to divide and segregate the expense into parts incurred for one purpose and parts for another, and Roskill LJ's remarks in the Court of Appeal were also addressed to such a situation. That is quite different from saying that, if the whole of an expense had both a trading and a non trading purpose, the existence of a trading purpose was sufficient to make the whole expense deductible. Such a result would seem to us to fly in the face of the statutory requirement that the purpose be "exclusively" a trading one.

77. We are not deflected from this conclusion by Lord Cross's example of a retailer who buys goods for £10 from his son in law rather than for the same price from his usual supplier. Lord Cross regarded the fact that the retailer purchased from the son-in-law to help him in his business did not prevent a deduction. But, whether the retailer buys for £10 from the previous wholesaler or his son in law he incurs the same expenditure, and, absent some particular factor, the object of that expenditure will almost certainly be found as a matter of fact to be obtain the goods, even though the manner of the expenditure may be to benefit his son in law. If the retailer pays £15 to obtain the goods from his son in law when he could have paid £10 to his usual wholesaler it will generally be an obvious deduction from the circumstances that as a matter of fact he must have had an additional object in incurring the expenditure and not merely a different object in the manner it was incurred. But neither conclusion follows as a matter of law, for the actual evidence before the tribunal may dictate or permit a different factual conclusion.

78. We therefore reject Mr Thornhill's second argument.

79. We should make one other observation. In the course of argument Mr Coleman suggested that the application of section 74 depends on identifying the relevant expense; that in the present case the relevant expense was step (2), the subscription for the shares; and that that step would not have been undertaken were it not for the purpose of getting a deduction. That step and the expense thus had a purpose other than that of the trade.

80. We do not think that this is a realistic way to view the facts to which section 74 must be applied. Our conclusions are not dependent upon treating the companies' expenditure as arising at particular point in the scheme. The scheme was a planned series of transactions which took place as planned. Those transactions are to be regarded as a whole. Section 74 requires the purpose of the expenditure to be ascertained: the expense the companies incurred arose as a result of the transactions

taken as a whole. The question to be asked is not the purpose of any one of those transactions, but what was the object of incurring the expense to which the combination gave rise.

81. Even if it were correct to examine any particular step in isolation as the relevant expense for which deduction is made, it is not right, in our view, to view that expense, counter-factually, as taking place as if it were not part of a wider set of arrangements. Accordingly, the correct question to ask is what the purpose of that expense was in the context of the scheme as a whole and to ascertain what the intentions of SAML and SFML were in subscribing the shares and permitting Newco to grant the options. The answer on the factual findings of the FTT, is that one purpose was to implement a pre-arranged scheme in order to obtain a tax deduction; the purpose was not simply to benefit employees and directors through the medium of an employment benefit scheme. The deductibility which it was hoped to achieve was not simply inherent in the (allegedly sole) purpose of benefiting employees and directors.

Conclusions

82. We dismiss the Appellants' appeals. The effect of Schedule 24 is to deny the Appellants a deduction for the expense of any contribution to the arrangements. Further, even if that is wrong, it has not been shown that FTT erred in law in finding that the expense was not incurred wholly and exclusively for the purposes of the Appellants' respective trades.

83. Given those conclusions we do not think it necessary or helpful to address the other issues which have been raised namely (i) the charged deposits (discussed by the FTT at [137]*ff* of the decision) (ii) asset stripping (discussed by the FTT at [140]*ff* of the decision) and the enforceability of the options.

Mr Justice Warren, Chamber President

Judge Charles Hellier

Release Date 13 February 2015