Neutral Citation: **[2025] UKUT 00183 (TCC)**

Case Number: UT-2023-000116

UPPER TRIBUNAL
(Tax and Chancery Chamber)

Hearing venue: The Rolls Building
Fetter Lane
London
EC4A 1NL

Heard on: 7 May 2025
Judgment date: 13 June 2025 2025

INCOME TAX – transactions in securities - share buyback — shares benefitting from EIS CGT disposal relief – main purpose to obtain CGT relief – was there necessarily a main purpose to obtain an income tax advantage

Before

MR JUSTICE MEADE
JUDGE GUY BRANNAN

Between

HUGH EDWARD MARK OSMOND
MATTHEW CHARLES ALLEN

Appellants

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Jonathan Peacock KC and Edward Hellier instructed by James Morris

For the Respondent: Imran Afzal KC and Harry Winter, Counsel, instructed by the General Counsel and Solicitor to His Majesty's Revenue and Customs

DECISION

INTRODUCTION

1. This appeal raises a short but important point on the construction of sections 684 and 687 Income Tax Act 2007 **("ITA 2007")** which form part of the transactions in securities **("TIS")** regime. Essentially, the issue is whether the fact that the Appellants **("the Taxpayers")** had a main purpose of obtaining the benefit of Enterprise Investment Scheme **("EIS")** disposal relief – a capital gains tax **("CGT")** relief – on a buyback of their shares meant that their main purpose (or a main purpose) was necessarily to obtain "an income tax advantage" within the meaning of section 687 ITA 2007 even given a factual finding that that was not their subjective intention. The EIS relief reduced the Appellants' CGT liability in respect of the share buyback to nil.

2. The First-tier Tribunal **("FTT")**, in a decision released on 8 May 2024 (**"the Decision"**), held that the Appellants' main purpose of obtaining EIS relief necessarily (and without regard to the absence of a subjective intention to do so) meant that they had a main purpose of obtaining an income tax advantage. The Taxpayers were, therefore, liable to a counteraction notice, issued by the Respondents (**"HMRC"**) in respect of that advantage under section 684 ITA 2007.

3. With the permission of the FTT granted on 11 July 2024, the Taxpayers now appeal to this Tribunal and, for the reasons given below, we allow their appeal.

FACTUAL BACKGROUND

4. We summarise the background to this appeal. References in our decision to FTT [**] are references to the Decision, unless otherwise specified.

5. The facts are fully set out by the FTT at FTT [11]-[12] and can be summarised as follows.

6. The Taxpayers are entrepreneurs who have made successive investments, both independently and together, over a period extending over 30 years with a view to realising capital gains: FTT [11(1)].

7. In accordance with the EIS, the Taxpayers invested in a company called Xercise Ltd. Their initial investments were made between February 1996 and May 1998: FTT [11(2)].

8. Xercise Ltd's activities changed over time, but throughout the Taxpayers were careful to preserve their EIS relief CGT benefit. After various iterations of Xercise Ltd's role, and after further investors had become shareholders, at the end of 2009 the members of Xercise Ltd comprised a disparate group of 17 investors with differing preferences as to the extent to which they wished to realise their investment: FTT [11(3)-(10)].

9. Of the shareholders of Xercise Ltd as at the end of 2009, it was only the Taxpayers who had the benefit of the ongoing EIS relief CGT benefit. Therefore, there was a commercial need to segregate the groups of shareholders (the groups being those who could benefit from EIS relief, and those who could not).

10. This was effected by a voluntary liquidation of Xercise Ltd following the interposition of Xercise2 Ltd as a new holding company owning the entire issued share capital of Xercise

Ltd: FTT [11(11)]. Each shareholding in Xercise2 Ltd was subscribed for by the previous shareholders in Xercise Ltd on a share-for-share basis, and the CGT treatment applying to the Taxpayers' shares in Xercise Ltd was accordingly transferred to their shares in Xercise2 Ltd: FTT [11(12)].

11. Towards the end of 2014 and at the start of 2015, the Taxpayers, particularly Mr Allen, were concerned that a change of Government could bring with it changes in the tax code that would remove their ability to benefit from EIS relief: FTT [55], [11(41(b))] and [12(3)].

12. Therefore, in order to preserve their EIS relief, the Taxpayers sought to enter into the Share Buybacks **("the Buybacks"**) with Xercise2 Ltd. The board minutes of a meeting of the directors of Xercise2 Ltd in March 2015 record that the draft accounts for the year ending 31 December 2014 disclosed a credit balance on the profit and loss account of some £36,733,000 meaning that the company had sufficient funds in order to effect the Buybacks: FTT [12(5)] and [11(16)].

13. By written resolutions dated 12 and 13 March 2015 the ordinary shareholders of Xercise2 Ltd approved the terms of the Buyback contracts with the Taxpayers: FTT [11(15)] and [(17)].

14. As a result, and on 16 and 17 March 2015, the Taxpayers entered into the following Buybacks:

(1) Mr Allen's Share Buyback on 16 March 2015 involving the buyback of 8,738 epsilon shares for total cash consideration of £9 million; and

(2) Mr Osmond's Share Buyback on 17 March 2015 involving the buyback of 11,056 beta shares for total cash consideration of £11 million. FTT [11(18)]

15. The Buybacks were disclosed on each Taxpayer's self-assessment return for the year ending 5 April 2015. As the consideration was capital and benefited from EIS relief, those returns were made on the basis that no CGT was payable on the consideration: FTT [11(20)]. HMRC first opened enquiries into the returns in January 2017. Those enquiries were closed without amendment in September 2017: FTT [11(21)].

16. It was only after later correspondence that on 31 March 2021 HMRC issued the counteraction notices and assessments that are the subject of this appeal. Following a review, HMRC upheld their decision, and in November 2021 the Taxpayers appealed to the FTT: FTT [11(22)-(24)].

17. The FTT recorded the evidence of the Taxpayers as to their motives. In summary:

(1) Mr Osmond:

(a) Invested in EIS companies in order to make a capital gain. He would never have taken a dividend from an EIS company and would have extracted value by way of share sale: FTT [11(40)(a)]. It was important to him that his investments in Xercise Ltd retained EIS relief: FTT [11(40)(b)].

(b) Was not, in 2015, considering taking a dividend from Xercise2 Ltd. He did not need to extract value and had sufficient sums in his bank account. Mr Allen

was concerned about EIS relief being withdrawn and they wanted to capture it. "This was the sole purpose of the share buyback": FTT [11(40)(c)].

(c) Stated that had it been possible to find a third-party buyer for their shares the Taxpayers would have sold them. However, such an option was not available to them: FTT [11(40)(b)]. The possibility of extracting a dividend equal to all or part of the consideration Mr Osmond received for his Share Buyback would never have occurred to him as his sole purpose was to procure a disposal of some of his shares: FTT [11(40)(e)]. Had someone suggested that Mr Osmond take a dividend he would have dismissed that suggestion because it would not have resulted in a disposal of his shares and would not have secured the benefit of EIS relief: FTT [11(40)(f)].

(2) Mr Allen:

(a) Was worried that the Government could change the EIS legislation and therefore *"*wanted to crystallise the benefits of that relief before an election": FTT [11(41)(d)].

(b) Stated that it would have made no sense to take dividends from an EIS company: FTT [11(41)(c)]. EIS relief was very valuable and he wanted to extract cash by way of the Share Buyback to preserve that relief: FTT [11(41)(e)]. Like Mr Osmond, Mr Allen did not need cash from the company, he "would have been perfectly happy to have left the money in the company": FTT [11(41)(f)].

(c) Categorially denied that he had a purpose of gaining an income tax advantage. His "sole purpose was to ensure that EIS disposal relief… was banked and not potentially exposed to capricious government intervention": FTT [11(41)(i)].

18. The FTT made findings of fact (at FTT [12]) as to the purpose for which the Buybacks were entered into:

> "12. From this evidence we make the following further findings of fact:
>
> (1) EIS disposal relief is a valuable asset which [the Taxpayers] wished to preserve.
>
> (2) They structured the transactions set out at [(2)-(14)] above in order to achieve this.
>
> (3) The reason that the share buyback was undertaken in March 2015 was because of the second appellant's concern that the EIS disposal relief might be withdrawn following a change of government.
>
> (4) A main purpose of the share buybacks in 2013 had been to enable [the Taxpayers] to crystallise or bank EIS disposal relief.
>
> (5) A main purpose of the share buybacks in 2015 was to enable [the Taxpayers] to crystallise or bank EIS disposal relief.
>
> (6) If [the Taxpayers] had been able to crystallise this relief without the necessity of undertaking a share buyback or some other transaction, they would have done so.
>
> (7) The extraction of value from the company was not a purpose of the share buyback.

> (8) At the date of the share buyback, [the Taxpayers] had known for many years that dividends from an EIS company would attract income tax.
>
> (9) At the date of the share buyback [the Taxpayers] had known for many years that any consideration for a share buyback which was greater than a return of capital would be treated as income and would be subject to income tax.
>
> (10) The consideration payable for the share buyback was calculated to ensure that it was an amount which was not greater than a return of capital. And [the Taxpayers] knew that it would be treated as capital and so there would be no amount which would be treated as income. Furthermore, [the Taxpayers] knew that there would be no CGT on the consideration due to EIS disposal relief.
>
> (11) [The Taxpayers] understood that the effect of the counteraction notices and the assessments was that HMRC were assessing them to income tax on the share buyback consideration as if it had been treated as an income distribution and not capital (and so subject to income tax rather than CGT from which they benefited from EIS disposal relief which they had claimed in their tax returns)." (FTT [12])

19. Finally, in relation to HMRC's secondary argument (see below) the FTT held that obtaining an income tax advantage was "not a main purpose of entering into the share buyback. It was a consequence of doing so. [The Taxpayers'] main purpose was to crystalise [an] EIS disposal." (FTT [54] and [55])

THE DECISION

20. The FTT referred to HMRC's primary submission (FTT [23]) in the following terms:

> "We now consider Mr Afzal's primary submission which is one which we have not seen made by HMRC in any previous case in which, at first blush, caused the judge to raise a quizzical eyebrow. However, for the reasons given below, we think he is correct when he says that, as a matter of law, the [the Taxpayers'] main purpose of being a party to the share buybacks was to crystallise or bank their EIS relief was also a main purpose of obtaining an income tax advantage."

21. The FTT continued (FTT [24]-[38]):

> "24. [The Taxpayers] have accepted that the effect of the share buyback is that less income tax has been paid on the consideration would have been the case had it been paid to them as a qualifying distribution. This is because they have obtained EIS disposal relief on the consideration. And so paid no CGT. So, the amount of income tax that would have been paid on the consideration was less in the CGT actually payable.
>
> 25. [Mr Afzal] accepts that this is not the test. The effect of the transaction was to generate an income tax advantage, but he needs to go further than that. He needs to show that it was a main purpose.
>
> 26. He says that there was. His logic runs as follows. The definition of income tax advantage is, essentially, that the actual amount of income tax payable (in these appeals zero as the consideration is allegedly subject to CGT) in respect of the consideration is less than the income tax payable if that consideration had been paid by way of a qualifying distribution.

27. But if you obtain EIS disposal relief, you must be within the definition of an income tax advantage as the CGT payable is necessarily less than the income tax which would have been paid had the consideration been paid as a qualifying distribution.

28. So, it must necessarily follow that if you have, as a main purpose, the obtaining of EIS relief, you must necessarily have, as a main purpose, the obtaining of an income tax advantage. A claim for EIS disposal relief is necessarily an income tax advantage and so the main purpose of obtaining that relief must also necessarily be a main purpose of obtaining that income tax advantage.

29. And we need go no further than that.

30. Mr Gordon's[1] view is that this cannot be right that because if someone has a main purpose of obtaining a CGT "benefit" (our words) that automatically means they have a main purpose of obtaining an income tax relief. There must be more. Conscious thought must be given to the alternative transaction which would have generated the higher income tax charge. And, as *Brebner* shows, simply because someone carries out a transaction in a tax efficient way does not mean that one can infer that they had, as a main purpose, the obtaining of an income tax advantage.

31. We have to apply the legislation to a specific transaction, namely the share buybacks. That is a real life transaction. We have found as a fact that a main purpose of the parties for the share buybacks was to enable [the Taxpayers] to enable them to crystallise or bank the EIS disposal relief which they had preserved and nurtured for many years.

32. It therefore follows that, as a matter of remorseless statutory logic, that a main purpose was also to obtain an income tax advantage as, as that phrase is defined. The amount of income tax which would have been paid had the consideration been paid by way of a qualifying distribution was always going to exceed the CGT payable on the consideration in light of the benefit of EIS disposal relief.

33. In response to Mr Gordon's assertion that there needs to be a consciously considered comparable transaction (something with which we deal in the discussion regarding HMRC's second submission on the main purpose issue) our view is that the alternative transaction is already built into the definition of income tax advantage. The alternative transaction is the qualifying distribution identified in that definition. In essence it is a deeming provision limited only by the availability of distributable reserves Whether or not the parties have any intention of carrying out a transaction in an alternative way, and in particular whether they consciously or subconsciously considered paying the consideration by way of a qualifying distribution, is, when considering the statutory provisions, neither here nor there. The legislation itself identifies the alternative transaction which would incur an income tax cost. It is the qualifying distribution.

34. We can only reach this conclusion because [the Taxpayers'] reason for undertaking the share buybacks was so clearly to obtain the benefit of EIS disposal relief. As soon as that is found to be a main purpose, it is necessarily, and as a matter of law, a main purpose of obtaining an income tax advantage.

[1] Counsel for the Taxpayers before the FTT.

> 35. Mr Gordon observes that this would then bring taxpayers into the ambit of the TIS regime which were never intended to be so affected by it. But the TIS regime is intended to be a freestanding anti-avoidance provision and, in our view, deliberately casts its net very widely. And indeed, when it was introduced in 1960, it was, in shorthand, designed to ensure that individuals who sought to structure a transaction in a way to avoid paying income tax which might otherwise have been justifiably payable on sums extracted by an income taxable distribution should be brought back into the income tax net. Effectively schemes which "converted" income to capital were to be subject to the TIS regime. And so, it is unsurprising to us that where someone has, as a main purpose of entering into a transaction, the obtaining of a CGT benefit, that person is potentially within the ambit of the TIS regime. As a matter of statutory construction, when considering the legislation in its context and in a purposive way, we do not think that this interpretation leads to injustice.
>
> 36. But this does not mean, as Mr Gordon seems to imply, that one can simply sleepwalk into the TIS regime. We accept that conscious thought must be given to the entering into of the transaction. But if that conscious thought includes a main purpose of obtaining a CGT benefit or advantage, we cannot see anything absurd about the legislation applying. Indeed, as Mr Afzal accepts, it is only because [the Taxpayers] have been so frank about their motives that he can run this primary argument.
>
> 37. We can see no principled reason why a main purpose of obtaining a CGT benefit or advantage cannot also be a main purpose of obtaining an income tax advantage. On both a literal and purposive interpretation of the legislation it can be. And it is our view that Mr Afzal's submission regarding the law and its application to these [Taxpayers] is correct.
>
> 38. For these reasons we conclude that, as a matter of law, [the Taxpayers] did have, as a main purpose of entering into the share buyback, the obtaining of an income tax advantage."

22. The FTT then turned to consider HMRC's secondary and alternative submission, viz that the evidence showed that the Taxpayers did have a main purpose of obtaining an income tax advantage when entering into the Buybacks (FTT [39]-[56]):

> "39. We now consider Mr Afzal's secondary submission. He says that if we are against him on his primary submission, then the evidence shows that [the Taxpayers] did have a main purpose of obtaining an income tax advantage when entering into the share buybacks.
>
> 40. He submits that [the Taxpayers] knew that if they had taken the consideration by way of qualifying distribution, that it would have been subject to income tax save to the extent that it represented a return of capital. The consideration therefore was calculated to ensure that there was no such excess, and the £20 million or so paid for the share buybacks was all a return of capital. So conscious thought was given to the way in which the transaction was structured so as to ensure that no income tax was paid on the consideration. This is clear from both the oral evidence, and the way in which the buybacks were structured (as a capital transaction with payment made out of share premium).
>
> 41. Mr Gordon says that the evidence shows that no conscious thought was given to taking the consideration by way of distribution. Indeed, the evidence clearly shows that [the Taxpayers] did not want to extract any value from the company at all. They were sitting on piles of cash and the last

they wanted was to extract more. If the crystallisation of EIS disposal relief could have been obtained without undertaking any form of transaction, then that is what [the Taxpayers] would have done. But their advice was that it was not possible to achieve that crystallisation without a real-life transaction. If [the Taxpayers] did have any purpose of obtaining an income tax advantage by effecting the share buyback, that was a subconscious motive and should be discounted.

42. Shortly stated, we are with Mr Gordon on this point. We have accepted, and found as a fact, that [the Taxpayers] did not wish to extract funds from the company. It was not as though they wished to and consciously chose between two alternative ways of achieving this at the lowest tax cost. Nothing could be further from the truth.

43. It was inevitable that to achieve their stated purpose, the transaction needed to be a capital transaction to which CGT would be prime facie applicable. We do not see this as evidence from which we can infer that [the Taxpayers] had as a main purpose the obtaining of an income tax advantage.

44. We do not believe that the legislation applies where someone, having undertaken a transaction which has a certain tax consequence, is required to look around to see whether there are other, detrimental, tax consequences of that transaction and then compare the tax consequences of the actual transaction with those detrimental tax consequences to decide whether there was a main purpose of obtaining an income tax advantage. This is what HMRC appear to be doing in this case. Having taken the real-life transaction, namely a share buyback consideration for which was paid by a return of share premium, they have looked around to see what alternative transactions might be (a qualifying distribution) and said that that is evidence that [the Taxpayers] had a tax avoidance motive.

45. But we do not accept this. As Mr Allen said in his evidence, another alternative might have been to extract value from the company by way of a bonus. But that would have been bonkers (we have paraphrased his evidence). Why on earth, he asked rhetorically, would he take money which he didn't need from the company in a tax inefficient way. And we are with him on this. We cannot infer from [the Taxpayers] structuring of the transactions as a capital transaction that they had a main purpose of obtaining an income tax advantage when entering into that transaction.

46. The same is true of Mr Afzal's submission that further evidence of a main purpose of obtaining an income tax advantage is the fact that the consideration was tailored specifically to ensure that there was no income tax payable on the share buyback as it represented a return of capital on which no income tax was payable.

47. Mr Afzal submits that the fact that [the Taxpayers] did not require the consideration is an irrelevance. We think it is highly significant. The transaction did not proceed on the basis that [the Taxpayers] needed a certain amount of money from the company and then decided how best to extract it paying as little tax as possible. The share buyback was undertaken with some reluctance as it was the only way to crystallise the EIS disposal relief. It is inevitable, therefore, that to obtain the benefit of that relief, the transactions would be structured in a tax efficient way.

48. The purpose was achieved only if there was to be no income tax payable and this meant that the maximum to be extracted was limited to a return of share capital. It would have been bonkers to have extracted more than the amount of share capital, as the excess would have been subject to

income tax. And, paraphrasing Lord Upjohn, no commercial man in their right mind is going to structure a transaction so that he pays the maximum amount of tax.

49. Mr Afzal cites *Lloyd* to support his position where it was found that the taxpayer's motive in that case was to obtain retirement relief. "The tax treatment of the transaction was important to the existence and timing of the transactions". Mr Gordon's view is that in the case of these [Taxpayers], that tax advantage was an effect rather than an object of the transactions.

50. The difference between *Lloyd* and these appeals, is that in *Lloyd* it was possible for the judge to posit a reasonable alternative transaction namely "if the only object was for Holdings to acquire the appellant's shares there could have been a share for share exchange". On the facts of these appeals, there could not realistically have been an alternative transaction which would have achieved the same object. And it is clear from the evidence, and from our findings of fact, that it would be both unusual, generally, to extract funds from EIS companies by way of distribution, and that, in the specific circumstances of these [Taxpayers], there was no realistic possibility that they would wish to extract funds either at all, or by way of such a distribution. We do not think that a dividend from the company is a relevant alternative transaction against which an income tax advantage should be tested.

51. So, [the Taxpayers] sensibly structured the share buyback so that they could bank their maximum EIS disposal relief. This meant that the maximum amount that could be paid as consideration for the shares was reflected by the value of their share premium accounts.

52. It is true that at the time of the share buyback, the distributable reserves of the company were about £36 million. And so, theoretically, the shares could have been repurchased for that amount. But we reject any suggestion that this is an alternative transaction against which we should test whether [the Taxpayers] had an income tax advantage motive. This might have been the case had they wanted to extract money from the company but had restricted it to the £20 million reflected by the share premium account. But the facts do not show this.

53. We accept that [the Taxpayers] knew the time of the share buyback, and had known for years, that value extracted from a company by way of a dividend would bear income tax. And they consciously structured the share buyback to ensure that no such income tax was paid by distributing, to themselves, an amount equal to share premium account as consideration for the share buyback. And so, no CGT was payable because of the application of EIS disposal relief.

54. [The Taxpayers] accept that, as a matter of fact, they obtained an income tax advantage.

55. But in our view, as submitted by Mr Gordon and at the risk of labouring the point, this was not a main purpose of entering into the share buyback. It was a consequence of so doing. [The Taxpayers’] main purpose was to crystallise EIS disposal. They were concerned that a change of government would affect its availability in their circumstances. They therefore structured the transaction (the share buybacks) to crystallise that relief and did so in a tax efficient way. They did not need the money. There was no point in extracting more than their share premium. Whilst this meant that they paid no tax on the consideration something which they knew would have been the case had they extracted those sums by way of dividend, this

> was not a main purpose. It was a CGT play. It was designed to ensure that they obtained the benefit of CGT relief now. They did not have, as a main purpose, the obtaining of an income tax advantage.
>
> 56. If, therefore, we had not found for HMRC on their primary submission, we would have found against them on their secondary submission."

GROUNDS OF APPEAL

23. The Taxpayer's key ground of appeal is that the FTT erred in law by agreeing with HMRC's primary submission, viz "that given [the Taxpayers'] stated purpose of securing EIS disposal relief, it necessarily follows that they had a main purpose of obtaining an income tax advantage. This arises from the definition of income tax advantage in section 687."

24. HMRC have confirmed in their Response to the Notice of Appeal that they do not seek to challenge the FTT's decision on HMRC's secondary submission that, setting aside the conclusion on HMRC's primary submission, the Taxpayers did not have a main purpose of obtaining an income tax advantage as a matter of fact and evidence.

LEGISLATION

25. We set out below the relevant statutory provisions as they stood at the time of the Buybacks.

26. There are two statutory provisions from the TIS code which are particularly relevant to this appeal. The first is section 684 ITA 2007 which provided:

> "(1) This section applies to a person where—
>
> (a) the person is a party to a transaction in securities or two or more transactions in securities (see subsection (2)),
>
> (b) the circumstances are covered by section 685 and not excluded by section 686,
>
> (c) the main purpose, or one of the main purposes, of the person in being a party to the transaction in securities, or any of the transactions in securities, is to obtain an income tax advantage, and
>
> (d) the person obtains an income tax advantage in consequence of the transaction or the combined effect of the transactions.
>
> …
>
> (3) Section 687 defines "income tax advantage".
>
> …"

27. The Taxpayers are not, as we understood it, contesting that section 684(1)(a), (b), and (d) ITA 2007 were satisfied. They dispute that there was a main purpose of obtaining an income tax advantage.

28. The second relevant statutory provision from the TIS code is section 687 ITA 2007, which defined whether a person obtains an "income tax advantage" and provided:

"(1) For the purposes of this Chapter the person obtains an income tax advantage if—

(a) the amount of any income tax which would be payable by the person in

respect of the relevant consideration if it constituted a qualifying distribution exceeds the amount of any capital gains tax payable in respect of it, or

(b) income tax would be payable by the person in respect of the relevant consideration if it constituted a qualifying distribution and no capital gains tax is payable in respect of it.

(2) So much of the relevant consideration as exceeds the maximum amount that could in any circumstances have been paid to the person by way of a qualifying distribution at the time when the relevant consideration is received is to be left out of account for the purposes of subsection (1).

(3) The amount of the income tax advantage is the amount of the excess or (if no capital gains tax is payable) the amount of the income tax which would be payable.

…"

29. There are two further statutory provisions that we should mention. At the time of the Buybacks, section 685 ITA 2007 provided:

"(1) The circumstances covered by this section are circumstances where condition A or condition B is met.

(2) Condition A is that, as a result of the transaction in securities or any one or more of the transactions in securities, the person receives relevant consideration in connection with—

(a) the distribution, transfer or realisation of assets of a close company,

(b) the application of assets of a close company in discharge of liabilities, or

(c) the direct or indirect transfer of assets of one close company to another close company,

and does not pay or bear income tax on the consideration (apart from this Chapter).

(3) Condition B is that—

(a) the person receives relevant consideration in connection with the transaction in securities or any one or more of the transactions in securities,

(b) two or more close companies are concerned in the transaction or transactions in securities concerned, and

(c) the person does not pay or bear income tax on the consideration (apart from this Chapter).

(4) In a case within subsection (2)(a) or (b) "relevant consideration" means consideration which—

(a) is or represents the value of—

(i) assets which are available for distribution by way of dividend by the company, or

(ii) assets which would have been so available apart from anything done by the company,

(b) is received in respect of future receipts of the company, or

(c) is or represents the value of trading stock of the company.

(5) In a case within subsection (2)(c) or (3) "relevant consideration" means

consideration which consists of any share capital or any security issued by a close company and which is or represents the value of assets which—

(a) are available for distribution by way of dividend by the company,

(b) would have been so available apart from anything done by the company,or

(c) are trading stock of the company.

…"

30. Section 686 ITA 2007 provided:

"(1) Circumstances are excluded by this section if—

(a) immediately before the transaction in securities (or the first of the

transactions in securities) the person (referred to in this section as "the party") holds shares or an interest in shares in the close company, and

(b) there is a fundamental change of ownership of the close company.

(2) There is a fundamental change of ownership of the close company if—

(a) as a result of the transaction or transactions in securities, conditions A, B

and C are met, and

(b) those conditions continue to be met for a period of 2 years.

(3) Condition A is that at least 75% of the ordinary share capital of the close company is held beneficially by—

(a) a person who is not connected with the party and has not been so connected within the period of 2 years ending with the day on which the transaction in securities (or the first of the transactions in securities) takes place, or

(b) persons none of whom is so connected or has been so connected within that period.

(4) Condition B is that shares in the close company held by that person or those persons carry an entitlement to at least 75% of the distributions which may be made by the company.

(5) Condition C is that shares so held carry at least 75% of the total voting rights in the close company."

SUBMISSIONS (IN OUTLINE)

Submissions for the Taxpayers

31. Mr Peacock KC, appearing with Mr Hellier for the Taxpayers, submitted that the FTT had found that the Taxpayers' purpose in entering into the Buybacks was to achieve a capital gains tax a CGT benefit, viz crystallising EIS relief. The FTT further found that, disregarding HMRC's primary argument, the Taxpayers did not in fact have a main purpose of obtaining an income tax advantage. Consequently, in Mr Peacock's submission, section 684(1)(c) ITA 2007 was not satisfied and, therefore, the TIS regime could not apply. In essence, Mr Peacock submitted that the FTT erred by confusing the Taxpayers' *purpose* in entering into the Buybacks (to obtain CGT relief) with the *effect* of the Buybacks (to obtain an income tax

advantage). Mr Peacock relied on the recent decision of the Court of Appeal in *Blackrock HoldCo 5 v HMRC* [2024] STC 740 at [144] to [151] ("***Blackrock***") which explicitly recognised that purpose should be distinguished from effect.

32. The effect of the FTT's decision, in Mr Peacock's submission, was heavily to circumscribe the application of EIS relief – this could not have been Parliament's intention when enacting section 687 ITA 2007.

33. Mr Peacock referred to HMRC's "Simplifying Transactions in Securities Legislation Consultation Document" of 31 July 2009 (the **"Consultation Document"**). The Consultation Document preceded the amendments to the TIS legislation which led to the new definition of income tax advantage contained in section 687, which was in force at the time of the Buybacks. At paragraph 3.3 of the Consultation Document it was stated that the new definition of tax advantage contained in section 687 of tax advantage "would make it clear that the TIS legislation does not apply to TiS where an advantage in relation to tax on chargeable gains is obtained." It was, therefore, clear that Parliament's intention was not to provide that there was automatically an income tax advantage where the effect of the particular transaction was to produce a lower charge to CGT. Mr Peacock further submitted that the Consultation Document made it clear that the purpose of the new section 687 was to formalise the *quantification* of the income tax advantage. The Consultation Document also indicated (at paragraph 7.5) that the new quantification of the income tax advantage would be revenue neutral because it was closely based on current HMRC practice.

34. Mr Peacock submitted that the FTT's decision marked a substantive change from the pre-existing provisions and constituted an improper broadening of the purpose test as a result of its interpretation of sections 684 and 687.

35. Finally, Mr Peacock submitted that the FTT had failed to apply the case law on the proper application of the main purpose test contained in section 684. The authorities demonstrated that in order for the main purpose test to be applied there had to be a possible alternative transaction to which the actual transaction could be compared (*IRC v Parker* [1966] 43 TC 396 at 441 *per* Lord Wilberforce and *Allam v HMRC* [2022] STC 37 at [172]). In view of the FTT's rejection of HMRC's secondary (i.e. its factual) case, there was no alternative transaction by which the Taxpayers would have extracted value from the company by way of the transaction leading to an income tax charge.

Submissions for HMRC

36. Mr Afzal KC, appearing with Mr Winter for HMRC, submitted that the FTT did not hold (at FTT [55]) that obtaining an income tax advantage was not the main purpose of entering into the Buybacks – that holding was in relation to HMRC's secondary argument on the assumption that HMRC had not succeeded on their primary argument.

37. Mr Afzal submitted that the Taxpayers had, in fact, obtained a tax advantage, as defined. The Taxpayers, he argued, had accepted that, having paid less CGT than the income tax that would have been payable had the consideration for the Buybacks constituted qualifying distributions, they had therefore satisfied section 684(1)(d) ITA 2007 (i.e. they obtained an "income tax advantage" as defined in section 687 ITA 2007). Mr Afzal noted that it was not in dispute that the Taxpayers had obtained an income tax advantage. The quantum of that advantage was the difference between (i) the amount of income tax that would have been payable had the consideration for the Buybacks constituted qualifying distributions, less (ii) the amount of CGT payable (i.e. £nil). In other words, because no CGT was payable, the

amount of the income tax advantage was the amount of income tax that would have been payable had the consideration for the Buybacks constituted qualifying distributions.

38. The requirement that obtaining an income tax advantage was a main purpose was met, according to Mr Afzal, because obtaining the benefit of EIS relief was a main purpose. Although EIS disposal relief was a CGT relief, it was also a type of income tax advantage based on the specific definition contained in section 687(1)(b) ITA 2007. Obtaining EIS disposal relief necessarily amounted to obtaining an income tax advantage according to the statutory wording.

39. HMRC accepted that there was a difference between "purpose" and "effect". However, Mr Afzal submitted that nowhere in its analysis did the FTT state that its conclusion as to purpose was based on effect. The FTT (at FTT [25]) stated that:

> "The effect of the transaction was to generate an income tax advantage, but [Mr Afzal] needs to go further than that. He needs to show that it was a main purpose."

40. Mr Afzal submitted that the FTT could use the effect of what a taxpayer did as a piece of evidence in its assessment of the distinct question of whether the Taxpayers had the requisite purpose. The FTT was well aware that the mere effect of achieving an income tax advantage was not enough to find a purpose of achieving that advantage. Instead, the FTT's reasoning concerned the subsequent legal characterisation of a factual main purpose of obtaining EIS disposal relief. The FTT found, correctly in Mr Afzal's submission, that a factual main purpose of obtaining that CGT relief was, in law and as a matter of statutory definition, a main purpose of obtaining an income tax advantage. It was not an error of law for the FTT to apply the definition of "income tax advantage" in section 687 ITA 2007 in seeking legally to characterise the main purpose of obtaining EIS disposal relief. That remained the case, Mr Afzal contended, even though that definition was given in terms of an effect of a transaction.

41. As to the Taxpayers' argument that the effect of the FTT's conclusion was that EIS relief was effectively curtailed, Mr Afzal countered by saying that it was only where a taxpayer carried out a transaction in securities which had a main purpose of obtaining CGT relief and which met all the other requirements of section 684 ITA 2007 that he or she would be at risk of a counteraction notice. In a normal, commercially-motivated, transaction such a relief would not even be a purpose, let alone a main purpose.

42. Secondly, Mr Afzal addressed Mr Peacock's arguments in relation to the Consultation Document.

43. As regards paragraph 3.3 of the Consultation Document, Mr Afzal noted that the paragraph continued by stating: "This would be more relevant for corporation tax." This was because the definition of "tax advantage" in the TIS code applicable to corporation tax (found in section 709 (1) ICTA 1988) would catch tax advantages from converting a chargeable gain into income. The proposed changes envisaged by the Consultation Document, Mr Afzal argued, would prevent this from happening and that was why paragraph 3.3 of the Consultation Document stated that this was "more relevant for corporation tax" because the definition of tax advantage in the income tax TIS code (at that time section 683 ITA 2007) was fairly clear that it would not catch tax advantages from converting a chargeable gain into income. The version of section 687 ITA 2007 relevant in the present case then put it beyond doubt because it required more income tax than CGT to be payable.

44. In relation to the Taxpayers' argument that there had to be an alternative transaction with which to compare the actual transaction, Mr Afzal noted that this argument had been considered and rejected by the FTT at FTT [33] where the FTT considered that the alternative transaction was already built into the definition of income tax advantage. The alternative transaction was the qualifying distribution identified in that definition. The purpose of the TIS provisions was to ensure income tax was not avoided. That purpose would be frustrated if there had to be an alternative transaction but not one bearing income tax.

DISCUSSION

45. The TIS provisions date back to section 28 of the Finance Act 1960. Originally directed at tax avoidance transactions known as "bond washing" and "dividend stripping", the courts have repeatedly warned that the TIS provisions have a wider application.[2] Although the TIS provisions were enacted originally before the introduction of CGT in 1965 and at a time when progressive income tax rates were as high as 98%, the main application of the provisions, since that time, has tended to be directed towards schemes which are designed to convert income into capital receipts, albeit their effect since 1965 has been to prevent a charge to capital gains tax being substituted for a charge to income tax, rather than to prevent tax being avoided entirely.

46. The Consultation Document in 2009 presaged significant changes to the TIS provisions and these were eventually enacted by the Finance Act 2010. It is these relatively new provisions that are the subject matter of this appeal. We shall return to the Consultation Document and its significance later in our decision.

47. We should record at the outset that it was common ground that in determining a taxpayer's main purpose in being a party to the transaction in securities it was necessary to ascertain the subjective intentions of the relevant party (*IRC v Brebner* [1967] 2 AC 18 at 27 *per* Lord Pearce and at 30 *per* Lord Upjohn). We consider this to be a correct statement of the law.

48. HMRC's argument is, in effect, that the Taxpayers' subjective intention was to dispose of their shares in the Buybacks and, by claiming EIS relief, to pay no CGT. We do not think that that statement of the Taxpayer's subjective intention is in dispute. Indeed, that is the effect of the FTT's finding at FTT [12], [54] and [55].

49. It is at this point, however, that we part company with Mr Afzal's submissions and the FTT's analysis. We accept Mr Peacock's submission that the income tax advantage, as defined in section 687 ITA 2007, was the effect rather than the purpose of the Taxpayers entering into the Buybacks. In particular, we do not accept that because the Taxpayers' purpose in entering into the Buybacks was to obtain EIS CGT relief, which resulted for the purposes of section 687 ITA 2007 in an income tax advantage, they necessarily had a main purpose of obtaining that income tax advantage. It seems to us that section 687 does not have the effect of "deeming" a main purpose to exist which does not in fact exist.

50. It is in this context that the finding by the FTT at FTT [55] that obtaining an income tax advantage "was not a main purpose of entering into the share buyback" is important. That this finding was made in the context of HMRC's secondary argument is clear enough, but it does not mean that it is somehow irrelevant to the issue that arises in the context of their primary

[2] See, for example, the comments of Viscount Dilhorne in *IRC v Parker, ibid,* at p 430

argument on the effect of section 687 ITA 2007 and we reject Mr Afzal's submission to that effect. That finding cannot be compartmentalised in that way.

51. The Taxpayers accepted that in fact they obtained an income tax advantage: FTT [54]. The FTT's finding at FTT [55] was that that was not a main purpose of entering into the Buybacks but was, rather, *a consequence* of the Buybacks. As the FTT said at the end of that paragraph:

> "Whilst this meant that they paid no tax on the consideration something which they knew would have been the case had they extracted those sums by way of dividend, this was not a main purpose. It was a CGT play. It was designed to ensure that they obtained the benefit of CGT relief now. They did not have, as a main purpose, the obtaining of an income tax advantage."

52. In *Blackrock* the Court of Appeal considered the "unallowable purpose" test in relation to the loan relationships provisions. The FTT at [119]-[121] of *Blackrock Holdco 5 v HMRC* [2021] SFTD 267 found at [120] that the "inevitable and inextricable consequence" of the loans in question was (ignoring the application of the main purpose test) a tax advantage. This led the FTT in that case to conclude at [121] that the advantage was a main purpose in entering into the loans.

53. Falk LJ, with whom Nugee and Peter Jackson LJJ agreed, said at [124]:

> "For present purposes 'object' can also be regarded as synonymous with purpose. So far as relevant to this case, and gathering the points together, I would summarise the key points as follows:
>
> a) Save in 'obvious' cases, ascertaining the object or purpose of something involves an inquiry into the subjective intentions of the relevant actor.
>
> b) *Object or purpose must be distinguished from effect. Effects or consequences, even if inevitable, are not necessarily the same as objects or purposes.*
>
> c) Subjective intentions are not limited to conscious motives.
>
> d) Further, motives are not necessarily the same as objects or purposes.
>
> e) 'Some' results or consequences are 'so inevitably and inextricably involved' in an activity that, unless they are merely incidental, they must be a purpose for it.
>
> f) It is for the fact finding tribunal to determine the object or purpose sought to be achieved, and that question is not answered simply by asking the decision maker." (Emphasis added)

54. Falk LJ continued at [146] and [151]:

> "[146] Purpose must be distinguished from effect. Even unavoidable effects are not necessarily the same as purposes.… It cannot therefore be the case that any inevitable consequence can be a purpose."
>
> "[151]… [T]he FTT made an error of law in proceeding on the basis that the 'inevitable' consequence of tax relief was, without more, a main purpose."

55. It may be that in the present appeal the FTT's findings concerning the purposes for which the Taxpayers entered into the Buybacks were generous to the Taxpayers. Those findings, however, were not challenged before us. On the basis of those findings we conclude that, although the effect of the Buybacks was that the Taxpayers achieved an income tax

advantage within the meaning of section 687 ITA 2007, that was not a main purpose in entering into the Buybacks.

56. Accordingly, we consider that the FTT's conclusion at FTT [32] that "as a matter of remorseless statutory logic" the Taxpayers' purpose of crystallising the EIS disposal relief also necessarily constituted a main purpose of obtaining an income tax advantage was an error of law.

57. We are strengthened in this conclusion by consideration of the statutory background to the introduction of sections 684 and 687 ITA 2007 in 2010. We have already mentioned the Consultation Document. Nowhere in that Consultation Document do we see any evidence of an intention to amend the TIS legislation so that a main purpose of obtaining a CGT exemption should necessarily constitute a purpose of obtaining an income tax advantage.

58. We asked Mr Afzal whether, under the TIS provisions which preceded the amendments made in 2010, the argument which HMRC now advanced would have been possible. Mr Afzal argued, unconvincingly in our view, that such an argument could have been advanced on the earlier provisions. Mr Peacock submitted that that argument could not have been put forward. In our view, that argument was simply not open to HMRC under the earlier versions of the TIS provisions.

59. It seems strange that such a fundamental change as that contended for by HMRC, should be wrought without any notice being given and without any discussion in the Consultation Document which heralded the introduction in 2010 of the new sections 684 and 687. That, of itself, suggests that HMRC's argument is unsound, although it is not necessary to our conclusions which are based on the proposition that something being an inevitable result does not necessarily and without more, and without consideration of subjective intention, make it a main purpose.

60. Although it forms no part of our reasoning, as an expert tribunal we might add that our own understanding of the earlier TIS legislation was that where transactions were carried out which had a main purpose of avoiding CGT (but with no main purpose of avoiding income tax)[3] the general understanding amongst practitioners was that the TIS provisions simply did not apply.

61. We have referred above to the parties' arguments on the necessity for a possible alternative transaction. We think it was a consequence of HMRC's deeming approach to main purpose, as accepted by the FTT, that it was necessary also, as a matter of analysis, for the FTT to envisage the alternative transaction as being built in, since subjectively speaking no possible alternative transaction was in the minds of the Taxpayers. So we think the possible alternative transaction arguments are just a facet of, or different way of looking at, the main point.

62. We have not found it necessary to address every argument put forward by the parties. We have, however, carefully considered all of those arguments put forward by Mr Peacock and by Mr Afzal, whose submissions we found to be of great assistance.

[3] and in relation to corporation tax, the avoidance of corporation tax on chargeable gains in the absence of a main purpose of avoiding corporation tax on income.

CONCLUSION

63. In conclusion, we allow the Taxpayers' appeal.

COSTS

64. Any application for costs in relation to this appeal must be made in writing and served on the Tribunal and the person against whom it is made within one month after the date of release of this decision as required by rule 10(5)(a) and (6) of the Tribunal Procedure (Upper Tribunal) Rules 2008.

MR JUSTICE MEADE
JUDGE GUY BRANNAN

UPPER TRIBUNAL JUDGES

Release date: 16 June 2025