[2020] UKUT 0168 (TCC)

Appeal number: Upper Tribunal/2019/0078

INCOME TAX – company buyback of shares – meaning of s385 ITTOIA 2005 – person receiving or entitled to distribution – appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

BOSTAN KHAN

Appellant

- and -

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

TRIBUNAL: JUDGE SWAMI RAGHAVAN
JUDGE ANDREW SCOTT

Sitting in public at The Royal Courts of Justice, Strand, London WC2 on 14 January 2020

Laurent Sykes QC, instructed by Markel Tax, for the Appellant

Charles Bradley, counsel, instructed by instructed by the General Counsel and Solicitor to Her Majesty's Revenue & Customs, for the Respondents

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DECISION

Introduction

1. This is an appeal by Mr Bostan Khan against a decision of the First-tier Tribunal ("FTT") issued on 23 November 2018 ("the FTT Decision"). The FTT Decision concerned the tax treatment of transactions entered into by Mr Khan in relation to a company, Computer Aided Design Limited (the "Company"). Mr Khan, who is an accountant, was familiar with the business of the Company as he had prepared its accounts and the Company rented its premises from him. On 28 June 2013 Mr Khan bought all 99 of the issued shares of the Company from the Company's three shareholders for £1.95m plus the net asset value of the Company over that amount. On the same day the Company immediately bought back 98 of the 99 shares for consideration of £1.95m leaving him with one share in the Company.

2. Before the FTT, Mr Khan sought to appeal HMRC's closure notice which amended his tax return for the tax year 2013/14. The closure notice increased the income tax due for that tax year by £594,814.57 on the basis that the buy-back of shares was a distribution taxable under s383 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA").

3. Mr Khan's principal argument before the FTT was that the purchase and sale of shares in the Company was a trading transaction and that the disposal of shares amounted to a disposal of trading stock. The FTT disagreed and upheld HMRC's closure notice. It found Mr Khan's acquisition of the company was in the nature of an investment. The FTT also dismissed Mr Khan's alternative argument that what happened should be viewed as a single composite transaction whose effect was to make Mr Khan the owner of one share in the Company with a small net cost.

4. With the Upper Tribunal's permission, Mr Khan now appeals to this tribunal. His ground of appeal relates solely to the alternative ground of appeal: that the FTT erred in failing to recognise the true substance of the transaction which was that it was a composite transaction whereby Mr Khan received the remaining share in the Company devoid of £1.95m of distributable reserves in return for entering into the various transactions. His liability to tax accordingly should have been on his net receipt of the single share chargeable under s687 ITTOIA.

The facts and background and the FTT Decision

5. The FTT had a documents bundle which included copies of the agreements that had been entered into and e-mail correspondence between Mr Khan and his solicitor and between his solicitor and the shareholders' solicitor in the run up to the transaction. It also heard oral evidence from Mr Khan, who had provided a witness statement in advance of the hearing.

6. The facts found as indicated by paragraph numbers refer to those in FTT Decision unless context requires otherwise.

7. The Company's business was an employment bureau for consultants. The three shareholders ("the selling shareholders") no longer wished to work together. In 2013 they approached Mr Khan to see if he was interested in buying the Company with a view to winding it up. Mr Khan had prepared the management accounts of the company since the mid-1990s and the Company rented space in his offices. [3]-[5].

8. Originally it was planned that the Company would buy back 96 out of the 99 shares from the selling shareholders for £1.8m and then Mr Khan would buy the remaining three shares for £200,000 - £300,000 (later reduced to around £35,000 - £50,000) and draft documentation was prepared on this basis. On 20 June 2013, the selling shareholders' solicitors referred to accountancy advice that queried whether the selling shareholders might not qualify for entrepreneurs' relief for the purposes of capital gains tax under the proposed deal. A tax indemnity was proposed on 25 June 2013 but was rejected by Mr Khan. On 27 June 2013 Mr Khan's solicitor wrote to Mr Khan to say the revised structure of the deal was in effect to reverse the order of the share purchase and buyback so that Mr Khan would buy all of the selling shareholders' shares and sell all bar one of the shares to the Company. Mr Khan's solicitor recorded that Mr Khan, as accountant for the company was satisfied that there were sufficient distributable reserves for the buyback to take place. The shareholders and Mr Khan had separate legal representation and the deal was fully documented [6].

9. The deal entered into as described by the FTT was as follows. Mr Khan bought the entire issued capital (99 shares) for cash consideration of £1.95m plus net asset value (ignoring the reserves representing £1.95m). The Company then immediately bought back from Mr Khan 98 of the shares for cash consideration of £1.95m. The share sale and buy-back transactions, both of which completed on 28 June 2013 were documented respectively in a share purchase agreement ("SPA") and an off-market purchase agreement ("OMPA") [7].

10. Most of the cash for the buyback came from the drawdown of an invoice discounting facility made available by NatWest. Mr Khan indemnified the selling shareholders against any liability under that facility and also provided NatWest with a personal guarantee. The Company's bank statement showed a receipt of £1,216,000 from NatWest and a payment of £1,950,000 to Mr Khan. Mr Khan's bank statement showed a receipt of £1,950,000 and a payment of an identical amount to his lawyer [8] [9].

11. The FTT recorded Mr Khan's evidence as explaining that while Mr Khan did not have the technical knowledge of the business to continue trading in the long-term, he could, as an accountant, effect an efficient winding up, which he expected to do within two to three years and could then benefit from any surplus on the winding-up and the profits of a short period of continued trading. The price sought by the selling shareholders could be funded by the Company's resources; and he could not have afforded the transaction otherwise. [10].

12. The FTT recorded the appellant's submission on the alternative argument as follows:

> "the whole transaction could be viewed as a single whole whose effect was to place Mr Khan as the owner of one share in the Company, with a small net cost: *PA Holdings v RCC* [2012] STC 582 (at 58-60)."

13. In response HMRC submitted that there was clearly a purchase of 99 shares followed immediately by a sale (the buyback by the Company) of 98 shares; it was a misinterpretation to describe this as being only one transaction. Each transaction was separately documented with its own (separate) legal and factual consequences. The documentation, accounts and professional advice received by Mr Khan were all explicit that the buyback consideration was met out of the distributable profits of the Company. Mr Khan still held one share with a significant capital acquisition cost, available for offset against any future disposal proceeds.

14. The reasoning regarding the alternative argument was shortly stated:

> *"Whether the transactions should be reanalysed*
>
> 23. We deal first with the Appellant's contention that the transactions should be analysed as involving the acquisition of a single share by Mr Khan. Mr Sykes emphasised that this was his client's subsidiary argument, and he did not press it hard. We do not find the contention is supported by the passage from Moses LJ's decision in *PA Holdings* cited in argument. Taking a broad view of the acts of the parties (as advocated there) we consider that the selling shareholders wished to sell the Company which had accumulated sizeable distributable profits. The selling shareholders apparently did not like the tax consequences of extracting the reserves by declaring a pre-sale dividend, nor effecting a pre-sale buyback of shares by the Company. Instead, it was agreed that they would sell the shares to Mr Khan and he would extract the reserves in cash (by a share buyback). That view of the acts of the parties is clearly supported by the deal documentation and the professional advice received by the respective parties at the time of the deal. It is also the view taken by HMRC in the Disputed Closure Notice."

15. The majority of the FTT Decision was concerned with the argument that purchase and sale of shares was a trading transaction [24] – [27]. In dealing with that issue the FTT noted (at [26]) that "the acquisition was self-funded in the sense that the resources came from within the Company and Mr Khan did not borrow funds (although as the new owner of the Company he did provide personal guarantees to Natwest)". It also noted that he owned the buyback shares "for only a short time".

16. The FTT rejected Mr Khan's trading argument. It noted that he was not a securities trader but instead had seen an opportunity to acquire the Company as an investment, albeit not a long-term investment, funding that investment using the Company's own reserves and borrowings [27]. The FTT concluded that the disputed closure notice correctly stated the tax consequences of the buyback as being receipt of a company distribution taxable in Mr Khan's hands.

Permission required for new ground?

17. HMRC argued, as a preliminary matter, that Mr Khan's ground of appeal raised a new point and that Mr Khan therefore needed this Tribunal to give permission before the ground could be argued. We invited the parties to address us on the significance of the fact that permission had already been granted by the Upper Tribunal's decision given on the papers on 1 July 2019.

18. The parties referred us to *Southill Finance Limited* [2009] EWCA Civ 2. There, permission to appeal having been granted ahead of the substantive hearing, the question nevertheless arose at the subsequent hearing of whether the appellant should be allowed to present his case on appeal on new points that had not been raised in the case below under appeal. Lloyd LJ explained at [29] that:

> "Points of this kind more often arise at the stage of an application for permission to appeal or, if permission has been granted, on seeking to amend the grounds of appeal. Here, by contrast, permission to appeal has been given on grounds which include the new points. However, the grant of permission, on which the Respondent was not heard, only shows that there were thought to be reasonable prospects of success. It does not amount to a grant of leave, binding on both parties, to rely on the new point. All it means is that the Appellant was given the right to argue in favour of this at a full hearing…"

19. While the above case suggests it is open in principle to take issue with the ground of appeal being a new point, we agree with the appellant that the appellant's ground is not in substance a new ground. Regarding the appellant's reliance on its alternative argument on *PA Holdings v Revenue and Customs Commissioners* [2011] EWCA Civ 1414, HMRC argue that, as is evident from [66] of Moses LJ's judgment in *PA Holdings*, the reasoning in the case does not depend on the identification of any *Ramsay*-type composite transaction: it simply depends on the mutual exclusivity of the Schedules under which income tax is charged. However, having considered the parties' skeleton arguments before the FTT and the passages in the parties' notes of the hearing we were referred to, we reject HMRC's case that the ground raised before us is new. It is clear the appellant's reference to *PA Holdings* concerned whether the construction of a statute (properly understood in the light of its purpose) required a consideration of one element of a composite transaction or the whole of the transactions viewed together as a composite ([56] and [58] of judgment). Further, as the appellant highlighted, the FTT did not take any issue with the proposed ground being new when it refused permission in its decision of 29 May 2019. In fact, it sought to explain, by reference to its own reasoning, that the FTT adopted the approach of Moses LJ by looking to the substance and purpose of the payments and not the mere form in which they were received.

20. It is true, however, that the argument the appellant now advances before us was very much run as a subsidiary argument before the FTT. HMRC argue that, because what the appellant argues amounts to a new point, a number of findings were not made (regarding control of funds/ borrowing etc.). We come on to discuss the significance of these later but for present purposes we consider that any lack of

findings arose not because the current ground is a new argument, but because either the argument was subsidiary, or the FTT did not think the findings relevant.

21. We conclude the appellant's ground does not raise a new argument. Mr Khan does not therefore require permission from us before it can be run.

5 **Error of law vs. error of fact?**

22. HMRC argue, in any case, that it must be recognised that the appellant's ground raises not a point of law but a point of fact. They submitted that the question as to whether there is a composite transaction is a question for the fact-finding tribunal that can only be challenged on *Edwards v Bairstow* [1956] AC 14 principles. The 10 significance of this is that Mr Khan would have to show that the only possible inference from the primary facts was that there was a single composite transaction of the kind put forward i.e. that no reasonable tribunal could have failed to find that the distribution was one received by the selling shareholders. In support, Mr Bradley for HMRC, referred us to *Furniss v Dawson* [1984] AC 474 per Lord Brightman at 527F- 15 528D.

> "The formulation by Lord Diplock in Burmah expresses the limitations of the Ramsay principle. First, there must be a pre-ordained series of transactions; or, if one likes, one single composite transaction. This composite transaction may or may not 20 include the achievement of a legitimate commercial (i.e. business) end. …Secondly, there must be steps inserted which have no commercial (business) purpose apart from the avoidance of a liability to tax-not" no "business effect". If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must 25 then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied….
>
> …The formulation, therefore, involves two findings of fact, first whether there was a pre-ordained series of transactions, i.e. a 30 single composite transaction. Secondly, whether that transaction contained steps which were inserted without any commercial or business purpose apart from a tax advantage. Those are facts to be found by the Commissioners. They may be primary facts or, more probably, inferences to be drawn from the primary facts. If 35 they are inferences, they are nevertheless facts to be found by the Commissioners. Such inferences of fact cannot be disturbed by the court save on Edwards v Bairstow principles."

23. Mr Sykes, for the appellant, referred us to various extracts suggesting the contrary: the House of Lords' judgment in *IRC v Fitzwilliam and others* [1993] 1 40 WLR 1189, where it held that the process of construction is matter of law not fact – per Lord Keith at 1204. He also referred to the Upper Tribunal's decision in *The Trustees of the 2002 Maintenance Trust v CIR* [2017] UKUT 300 (at [23]) where the Upper Tribunal explained:

> "There is no dispute that the question whether a sequence of steps is properly to be categorised as a single composite transaction for the purposes of the TCGA is reviewable as an issue of law. Nor is there any dispute that it is not the function of this Tribunal simply to substitute its own assessment for that of the FTT. The question is whether the FTT has fallen into error."

24. Further in *IRC v Scottish Provident Instiution* [2005] STC 15 (at [19]), the House of Lords confirmed that the meaning of "entitlement" in the relevant statute was a question of statutory interpretation and, hence, it was a question of statutory interpretation whether the interdependence of transactions was relevant or not. Therefore, the failure to appreciate that was an error of law.

25. In our judgment, the extract relied on from Lord Brightman's speech in *Furniss v Dawon* highlights that, the question whether there is a composite transaction (in the sense that one step follows in all practical likelihood from the other), and the question of purpose, are both questions of fact (or more likely inferences from fact, but fact nevertheless).

26. But that is not the issue here. The issue is whether, in the light of the proper understanding of s385 ITTIOIA, the section is "sensitive", as Mr Sykes put it, to a consideration of whether transactions are to be looked at as a composite whole or whether the focus is instead on the individual transactions. In other words, the question as to whether two contracts are properly to be categorised as a single composite transaction for the purposes of s385 ITTOIA is also a question of law. Given the clear law that a realistic appraisal of the facts is by reference to the statutory purpose of the provision in question, it is difficult to see how that question could not be one of law – the tribunal needs to decide what facts are relevant in the light of its interpretation of the statute. Once it is decided the statute is "sensitive" to composite transactions the question of whether the transaction in question *is* a composite transaction and its purpose (so far as relevant) are then questions of fact or inferences of fact.

27. In other words, the question of which facts to consider will depend on construing the statute, and that is clearly a question of law. But, once a factual issue is relevant to the application of the statute to the case in question, a particular finding as to that issue is a finding of fact with all that entails in terms of susceptibility to challenge on appeal. Understood thus, the appellant's ground is, in essence, that, having regard to the statutory purpose of the provision (s385 ITTOIA), the FTT failed to make relevant findings of fact. In our view that ground properly raises a question of law rather than a question of fact.

Appellant's grounds of appeal

28. In the hearing before us, Mr Sykes articulated the error of law as the FTT failing to take account of relevant considerations, most significantly the crucial issue of whether the transactions were interdependent or not and taking account of irrelevant considerations. The FTT also erred in failing to consider the purpose of the relevant statutory provision.

Did the FTT err in law?

General approach to statutory interpretation

29. We consider that the modern approach to the interpretation of taxing statutes is set out by the House of Lords in *Barclays Mercantile Business Finance Ltd v Mawson* [2005] STC 1 ("*BMBF*") and more recently by the Supreme Court in *UBS AG and DB Group Services v HMRC* [2016] UKSC 13.

30. In approaching both the facts in issue in that case and in the other cases referred to in its judgment, it is plain that the House of Lords in *BMBF* was firmly focused on the meaning of the particular enactment concerned:

> "But, however one approaches the matter, the question is always whether the relevant provision of the statute, upon its true construction, applies to the facts as found." [32]
>
> "It elides the two steps which are necessary in the application of any statutory provision: first, to decide, on a purposive construction, exactly what transaction will answer to the statutory construction and secondly, to decide whether the transaction in question does so." [36]
>
> "*MacNiven* shows the need to focus carefully upon the particular statutory provision and to identify its requirements before one can decide ..." [38]
>
> "The present case, like *MacNiven*, illustrates the need for a close analysis of what, on a purposive construction, the statute actually requires." [39]

31. In *UBS/Deutsche Bank* the Supreme Court adopted the same approach. Its decision also contained some important dicta on the meaning of 'reality', which, again, put the words of the statute front and centre stage. So:

> "References to "reality" should not, however, be misunderstood [...]
>
> [...] it might be said that transactions must always be viewed realistically, if the alternative is to view them unrealistically. The point is that the facts must be analysed in the light of the statutory provision being applied. If a fact is of no relevance to the application of the statute, then it can be disregarded for that purpose. If, as in *Ramsay*, the relevant fact is the overall economic outcome of a series of commercially linked transactions, then that is the fact upon which it is necessary to focus. If, on the other hand, the legislation requires the court to focus on a specific transaction, as in *MacNiven* and *Barclays Mercantile*, then other transactions, although related, are unlikely to have any bearing on its application." ([67] and [68])

32. The process of statutory construction will thus reveal, among other things, the relevance or otherwise of the economic effect of transactions. It is wrong, however, to assume that economically equivalent transactions should be taxed in the same way. As Lord Greene MR said in *Inland Revenue Commissioners v Wesleyan and General Assurance Society* (1946) 30 TC 11, 16:

> "In dealing with income tax questions it frequently happens that there are two methods at least of achieving a particular financial result. If one of those methods is adopted, tax will be payable. If the other method is adopted, tax will not be payable."

33. Mr Sykes sought to depict *Wesleyan* as out of date, pointing to Viscount Simon's endorsement in the House of Lords of Lord Greene MR's statement by reference to *Duke of Westminster v IRC* 19 TC 490 and suggesting things had moved on since that case. However, as Mr Bradley pointed out, *Wesleyan* was expressly approved by Lord Wilberforce in *Ramsey* and we consider that it clearly remains good law.

34. As regards the welter of case-law on the treatment of composite transactions, while Mr Sykes took us to *Scottish Provident, Berry v HMRC* [2011] UKUT 81 (TCC) *IRC v Fitzwilliam* [1993] 1 WLR 1189*, Craven v White* [1989] AC 398*, Furniss v Dawson, WT Ramsay v IRC* [1981] STC 174 and *Eilbeck v Rawling* [1980] STC 192, there is no need for us to dwell on these. It is clear each are rooted in their particular statutory context.

35. We do not think that there was any disagreement between the parties as to the principle that certain statutory provisions may require a series of steps to be looked at as a composite whole whereas others are only interested in specific transactions. The dispute here is how that applies in relation to s385 ITTOIA.

36. Does s385 require one to look at the composite effect of what happened under the various transactions entered into, as the appellant submits? Or, does the analysis, as HMRC suggest, simply stop with the fact that under the share buy-back agreement Mr Khan was entitled to receive, and did receive, £1.95m for selling the shares back to the Company?

37. Bearing the above approach in mind, it is clear from the outset, that whatever the outcome of the analysis in relation to that issue is, the FTT erred in law in failing to construe the relevant provisions in the light of their statutory purpose. That may be explained by the low prominence the appellant gave to that argument, but the omission is an error in that part of the FTT's decision nonetheless. The error in turn meant it could not be assumed that the FTT's fact-finding with respect to the issue would necessarily encompass the facts relevant to the statutory question. In our judgment that error of approach alone means the FTT Decision must be set aside in so far as it dealt with the subsidiary issue. We also consider the FTT erred to the extent it included HMRC's views as expressed in the closure notice. That was clearly an irrelevant factor to consider. We will, however, defer considering whether we should remake that part of the decision or remit it to the FTT until we have analysed the statutory provisions.

The law

38. Section 383(1) ITTOIA provides that "Income tax is charged on dividends and other distributions of a UK resident company". That section relies on the meaning of distribution, which is given by Chapters 2 to 5 of Part 23 of the Corporation Tax Act 2010 ("CTA 2010"): see s989 of the Income Tax Act 2007 ("ITA 2007").

39. Section 385 ITTOIA provides that the person liable to the tax chargeable under s383 is "(a) the person to whom the distribution is made or is treated as made (see Part 6 of ICTA and sections 386(3), 389(3) and 396A), or (b) the person receiving or entitled to the distribution." It is paragraph (b) of that subsection that is relevant to this case.

40. S1000(1)B of the CTA 2010, which is contained in Part 23 of that Act, provides that "distribution" includes:

> "Any other distribution out of assets of the company in respect of shares in the company, except however much (if any) of the distribution—
>
> (a) represents repayment of capital on the shares, or
>
> (b) is (when it is made) equal in amount or value to any new consideration received by the company for the distribution."

41. It is common ground that the purchase by the Company of its own shares in this case meets that definition.

42. Of particular relevance to the current appeal is s1033 CTA 2010, which sets out circumstances in which a payment made by an unquoted trading company (such as the Company) on the purchase of its own shares is not a distribution. One case in which a purchase is not regarded as a distribution is where the purchase is made to benefit the company's or its subsidiary's trade (provided there is no purpose of avoiding tax or participating in the company's profits without receiving a dividend) and the further requirements set out in s1034 to 1043 are also met.

43. Section 1035 CTA 2010 provides that "the shares must have been owned by the seller throughout the 5 years ending with the date of the purchase". The expression "the seller" is defined by s1033(5) as "the owner of the shares at the time the redemption or purchase is made". Section 1036 then sets out certain rules in relation to how that period of ownership is determined. So, where during the 5 year period, the shares are transferred to the seller by the seller's spouse or civil partner with whom the seller was living, the period throughout which the spouse or civil partner owned the shares counts towards the period of ownership of the seller. Similarly, where the seller became entitled to the shares under the will or intestacy of another person, the previous ownership by such a person counts towards the seller's period of ownership (and that period is reduced to 3 years).

44. In this case, HMRC have accepted that the purchase by the Company of its own shares would not have been a distribution as a result of s1033 CTA 2010 but for the fact that Mr Khan, as the owner of the shares at the time the purchase was made, had not owned the shares throughout the period of 5 years ending with the purchase.

45. The appellant has not sought at any time in the proceedings to argue that Mr Khan did satisfy the ownership condition under s1035 CTA 2010. Mr Sykes put things in a slightly different way in that he appeared to approach matters as if there could be one

analysis of the effect of ss1033 to 1035 CTA 2010 in relation to the appellant and another in relation to the selling shareholders. In our view, that is plainly not how to interpret those sections. The application of those sections determines whether or not there is a distribution. The answer to the question does not depend on who is asking it. In any event, the appellant accepts that he, as the owner of the shares at the time of the purchase, does not meet the conditions in s1035 CTA 2010.

46. It follows from the above analysis of the statutory provisions that Parliament has:

(1) imposed a charge to tax on a distribution of a UK resident company,

(2) established that a distribution includes a distribution out of the assets of a company in respect of its shares (which includes a purchase by a company of its own shares),

(3) recognised that there are circumstances in which such a purchase should not be regarded as a distribution, but

(4) has conditioned that on the length of time for which the shares have been held by the owner of the shares at the time of the purchase taking account of ownership by a spouse/civil partner (as well as other conditions).

47. As was expressly confirmed at the hearing, it is not Mr Khan's case that s383 ITTOIA does not apply to the distribution. The appellant's case is, instead, that it is the selling shareholders rather than Mr Khan who received the distribution and any tax falls to be chargeable on them. That is the case even though the appellant appears to have conceded that ss 1033 to 1035 CTA 2010 are not engaged. That apparent concession is based on the fact that, for the purposes of s1035 CTA 2010, the seller at the time of the purchase was Mr Khan and it is unarguable that he had not owned the shares for a period of 5 years. Nonetheless, despite the apparent concession by the appellant that he was the owner of the shares at the time of the purchase, the appellant submits that he did not receive, and was not entitled to receive, the purchase price for the sale of the shares for the purposes of s385 ITTOIA.

48. It also follows that, if income tax under s383 ITTOIA is chargeable on the distribution (something that is not disputed by the appellant), the persons who are to be regarded as receiving or entitled to the distribution are – says the appellant – the selling shareholders even though, for the purposes of s1035 CTA 2010, they are not the owners of the shares at the time of the purchase.

49. To put it at its lowest, this leads to an interpretation of the statutory provisions in relation to this case that is hard to follow. The person who was the owner of the shares at the time of their sale is not the person who received, or was entitled to receive, the proceeds of their sale. And the person who was not the owner of the shares at that time is, nonetheless, the person who did receive, and was entitled to receive, those proceeds.

Section 385: who is liable to the tax charge on the distribution?

50. It follows from the above that the only issue in contention in this case is who is liable to the tax charge on the distribution. That issue is dealt with by s385 ITTOIA. We consider that the Explanatory Notes contain helpful material in setting out the relevant context.

51. In the House of Lords case of *R (Westminster City Council) v National Asylum Support Service* [2002] 1 WLR 2956 Lord Steyn held at [5] that a court can consider Explanatory Notes as an admissible aid to construction in so far as they "cast light on the objective setting or contextual scene of the statute, and the mischief at which it is aimed". Because the starting point in an exercise of statutory construction is that the language "conveys meaning according to the circumstances in which it was used", the context "must always be identified and considered before the process of construction or during it". Accordingly, it is permissible to take account of the Explanatory Notes in determining why s.385 ITTOIA takes the form that it does.

52. The Explanatory Notes for s385 are as follows:

> **Section 385: Person liable**
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> 1554. This section states who is liable for any tax charged.
>
> 1555. Under the source legislation there is no provision expressly stating who is liable for the tax charged. Although section 20(1) paragraph 1 of ICTA makes it clear that the charge to tax encompasses all distributions of a UK resident company made in a tax year, and includes a reference to the recipient, it does not actually specify the person liable.
>
> 1556. The person liable can however be deduced from the legislation as a whole (and this has been reflected in subsection (1)).
>
> 1557. Section 20(1) of ICTA refers to recipients of distributions and persons entitled to tax credits. Paragraph 1 of section 20(1) of ICTA provides that distributions are regarded as income "…however they fall to be dealt with in the hands of the recipient"; paragraph 2 of that section provides that where "…a person is entitled to a tax credit" in respect of a distribution it is the aggregate of the distribution and the tax credit which is taxed.
>
> 1558. Section 231(1) of ICTA (tax credits for certain recipients of qualifying distributions) provides that a UK resident "receiving" a qualifying distribution is entitled to a tax credit. And section 232 of ICTA (tax credits for non-UK residents) refers to distributions "received" by certain individuals. Section 231(4) of ICTA deals with the case where a distribution "is, or falls to be treated as, or under any provision of the Tax Acts is deemed to be, the income of a person other than the recipient", so that other person is treated as receiving the distribution for the purposes of section 231 of ICTA. So, section 231(4) of ICTA suggests that where the distribution actually belongs to someone other than the recipient, or under any provision of the Tax Acts is treated as belonging to someone other than the recipient, that other person is liable for the tax charged.

> 1559. Section 209 of ICTA is the main provision which defines the term "distribution". Section 209(1) of ICTA provides that "The following provisions of this Chapter, together with section 418 of ICTA, shall, subject to any express exceptions, have effect with respect to the meaning of "distribution" and for determining the persons to whom certain distributions are to be treated as made ...".
>
> 1560. Where an asset or liability is transferred by a company to a member, section 209(4) of ICTA requires an amount to be treated as a distribution made to the member.
>
> 1561. Distributions are made, in most circumstances, to shareholders. For the purposes of Part 6 of ICTA (company distributions, tax credits etc) section 254(12) of that Act regards something done "in respect of a share" as being done to the shareholder, or to someone who has at a particular time been the shareholder. This suggests that someone to whom a distribution is treated as made for the purposes of Part 6 of ICTA is liable.
>
> 1562. The definition of distribution is extended by section 418(1) of ICTA to include any amount which is required to be treated as a distribution by section 418(2) of ICTA. Under section 418(2) of ICTA, where a close company incurs expense in providing a benefit or facility for a participator "the company shall be treated as making a distribution to him of an amount equal to so much of that expense as is not made good to the company". While it does not explicitly identify the person liable in respect of the distribution, in practice the participator is regarded as the person liable.
>
> 1563. So, while there is no express person liable provision (as there is for Schedule D for example), there are provisions covering:
>
> the person to whom a distribution is made or to whom it is treated as made for the purposes of Part 6 of ICTA – sections 209(1) and (4), 254(12) and 418(2) of ICTA;
>
> the person receiving a distribution – sections 20(1)1, 231(1) and (4) and 209(4) of ICTA;
>
> the person entitled to the distribution – sections 20(1)2 and 231(4); and
>
> the person to whom the distribution, under any provision of the Tax Acts, is treated as belonging (where that person is not the recipient) – section 231(4) of ICTA.
>
> 1564. A provision stating who is liable for any tax charged on distributions from UK resident companies needs to cover all these possibilities save the last one. If a distribution is treated under any provision of the Tax Acts as the income of a person other than the recipient, that legislation will provide who is liable for the tax.

53. The Explanatory Notes thus reveal that s385 was merely making express what was implied from the existing law that was being rewritten. It was for that reason that a lengthier explanation was required in the Explanatory Notes of a provision that was, before ITTOIA, nowhere to be found in terms in the old law. The implication that the person liable was the person receiving or entitled to the distribution had to be found in a patchwork of other provisions that were being rewritten in ITTOIA.

54. Once the source law for s385 ITTOIA is considered, it is clear to us that the focus in s385 is on the recovery of tax from the actual recipient of the distribution and it is also clear that the section uses "entitlement" as a result of the way in which tax credits in respect of distributions previously operated (which was, in turn, relevant to the charge to income tax on UK distributions).

55. Under s231(4) Income and Corporation Taxes Act 1988 ("ICTA") the entitlement to a tax credit was transferred to someone other than the actual recipient in a case where the distribution "is ... the income of a person other than the recipient". That subsection operated by treating that person (the owner of the income) as if he or she had received the distribution (so as to entitle that person to a tax credit), going on to note, in brackets, that it is that person who is so entitled and "not the actual recipient".

56. Shortly put, we consider it is clear that Parliament has in enacting s385 ITTOIA provided that tax chargeable on any distribution is to be recovered from the actual recipient of the distribution or from someone other than the actual recipient in a case where the distribution is the income of that other person (on the basis that that other person is entitled to the distribution).

57. The appellant referred us to *Williams v Singer* 7 TC 387 by way of support for the proposition that the concept of receipt implies control and is not therefore met in Mr Khan's situation where money went into an account but then straight out again.

58. The relevant facts of that case were that UK resident trustees had directed payment of trust income to a foreign-domiciled beneficiary. Part of the Revenue's case rested on s100 Income Tax Act 1842, according to which, the duties upon profits imposed under Schedule D were to be charged on, and paid by, the persons "receiving or entitled unto" such profits. Viscount Cave in the House of Lords rejected the Revenue's argument that the trustees were liable as the persons legally entitled to receive it and that the Revenue were neither bound nor entitled to look beyond the legal ownership:

> "…if the Income Tax Acts are examined, it will be found that the person charged with tax is neither the trustee nor the beneficiary as such, but the person in actual receipt and control of the income which it is sought to reach."

59. But this case was dealing with entirely different statutory provisions in an entirely different context. In Mr Khan's case the buy-back funds were actually paid to, and received by, him whereas in *Williams v Singer* the trustee had directed that the payment be made directly to the beneficiary. *Williams v Singer* therefore has nothing to say about a situation where money has actually been received but then not much can be done with it because of the effect of other transactions.

60. So far as that case has anything of relevance to this case, we consider that it is what is said next that is more of note:

> "The object of the Acts is to secure for the State a proportion of the profits chargeable, and this end is attained (speaking generally) by the simple and effective expedient of taxing the profits where they are

> found. If the beneficiary receives them he is liable to be assessed upon them. If the trustee receives and controls them, he is primarily so liable."
>
> And Lord Wrenbury: "The appellants, however, seek to find in words of enlargement of the income charged an enactment affecting the characteristics of the person chargeable. I do not think that is the effect of s.5 of the Act of 1914. The two things are quite distinct; the property chargeable is one thing, the person liable to be charged is another."

61. In other words, there was then, and remains now, a fundamental distinction between the imposition of the tax charge (which is accepted by the appellant as arising under s.383 ITTOIA) and the persons from whom the tax may be recovered. In our view, the principle remains that Parliament has imposed a tax on the profits (in this case, the distribution) "where they are found".

62. Mr Sykes also referred us to a number of other cases for the proposition that the distributions charge and s385 ITTOIA were sensitive to composite transactions. None of these cases advance his case in our view as they each deal with materially different statutory provisions.

63. *BUPA Insurance Ltd v HMRC* [2014] STC 2615 concerned the meaning of "beneficially entitled" for the purposes of s403C(2)(b) ICTA in the different legislative context of consortium relief for the purposes of corporation tax. The beneficial entitlement determined the fraction relevant to limiting losses allowed under consortium relief. Further, even if the fact that the case was concerned with a different statutory provision is put to one side, to the extent there are more general principles that can be extracted from the case, then these are not helpful to the appellant.

64. The facts were that part of the price of Bupa Finance's (the appellant's parent) purchase from Tawa of shares in Tawa's wholly-owned subsidiary, CX Re, was "earn out" under which Bupa Finance agreed, within 10 days of a distribution by CX Re, to pay to Tawa 100% of the distribution up to $171million and 95% of the amount in excess. Was Bupa Finance "beneficially entitled" to a percentage of any profits available for distribution? (That question in turn determined the "relevant fraction" that limited the losses of CX Re that could be set against the profits of Bupa Insurance (the appellant)). BUPA Insurance argued that "beneficial entitlement" was the same as an equitable interest or that any proprietary interest more than a "mere legal shell" was enough. HMRC argued that BUPA Finance's contractual obligation meant it did not enjoy the receipt of the CX Re distribution in any meaningful sense. The Upper Tribunal found, in essence, that, despite the transaction being viewed realistically as a composite transaction, it did not matter that there was a contract obliging Bupa Finance to pay an amount equivalent to the distributions to another – Bupa Finance still had sufficient beneficial ownership of the distribution.

65. We note that the Upper Tribunal, in reaching this conclusion, referred at [81] to *Piggot v Staines Investments* [1995] STC 114 for the proposition that even a contractual obligation to deal in a particular way with the receipt of a dividend (for example, to pay an onward dividend as part of a composite transaction) would,

according to Knox J in that case, not prevent the two dividends from being treated as separate dividends. A realistic appraisal of the facts did not permit a recategorisation of the two dividends as a single payment by the bottom company to the top company. That principle is not helpful to appellant. Indeed, in our view, it supports HMRC's submission that, if a dividend is received in circumstances where the recipient is obliged to use it to settle a debt, that would not mean the creditor was liable to the tax charge on the dividend. Thus, if anything, *BUPA* seems to indicate that a person does not escape a tax charge merely because of commitments made to pay the money elsewhere or to use it for other purposes.

66. In *PA Holdings* the taxpayer adopted arrangements where, employees it wanted to reward with bonuses, were awarded shares and received dividends. It argued that the cash received was dividend income rather than employment income. Both the FTT and the Upper Tribunal considered that the income was both employment income and dividend income but that the application of s20(2) ICTA meant that the income had to be taxed as dividend income rather than as employment income. The Court of Appeal agreed that the income was employment income, but determined that, once that was established, then, recognising the fundamental principle that the Schedules were mutually exclusive, the sums were chargeable to income tax as employment income.

67. The case is consistent with the principle that a realistic view of facts should be taken in the light of the relevant statutory provision. But the relevant statute there was the provision relating to emoluments (s19 ICTA). The fact that the case decided that the arrangements for paying a dividend were mere machinery for remunerating an employee says nothing, in our view, about the proper construction of s385 ITTOIA.

68. Indeed, as can be seen from [46] to [57] of Moses LJ's judgment which appears to endorse the Upper Tribunal's statutory analysis of the taxing of the distribution, it was considered that (see [57]) "any transaction which came within the wide definition of a dividend or distribution, whether part of a series of transactions, of a composite transaction or of pre-ordained transactions, fell to be charged under Schedule F and not under Schedule E". The crucial point of difference which the Court of Appeal highlighted was not that the dividend fell within the wide charging provisions of Schedule F but that the Upper Tribunal failed to appreciate the mutual exclusivity of the Schedules – so once something was earnings from an employment there was no room for it to be taxed as anything else.

69. *Scottish Provident* concerned s150A(1) Finance Act 1995. The question was, in essence, whether an entitlement to gilts arose under an option. Again, it is clearly a very different context from that relevant to s385 ITTOIA.

70. *IRC v McGuckian* [1997] 3 All ER 817 concerned the "transfer of assets abroad code" (contained at the time in s478 of the Income and Corporation Taxes Act 1970) and whether there was "income" – the payment of a dividend (as opposed to capital – the sale of a right to receive dividend) arising to persons resident or domiciled outside the UK. The case was therefore about "income" and, not surprisingly, had nothing of relevance to say about the meaning of s385 ITTOIA. Lord Clyde started his analysis

with a commentary on the difficulty of distinguishing between capital and income and then tied his analysis to the particular purposes of s478(1) (see 831j) –

> "…but for the purposes of s478(1) the operations did not have the effect in substance or reality of doing anything else than making the income which was payable to Shurltust, in respect of the …dividend to be paid, to the extent of 99% of it, to Shurltrust. The income payable to Shurltrust was the income of Shurltrust for the purposes of the section."

71. We, accordingly, reject Mr Sykes' submission that, for the purposes of s385 properly construed, it is necessary to have regard to the whole of any interlinked transactions viewed as a composite. Having concluded, for the reasons above, that the purpose of s385 ITTOIA is the identification of the person from whom HMRC can seek to recover the tax, all that we need to do is determine whether, on the facts, Mr Khan was either the actual recipient of the distribution or, if not, he was entitled to the distribution. For the appellant to succeed, it must be because the facts show that the selling shareholders both actually received, and were entitled to receive, the distribution.

72. Before addressing that issue, we deal briefly with the relevance of the charge to income tax under s687 ITTOIA.

The charge to income tax under s687 ITTOIA

73. The appellant submits that it is appropriate to view the source of any income received as the composite transaction rather than the individual buyback transaction, and that his reward for his service in participating in such transaction falls to be taxed as miscellaneous income.

74. Section 687, which is to be found in Chapter 8 of Part 5 of ITTOIA, imposes a charge to tax under that Chapter on income "from any source that is not charged to income tax under or as a result of any other provision of this Act or any other Act".

75. It is important to note that this is the section that imposes the charge. The question of who is liable for the charge is dealt with in s689, which provides that the person liable for any tax charged under that Chapter "is the person receiving or entitled to the income".

76. If, as is (rightly) recognised by the appellant, tax is charged on a distribution under s383 of ITTOIA, there is no role for s687(1) to play in so far as what is sought to be taxed is the distribution as such. That provision is engaged only if income (in this case the distribution) is from a source (in this case a shareholding in a UK resident company) that is not taxed under the Act or elsewhere. But it is.

77. That is because the Chapter 8 charge is a residual charge. Unlike other charging provisions of the income tax code, there is no need for a priority provision between two different charges. There is simply no question of the charge to distributions under s383 overlapping with s687. That is a logically impossible outcome.

78. Instead, the effect of the appellant's argument is that, by reference to the composite nature of the transactions, he was performing a service the fruits of which fell to be taxed as income under a separate taxable source under s687. That seemed to acknowledge that, in addition to the distribution being charged directly under s383 ITTOIA, it was also to be taken into account in calculating the amount subject to a tax charge under s687 ITTOIA (but there was no suggestion that the distribution was itself charged as such).

79. The consequence of the appellant's argument, subject to whether the selling shareholders, as the appellant argues, could take advantage of s1033 CTA 2010, is that significantly more amounts fall to be taxed as income in relation to the transactions and as between the appellant and the selling shareholders than HMRC think is the case. In effect, the appellant is charged to income tax on the value of his remaining share (the profit from the service that he is deemed to supply) and the selling shareholders are liable to income tax on the distribution. By contrast, HMRC regard the value of the appellant's share as a capital matter of relevance to any future disposal of the shares for the purposes of capital gains tax.

Realistic appraisal of facts

If the dividend is taxable, who can HMRC seek to recover the tax from?

80. We consider that we can, and should, remake the part of the FTT Decision dealing with the issue under appeal before us rather than remitting it back to the FTT. We were referred to much of the relevant evidence regarding the transactions that was before the FTT. There was no issue over the matters of fact to be drawn from Mr Khan's evidence. And, in addition, we were shown the minutes of the board meeting and company meeting minutes, which were inadvertently not included in the bundle of documents before the FTT.

81. As explained above, s385 ITTOIA is concerned to identify the person from whom HMRC can seek to recover the tax. There are only two possible answers to the question 'who receives or is entitled to the distribution?' The first is Mr Khan. The second is the selling shareholders.

82. The key sequencing of the transaction on 28 June 2013 by reference to the formal documents is as follows:

(1) *The existing shareholders decided to sell the shares as per the board meeting*: The minutes of a board of directors meeting of the Company dated 28 June 2013 at 11.35am approved the transfer of shares from the selling shareholders to Mr Khan. He was appointed as director with immediate effect. The resignations of the selling shareholders as directors were accepted.

(2) *The SPA, which included provision about the payment of the consideration by Mr Khan and the indemnity given by him to the selling shareholders and the Company, was executed*: Under the SPA the selling shareholders agreed to sell, and Mr Khan agreed to buy, the sale shares for a purchase price equal to the total amount of the Completion Payment (defined as £1,950,000) and the

Balancing Consideration (defined as sum equal to Net Book Value). Net Book Value was defined as the aggregate value of the assets of the company less the aggregate amount of liabilities by reference to the 2013 Accounts, having taken into account the Buy Back Consideration. That term in turn was defined as "the consideration payable under the [OMPA]". At clause 7.1 Mr Khan undertook to indemnify the sellers in relation to the invoice discounting agreement for the purpose of financing the Company's acquisition of the Buy Back Shares "under the [OMPA] to be entered into immediately following Completion."

(3) *The company decided to purchase its own shares as per the board meeting, which among other things assessed the lawfulness of the distribution*: The minutes of a board of directors meeting (attended by Mr Khan alone as director) held the same day at 12.05pm recorded that the draft share buyback contract was produced and approved. Mr Khan was authorised to execute the buy-back contract [OMPA] on behalf of the company.

(4) *The board meeting was then adjourned so that the general meeting could take place.*

(5) *The general meeting took place at which the terms of the OMPA were approved and the company was authorised to enter into the OMPA*: The minutes for the General meeting were dated 28 June 2013 at 12.10pm – the special resolution approved the terms of the share buy-back contract and authorised the Company to enter into it. It was noted that the meeting had been called on short notice with the consent of the sole member, Mr Khan. The meeting also passed an ordinary resolution detailed in the notice for the meeting under which the sole shareholder, Mr Khan consented to the failure of the Company to display the Purchase Contract (i.e. the OMPA) for 15 days at the Company's registered office prior to the meeting.

(6) *The board meeting then resumed noting that the resolution to approve the OMPA had been duly passed.* Mr Khan was authorised to execute the OMPA on behalf of the Company.

(7) *The OMPA was executed.* Under the OMPA, which was entered into between the Company and Mr Khan, Mr Khan agreed to sell the Buy Back Shares (defined in the background provisions as 98 shares) for consideration of £1,950,000. The Company agreed to purchase them and pay the consideration to Mr Khan. Clause 3.1 and 3.2 provided that the seller (Mr Khan) agreed to sell the shares "with full title guarantee". He warranted that there were no liens, charges or other encumbrances over or in respect of the shares.

83. What is immediately apparent is that the transactions were not simultaneous. Once we look at the sequence of steps, there can surely only be one answer to the question posed above as to who received the distribution. At the time that the distribution was received (the time at which the income tax charge arises) Mr Khan was the sole shareholder. The selling shareholders cannot be regarded as receiving the distribution in any meaningful sense: they were not shareholders at the time and Mr Khan did not receive the distribution as a trustee for them (the appellant did not argue that this was the case).

84. Nor can the selling shareholders be regarded, on any version of reality, as being entitled to the distribution. That is, in our view, a complete inverse of the true position. At the time of the distribution, the selling shareholders did not legally own the shares and nor, in any sense (legal or factual), can it be said that they were entitled to the distribution so as to make the distribution their income. If that were the case, it would mean that they were, in effect, entitled to two lots of £1.95m. The shareholders were already legally entitled to receive £1.95m in respect of the sale of their shares. They cannot also be regarded by reference to a transaction that occurred <u>after</u> they were shareholders to be legally entitled to the distribution as well (so as to make it their income).

85. The most that can be said is that the transaction could have been structured in a different way so that the selling shareholders could have received a distribution. But that is not what happened. And, moreover, that is precisely what the parties determined should <u>not</u> happen. The reality was that Mr Khan owned the shares at the time that they were purchased by the Company. He was the registered proprietor. He was the legal owner. The notices and minutes of company meetings recognise the undoubted fact that Mr Khan was then the sole shareholder: it was Mr Khan alone who consented to the short notice of the general meeting and it was Mr Khan alone who consented to the failure to display the purchase contract for the requisite period. He did not receive the proceeds on trust for anyone else.

86. The appellant regards the following factors as relevant: the share sale and buyback transactions were designed to, and did, happen simultaneously as shown by Mr Khan's evidence to that effect, the short sequencing, the interdependent drafting of the documents, the absence of borrowing (with the result it was unclear how, if the transactions were not simultaneous, Mr Khan could pay for the shares), the lack of control Mr Khan had over the funds entering his bank account and that there was no purpose to the change in the structuring of the transactions apart from tax. The appellant submits that once the relevant factors above are taken into account the transactions were an integrated whole.

87. We find the two transactions (the share sale by the selling shareholders and the buyback of shares from Mr Khan) were agreed and implemented as one having regard to their interdependency and the short time period over which they took place. We also agree there was no practical likelihood the transactions would not have happened together. As the appellant pointed out, the FTT had already found there was no independent purpose to the change in transaction from the selling shareholders' point of view other than reasons of tax (they feared the loss of entrepreneur's relief for the purposes of capital gains tax). As regards Mr Khan's evidence that he had no control over the buyback proceeds we accept this was true as a matter of practical fact. However, this was only because of the terms of the agreement that he had agreed to enter into.

88. The various board and company meeting documents show the transactions were not simultaneous as the appellant suggests, but that they happened sequentially and, moreover, it was essential that they did happen sequentially in order to be effective legally. However, we disagree with any suggestion by HMRC that the transactions

were not interdependent. It is clear from the terms of the documentation that the SPA envisaged completion of the OMPA, and from the surrounding documentation that one transaction would not happen without the other.

89. However, none of these factors show that Mr Khan did not receive or was not entitled to the share buyback proceeds:

(1) *Interdependence* - The fact that there is an interdependence in the transactions is nothing to the point. There is nothing in the statutory wording to suggest that s385 ITTOIA is concerned with the circumstances of the funding for buying the shares giving rise to the buy-back, or that it is concerned with the fact that the share purchase would not have happened without an expectation of funds having been provided by the company in return for the expected buy-back of shares.

(2) *Practical certainty that transactions would occur* - Nor is the fact that it was practically certain that all the transactions would occur. None of this has any bearing on the statutory question, which is focused on actual receipt and entitlement.

(3) *Money flows* - it is of no real relevance to the statutory question to analyse the monetary flows that are connected to the making of the distribution by the company. The monies flow as a result of the imposition of legal obligations on persons. They do not determine what those obligations are.

Did company make a loan to Mr Khan? Transactions properly analysed

90. Mr Sykes sought to underpin his submission on the simultaneous and interdependent characterisation of the share buy-back and the payment of £1.95m by referring to the absence of any finding that Mr Khan borrowed money from the Company. Thus, the source of the £1.95m had to be the buyback proceeds.

91. We reject that submission. We accept HMRC's submission that there was an unsecured loan from the Company to Mr Khan to enable him to buy the shares from the selling shareholders.

92. It is accepted by both parties that £1.95m did move from the Company to Mr Khan (and was not a loan by RBS) and, if that was not a loan, then what was it? It cannot have been a gift of £1.95m from the company to Mr Khan and the money was not given as consideration in return for any other transaction with Mr Khan. It was not to be held on any kind of trust. The money was clearly advanced though and there was, plainly, a legal obligation on Mr Khan to remit that money to the Company. Mr Khan had an entirely separate obligation to pay £1.95m to the selling shareholders. And it is clear that Mr Khan was going to use the monies advanced by the company to meet that separate obligation. We agree with HMRC that the appellant's position comes close to saying that, if A owes a debt of £100 to someone and gets a dividend of £100 and it is anticipated that the only way to meet the debt is to use the dividend, then that means A has not received the dividend but the creditor has – that is, in our view, clearly not the correct interpretation of s385.

93. The debt that Mr Khan owed to the company was then discharged by being set off against the matching liability of the company to pay to Mr Khan the same amount for the purchase of its own shares. Mr Khan had a liability to pay £1.95m to the company (in respect of the advance of money to him) and a right to receive £1.95m from the company.

94. (It is of passing interest that there was an acknowledgement of some risk of the transactions not happening: that is why Mr Khan gave the warranty to the selling shareholders and to the company in respect of the discount invoicing facility.)

95. That does not, however, mean that the proceeds of the share buyback were properly to be regarded as belonging to the selling shareholders. That is, in our view, unsustainable as a matter of law and as a matter of fact. Similarly, issues of control by Mr Khan on monies in his bank account are irrelevant. There is nothing to suggest from the wording of s385 ITTOIA or the wider statutory context that the statutory provision is interested in what purpose the distribution is put to or what conditions it is placed under.

96. The two transactions in question were different (albeit linked) transactions giving rise to distinct legal and factual consequences. The fact that one transaction led to an obligation assumed by Mr Khan to pay the selling shareholders an amount (and Mr Khan in turn raised the amount by an advance from the company) and another transaction led to an obligation on the company to pay an amount to Mr Khan (which was satisfied by the setting off of the loan made by the company to Mr Khan) cannot, and does not, lead to the legal result that the amount to which Mr Khan was entitled (the distribution) was received by someone other than Mr Khan still less that anyone other than Mr Khan had any legal entitlement to the distribution as such.

97. On the contrary, it is the very fact that Mr Khan was entitled to receive, and did receive, the distribution that, in fact and in law, allowed him to meet his liability to pay £1.95m to the company. The selling shareholders were entitled to £1.95m but that was in respect of the sale of the shares and not in respect of a distribution the entitlement to which, by definition, had to (and did) rest with the actual shareholder at the time. To elide one with the other would, in our view, be a remarkable interpretation of the statutory test.

98. Our view of the law and its application to this case avoids the significant difficulty that the owner of the shares at the time of their sale would not be regarded as the person who receives or is entitled to receive the proceeds of their sale (see [49] above) and also avoids an extended charge to income tax by reference to an inferred supply of a service that is, to put it at its lowest, hard to reconstruct from the transactions that actually took place (see [79] above).

99. In our view, it is plain that Mr Khan received the distribution and was entitled to receive it. Once that is established, the tax charge rests with him. HMRC accept that the appellant might be in an unfortunate position; but, as they also point out, that is not relevant to the tax treatment of the transactions he entered into. He is to be taxed in accordance with the transactions that he did enter into and not by reference to the

transactions that he was about to enter into (but did not) even if they might have left him in the same economic position.

100. In view of our conclusions stated above, there is no need to deal with HMRC's argument in the alternative that, if Mr Khan were to be regarded as assigning his rights to the sale proceeds, then he would still be liable to tax under Chapter 5A of Part 13 of ITA 2007.

101. We re-make the FTT Decision according to the analysis set out above. We reach the same conclusion as the FTT did albeit for the different reasons we have set out.

Decision

102. Mr Khan's appeal is accordingly dismissed.

Swami Raghavan
Judge of the Upper Tribunal

Andrew Scott
Judge of the Upper Tribunal

Release date: 2 June 2020