TC03056

Appeal number: TC/2012/03035 & TC/2012/04569

CORPORATION TAX – Schedule 23 Finance Act 2003 – does option have to be acquired, as a matter of fact, by reason of employment with the employer company – yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

METSO PAPER BENDER FORREST LIMITED **Appellants**
METSO PAPER BENDER MACHINE SERVICES LIMITED

- and -

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

TRIBUNAL: JUDGE LADY JUDITH MITTING
DEREK ROBERTSON

Sitting in Manchester on 24 – 27 September 2013

Alun James, Counsel for the Appellants

Peter Halford, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. The issue before the Tribunal is whether it is a condition for relief from corporation tax under Schedule 23 Finance Act 2003 that an option granted in 2004 by Bender Holdings Limited ("the Grantor") to Mr Gary Ritchie to subscribe for shares equal to 12.5% of the issued share capital of the grantor and exercised by Mr Ritchie in 2007 has to have been granted to or obtained by him by reason of his employment or office or former employment or office with the grantor. It being common ground and an agreed fact that it was not, as a matter of fact, so granted, the Respondents maintain that it is a condition for relief and the appeal must therefore fail. The Appellants contend that it is not such a condition.

2. It had been thought by the Appellants that the Respondents accepted that all the conditions for relief set out in paragraph 2 of Schedule 23 had been satisfied. It became apparent however immediately before and during the hearing that it was not accepted that paragraphs 2(a) and 2(d) had been met. This had not been pleaded by the Respondents and there was before us a strike out application in respect of that part of the Respondents' case which related to these issues. As these issues would only become live in the event that the Appellants succeed on the principal issue, the parties agreed that the strike out application be stayed and consideration of these issues be deferred pending determination of the principal issue. We record that the position over costs is reserved.

3. No oral evidence was called and the facts were not in dispute. The parties had agreed the following Statements of Agreed Facts:

(delivered to Tribunal on 16/11/2012 pursuant to Direction 2A of the Directions issued on 4/9/2012)

The Appellants and the UK subgroup

1. The Appellants were at all material times UK-resident companies, trading in the UK, and wholly-owned subsidiaries of a UK-resident company now named Metso Paper Bender Limited (incorporated in England and Wales and registered with company number 3734669) (**'UK SubHoldco'**) (the Appellants and UK SubHoldco being referred to below as the **'UK subgroup'**).

The relevant facts up to 17 February 2003

2. Prior to 17 February 2003, the shares in UK SubHoldco (which at that time was named Bender Holdings Limited) were held as to 80% by a company incorporated in the USA named Bender Machine Inc, as to 10% by a Mr Gary Ritchie (**'Mr Ritchie'**), and as to 10% by a Mr Jack Ritchie who was resident in the USA. Bender Machine Inc was in turn controlled by the

Ritchie family, including Mr Ritchie himself who held 27% of its issued share capital.

3. Mr Ritchie was, until 17 February 2003, a director and company secretary of each of the Appellants and UK SubHoldco. His directorships of the Appellants were unpaid, and he had no contract of employment with either of them; there is no record that he ever received any remuneration (whether in cash or otherwise) from either Appellant or from Uk SubHoldco. The Appellants' businesses were carried on entirely in the UK. Mr Ritchie spent a minimal amount of time in the UK (never more than two weeks a year), and by the few years leading up to February 2003 he was spending no more than about one week a year in the UK.

4. Mr Ritchie resigned as a director of each Appellant on 17 February 2003.

The buy-out and the grant of the 2003 Option

5. On 17 February 2003, the UK subgroup was bought out from Bender Machine Inc, and from Mr Ritchie, in a management buy-out.

6. For this purpose, two UK employees and directors of the Appellants, named Mr Barry Peter Brown (**'Mr Brown'**) and Mr Erwin Robert Byrom (**'Mr Byrom'**), established a new buy-out company, named initially Bender Limited, incorporated in January 2003 in England and Wales and registered with company number 4633646, and whose issued share capital was wholly owned by them – Mr Brown and Mr Byrom each subscribing for 100,045 shares of £1 each (the total issued share capital of the new company thus amounting to 200,090 shares of £1 each). This company (**'UK Buy-out Co'**) purchased the entire issued share capital of UK SubHoldco from Bender Machine Inc and from Mr Ritchie, for aggregate consideration of £2.1m.

7. In the buy-out, Mr Ritchie thus realised the value of his (10%) holding in UK SubHoldco. However, to assist the purchaser (and its shareholders, Mr Brown and Mr Byrom, who in substance were buying out him and his family) and to bridge a funding gap, Mr Ritchie agreed to make Mr Brown and Mr Byrom a personal loan of £127,146. (It is not known how the remainder of the purchase price was funded, or by what method the funding was introduced by Mr Brown and Mr Byrom into UK Buy-out Co to fund the purchase.)

8. It is not known for certain but it can be reasonably assumed that an appropriate part of the aggregate purchase price of £2.1m was attributable to or allocated to the sale of Mr Ritchie's personal (10%) shareholding in UK SubHoldco. However, in addition to paying to Mr Ritchie the portion (if any) of the total cash consideration allocable to his shares in UK SubHoldco, also on 17 February 2003 the purchaser, UK Buy-out Co, granted Mr Ritchie an option (in consideration of the sum of £100),

exercisable by him at any time after 17 February 2006, to subscribe for shares equal, at the time of exercise of the option, to 15% of the issued share capital of UK Buy-out Co (see clauses 2.1 and 2.3 and the definition of 'Option Shares' in clause 1.1 of the Option Agreement dated 17 February 2003), at an 'Exercise Price' (strike price) consisting of their nominal value (see definition of 'Exercise Price' in clause 1.1, *ibid.*). Further, in consideration of Mr Ritchie granting them the loan of £127,146 referred to in paragraph 7 above, Mr Brown and Mr Byrom agreed to procure that UK Buy-out Co would perform its obligations under the Option Agreement (i.e., principally, its obligation to issue the Option Shares for the Exercise Price on exercise by Mr Ritchie of the option): see clause 2.2, *ibid.*

9. The option granted by the Option Agreement dated 17 February 2003 (the **'2003 Option'**) was thus granted by UK Buy-out Co to Mr Ritchie, and obtained by Mr Ritchie, as one of the overall terms of the buy-out, and in return for Mr Ritchie making the loan (of £127,146) to its shareholders (Mr Brown and Mr Byrom). The loan was in turn granted by Mr Ritchie to facilitate the buy-out (i.e., the sale of the UK subgroup) as a whole.

10. Hence, the 2003 Option was not granted to or obtained by Mr Ritchie (as a matter of fact) for reasons connected with Mr Ritchie's directorships or former directorships of the Appellants. It was granted by reason of the buy-out and the above-mentioned loan of £127,146 to Mr Brown and Mr Byrom. It is accordingly agreed by the parties that, in determining the appeals, the Tribunal should assume that the 2003 Option was not, as a matter of fact, granted or obtained by reason of any employment or office or former employment or office with either of the Appellants.

11. At around the same time, the name of UK SubHoldco was changed from Bender Holdings Limited to Bender Limited, and the name of UK Buy-out Co was changed from Bender Limited to Bender Holdings Limited, in a direct name swap.

The surrender of the 2003 Option for the 2004 Option

12. In 2004 (the exact date is not known, since no signed or dated copy of the relevant documentation is available), Mr Ritchie agreed to surrender the 2003 Option in consideration of the grant to him by UK Buy-out Co of a new option (the **'2004 Option'**), likewise exercisable by him at any time after 17 February 2006, to subscribe for shares equal, at the time of exercise of the option, to 12.5% of the issued share capital of UK Buy-out Co (see clauses 2.1 and 2.2 and the definition of 'Option Shares' in clause 1.1 of the 2004 Option Agreement), at an 'Exercise Price' (strike price) consisting (again) of their nominal value (see definition of 'Exercise Price' in clause 1.1, *ibid.*). Again, Mr Brown and Mr Byrom agreed to procure that UK Buy-out Co would perform its obligations under the 2004 Option Agreement (i.e., principally, its obligation to issue the Option Shares, on exercise by Mr Ritchie of the 2004 Option, for the Exercise Price), in

consideration of Mr Ritchie continuing to make available to them the loan of £127,146.

13. The 2004 Option was thus granted to Mr Ritchie by UK Buy-out Co in consideration of the surrender by Mr Ritchie of the 2003 Option. The 2004 Option was not granted to or obtained by Mr Ritchie (as a matter of fact) for reasons connected with his former directorships of the Appellants. It is accordingly agreed by the parties that, in determining the appeals, the Tribunal should assume that the 2004 Option was not, as a matter of fact, granted or obtained by reason of any employment or office or former employment or office with either of the Appellants.

The 2007 take-over by Metso Paper, and the exercise of the 2004 Option

14. In July 2007, the entire issued share capital of UK Buy-out Co (and thus, with it, the entire UK subgroup) was sold for a gross sale price of £13.5m to the Finnish paper conglomerate, Metso Paper, a group whose parent company's shares are listed on the Helsinki stock exchange and (via American Depositary Receipts) on the 'OTC' market of the New York Stock Exchange and which is one of the world's largest suppliers of technology and services in process industries including (amongst others) pulp and paper manufacture. The £13.5m was, however, a gross price, part of which was deferred and part of which was reserved to meet costs. It is not known how much the final net price was.

15. In anticipation of the sale, Mr Ritchie exercised his option (the 2004 Option), thereby subscribing for and acquiring 33,349 ordinary shares of £1 each in UK Buy-out Co, for the Exercise Price equal to their nominal value – thus subscribing £33,349. (The 33,349 shares thereby acquired amounted, on exercise, to 12.5% of the issued share capital of UK Buy-out Co, because at the same time seven employees exercised options over another 33,349 ordinary shares of £1 each, granted under the 'enterprise management incentives' (EMI) legislation contained in Sch 5 of the Income Tax (Earnings and Pensions) Act 2003.) He then immediately sold these 33,349 shares, comprising 12.5% of the total issued shares in UK Buy-out Co, to Metso Paper for the corresponding proportion of the aggregate sale consideration.

16. On exercise of the 2004 Option and sale of the 33,349 shares in UK Buy-out Co that he thereby acquired, Mr Ritchie thus made a profit or gain equal to his due proportion (12.5%) of the aggregate net sale price minus his option exercise price of £33,349. The precise amount of his profit is not known (since the final net sale price of the sale to Metso Paper is not known). However, the Appellants' relevant company tax returns, in which they claim corporation tax relief under Schedule 23 Finance Act 2003, quantify his profit or gain at, in total, £1,654,151 (the claimed 'option gain') – comprising £1,687,500 (being 12.5% of the aggregate gross sale price of £13.5m) minus his option exercise price of £33,349.

17. Mr Ritchie was not subject to income tax (or any other UK taxation) on any profit or gain on his option – or on his disposal of the shares he acquired on exercise – because at all relevant times he was non-UK resident and not ordinarily resident in the UK: see s.474(1) Income Tax (Earnings and Pensions) Act 2003.

18. Following the take-over by Metso Paper, UK SubHoldco's name was changed again, to Metso Paper Bender Limited; and UK Buy-out Co's name was also changed, to Metso Paper Bender Holdings Limited.

The non-statutory clearance application

19. On 28 November 2008, the Appellants' tax representatives, Wrigley Partington, applied to HMRC for non-statutory clearance (as permitted under Inland Revenue Code of Practice 10) that the claimed option gain (quantified, as above, at £1,654,151) qualified for corporation tax relief under Sch 23 Finance Act 2003. After requesting certain further information, HMRC wrote to Wrigley Partington by letter dated 2 March 2009, refusing (with reasons) the clearance sought. Following provision on behalf of the Appellants of further information and argument to HMRC, clearance was again refused by further letters from HMRC dated 8 May and 1 June 2009.

Relief claimed in Appellants' company tax returns

20. On 26 June 2009, Wrigley Partington submitted to HMRC each Appellant's company tax returns and computations for the two accounting periods the profits of which were reported by each Appellant's audited financial statements for the period from 1 July 2007 to 31 December 2008. Under s.12(3) Income and Corporation Taxes Act 1988 (**'ICTA 1988'**), this period fell to be treated for corporation tax purposes as comprising two accounting periods, the first ending on 30 June 2008 (see s.12(3)(a) ICTA 1988) and the second ending on 31 December 2008 (see s.12(3)(b) ICTA 1988). Accordingly, for each Appellant a company tax return CT600 was submitted for the accounting period ending on 30 June 2008 and a company tax return CT600 was submitted for the accounting period ending on 31 December 2008.

21. In each Appellant's company tax return for its accounting period ending on 30 June 2008, corporation tax relief (a 'deduction') was claimed for a *'gain on unapproved share options'*. This related to the amount of the claimed option gain referred to at paragraph 16 above – i.e., the amount of Mr Ritchie's profit or gain claimed to arise on the exercise of the 2004 Option. The total amount claimed was £1,654,151 (see paragraph 16 above); this was split equally between the two Appellants, each of which claimed a deduction for 50% – i.e., £827,075 in the case of the first above-named Appellant, Metso Paper Bender Forrest Limited, and £827,076 in the case of the second above-named Appellant, Metso Paper Bender Machine Services

Limited. If any deduction is available, its computation and quantum are not in dispute.

Enquiry and amendment of company tax returns

22. On 16 September 2009, the inspector, Philip Hamblin, opened an enquiry under para 24(1) of Sch 18 Finance Act 1998 into each Appellant's company tax return for its accounting period ending on 30 June 2008, requesting further information and raising various questions in relation to the relief claimed in respect of Mr Ritchie's share option.

23. The enquiries were closed by the inspector on 22 September 2011, and each Appellant's self-assessment contained in its company tax return for the period ending 30 June 2008 was amended on 23 September 2011 to disallow the deduction claimed in respect of Mr Ritchie's share option, with consequential amendments being made accordingly. The inspector also made consequential amendments to the company tax return of the first-named Appellant (Metso Paper Bender Forrest Limited) for its accounting period ending on 30 June 2007 (to disallow the losses carried back from the period ending 30 June 2008 and arising from the deductions claimed in respect of Mr Ritchie's share option) and to the company tax return of the first-named Appellant for its accounting period ending on 31 December 2008 (to disallow the losses carried forward from the period ending 30 June 2008 and likewise arising from the deductions so claimed).

Appeals, reviews and notification of appeals to Tribunal

24. By letter dated 6 October 2011, each Appellant (via Wrigley Partington) notified HMRC under para 48 of Sch 18 Finance Act 1998 of its appeal against the relevant amendment. Under s.49C Taxes Management Act 1970 (**'TMA 1970'**), the Appellants each also requested an independent HMRC review of the matter.

25. On 16 January 2012, the review conclusions under s.49E TMA 1970 by an independent HMRC officer upheld the amendments of both Appellants' returns for all relevant periods.

26. On 13 February 2012, each Appellant filed a Notice of Appeal to the Tribunal.

4. Legislation

4.1 "Schedule 23 Corporation tax relief for employee share acquisition

Section 141

Part 1 General provisions
Introduction

1—

(1) This Schedule provides for corporation tax relief for a company where a person—

(a) acquires shares by reason of his, or another person's, employment with that company (an "award of shares": see Part 2 of this Schedule), or

(b) obtains by reason of his, or another person's, employment with that company an option to acquire shares and acquires shares pursuant to that option (the "grant of an option": see Part 3 of this Schedule).

(2) Part 4 of this Schedule makes further provision for cases where the shares acquired are restricted shares.

(2A) Part 4A of this Schedule makes further provision for cases where the shares acquired are convertible shares.

(3) In this Schedule—

"the employing company" means the company mentioned in sub-paragraph (1);

"the recipient" means the person acquiring the shares or obtaining the option; and

"the employee" means the person by reason of whose employment the shares are acquired or the option is granted.

Requirements for relief

2

Relief under this Schedule is available only if the requirements of this Schedule are met as to—

(a) the business for the purposes of which the award or grant is made (paragraph 3);

(b) the kind of shares acquired (paragraph 4);

(c) the company whose shares are acquired (paragraph 6 or 12); and

(d) the income tax position of the employee (paragraph 7, 14 or 20).

Business must be within the charge to corporation tax

3—

(1) The business for the purposes of which the award or grant is made must—

(a) be carried on by the employing company, and

(b) be within the charge to corporation tax.

(2) A business is within the charge to corporation tax if, or to the extent that, it is carried on by a company that is within the charge to corporation tax in respect of the profits of the business.[1]

Kind of shares acquired

4—

(1) The shares acquired must meet the following requirements.

(2) They must be ordinary shares that are fully paid-up and not redeemable.

(3) They must be—

(a) shares of a class listed on a recognised stock exchange, or

(b) shares in a company that is not under the control of another company, or

(c) shares in a company that is under the control of a company (other than a close company or a company that if resident in the United Kingdom would be a close company) whose shares are listed on a recognised stock exchange."

4.2 Then as regards an option one is directed to the provisions of Part 3 for the remaining requirements as to the company issuing the shares and as to the income tax position of the employee:

"Part 3 Grant of option

Introduction

11—

(1) The provisions of this Part of this Schedule apply in the case of the grant of an option to acquire shares.

(2) Where the shares acquired pursuant to the option are restricted shares, the provisions of this Part have effect subject to the provisions of Part 4 of this Schedule.

(3) Where the shares acquired pursuant to the option are convertible shares, the provisions of this Part have effect subject to the provisions of Part 4A of this Schedule.

The company whose shares are acquired

12

The company whose shares are acquired pursuant to the option must be—

(a) the employing company; or

(b) a company that, at the time the option is granted, is a parent company in relation to the employing company; or

(c) a company that, at that time, is a member of a consortium that owns the employing company or a company within paragraph (b); or

(d) where, at that time, the employing company or a company within paragraph (b) is a member of a consortium that owns another company (C), a company that, at that time—

(i) is a member of the consortium or a parent company in relation to a member of the consortium, and

(ii) is also a member of the same commercial association of companies as C; or

(e) a qualifying successor company (see paragraph 13).

...

Income tax position of the employee

14—

(1) It must be the case that the acquisition of shares pursuant to the option—

(a) is a chargeable event in relation to the employee for the purposes of section 476 of the Income Tax (Earnings and Pensions) Act 2003 (whether or not an amount counts as employment income by virtue of that event), or

(b) would be such a chargeable event in relation to the employee if the conditions specified in sub-paragraph (2) were met.

(2) The conditions mentioned in sub-paragraph (1)(b) are—

(a) that the employee was resident and ordinarily resident in the United Kingdom at all material times, and

(b) that the duties of the employment by reason of which the option was granted were performed in the United Kingdom at all material times."

4.3 Paras 15 and 16 provide for the amount of the relief and how it is given:

"Amount of relief

15—

(1) The amount of the relief is equal to the difference between—

(a) the market value of the shares at the time they are acquired pursuant to the option, and

(b) the total amount or value of any consideration given, by the recipient or another, in respect of the grant of the option or the acquisition of the shares pursuant to the option.

...

How relief is given

16—

(1) The amount of the relief is allowed as a deduction in computing for the purposes of corporation tax the profits of the business for the purposes of which the option was granted.

...

(4) If the option was granted for the purposes of more than one business within the charge to corporation tax, the amount of the deduction must be apportioned between them on a just and reasonable basis."

4.4 Finally as regards Schedule 23 it is necessary to refer to the definition provision in para 26:

"Meaning of "employment"

26

For the purposes of this Schedule—

(za) "employment" includes a former or prospective employment,

(a) references to employment by a company include holding an office with that company, and related expressions have a corresponding meaning, and

(b) members of a company whose affairs are managed by the members themselves are treated as holding an office with the company."

4.5 The relevant provisions of ITEPA 2003 are in s471 of Ch 5 Pt 7:

"471 Options to which this Chapter applies

(1) This Chapter applies to a securities option acquired by a person where the right or opportunity to acquire the securities option is available by reason of an employment of that person or any other person.

(2) For the purposes of subsection (1) "employment" includes a former or prospective employment.

(3) A right or opportunity to acquire a securities option made available by a person's employer, or a person connected with a person's employer, is to be regarded for the purposes of subsection (1) as available by reason of an employment of that person unless—

(*a*) the person by whom the right or opportunity is made available is an individual, and

(*b*) the right or opportunity is made available in the normal course of the domestic, family or personal relationships of that person.

...

(8) In this Chapter —

"the acquisition", in relation to an employment-related securities option, means the acquisition of the employment-related securities option pursuant to the right or opportunity available by reason of the employment,

"the employment" means the employment by reason of which the right or opportunity to acquire the employment-related securities option is available ("the employee" and "the employer" being construed accordingly), and

"employment-related securities option" means a securities option to which this Chapter applies."

4.6 It is also relevant to note that the definition of "connected" for the purpose of s471(3) is by virtue of s718 ITEPA to be found in s993 ITA 2007 and (so far as relevant) is as follows:

"(5) A company is connected with another company if—

(a) the same person has control of both companies,

(b) a person ("A") has control of one company and persons connected with A have control of the other company,

© A has control of one company and A together with persons connected with A have control of the other company, or

(d) a group of two or more persons has control of both companies and the groups either consist of the same persons or could be so regarded if (in one or more cases) a member of either group were replaced by a person with whom the member is connected.

(6) A company is connected with another person ("A") if—

(a) A has control of the company, or

(b) A together with persons connected with A have control of the company."

5. Relevant to the appeal was the timing of various amendments to the statutory provisions and Mr Halford very helpfully produced for us a chronology of the legislation which we set out below:

Metso Paper appeals: Chronology of legislation

Basic income tax charging provision, first introduced in 19th century; consolidated to s 19 ICTA 1988 ('Schedule E') [**Auths 2]**, and now contained in s 62 ITEPA 2003 [**Auths tab 8(ii)]**

Income tax charge on 'gains' on exercise of options granted by reason of employment: first introduced by s 25 Finance Act 1966; consolidated to Taxes Act 1970 and then to ss 135-140 ICTA 1988

HISTORY FROM 2001 ONWARDS

Date	**Income tax provisions**	**Corporation tax deduction**
7/3/2001		Budget 2001 **[Auth 41]**
		Consultation
27/11/2002		2002 PBR announces new relief **[Auth 43]**
19/12/2002		Draft legislation published **[Auth 47]**
1/1/2003		Commencement date of Sch 23 (a/cg periods beginning on or after 1/1/2003) **[Auth 6(ii)]**
6/4/2003	Ss. 135-140 'rewritten' to Ch 5 of Pt 7 ITEPA 2003 (original version): **[Auth 5(iii),** pp.27 to 35**]**. Commencement date: 6/4/2003: s.723 **[Auths 5(iv)]**	
9/4/2003	Budget 2003 (PN 07 **[Auth 45]** and REV BN 29 **[Auth 46]**) announces briefly that anti-avoidance legislation will be introduced in relation to share-based remuneration, and that definitions will be widened (but provides no detail beyond that)	

16/4/2003	Finance Bill 2003 published. Sch 22 substitutes completely new Chs 1 to 5 of Pt 7 ITEPA with effect from various commencement dates **[Auth 48(iii)]**	Sch 23 **[Auth 48(iv)]** contains the new corporation tax deduction rules in identical terms to the draft published on 19/12/2003. Also, Sch 22 **[Auth 48(iii)]** provides for various amendments of Sch 23 from various commencement dates.
16/4/2003	'New' Ch 5 of Pt 7 ITEPA 2003 comes into effect in relation to options to acquire securities other than shares **[Auth 8(ii),** p.5491**]** & **[Auth 9(iii)**, p.5717**]** (see para 10 of Sch 22 FA '03)	Para 26(za) of Sch 23 comes into effect **[Auth 9(iv)]** & **[Auth 9(iii),** p.5721**]** (see para 71 of Sch 22 FA '03)
1/9/2003	'New' Ch 5 of Pt 7 ITEPA 2003 comes into effect in relation to options to acquire shares **[Auth 8(ii)]** p.5491, **[Auth 9(iii)]** p.5717 (para 10 of Sch 22 FA '03) & **[Auth 15]** (Treasury Order)	Amendments to para 1(1)(b) & para 12 of Sch 23, & substituted para 14 of Sch 23 come into effect **[Auth 9(iv)], [Auth 9(iii)**, pp.5720-5721 paras 60, 63 & 65 of Sch 22 FA 2003

Appellants' Submissions

6. The crux of Mr James' contentions concerns the interaction of s471 ITEPA 2003 and Schedule 23 Finance Act 2003. On the face of it and taken in isolation, Schedule 23 provides for corporation tax relief for a company which offers share options to its employees by reason of their employment. Section 471(3) ITEPA deems an option to have been acquired by reason of employment where the option was quite simply made available by the employer to the employee. Within the terms of Schedule 23 alone, the Appellants would fail to attract relief because it is accepted that the option was not, as a matter of fact, acquired by reason of Mr Ritchie's employment. The option was granted to Mr Ritchie in return for his making a loan to Messrs Brown and Byrom to facilitate the buy-out. However, under the deeming provisions of s471(3) ITEPA, if they apply, the acquisition will be regarded as being made available by reason of employment even though it was not in fact so made – i.e. simply because of Mr Ritchie having been a director. The provisions of s471(3) therefore, contends Mr James, have to be read into an interpretation of Schedule 23 and they should be so read for a number of reasons.

7. Mr James contended that the language and structure of Schedule 23 pointed to paragraph 1(1) being introductory only. It is headed "Introduction" and in his submission contained no substantive requirements in its own right. Following the Rewrite style, the purpose of paragraph 1(1) was exactly what it said, "Introductory"

and described in general terms what the rest of the Schedule did. It was a signpost to the provisions which followed and should not be given any independent effect. It was paragraph 2 which set out the requirements for relief and that paragraph contained no reference back to paragraph 1(1). It could not therefore have been intended that it should be a specific requirement that the option had to be obtained as a matter of fact by reason of the employment.

8. Further, if paragraph 1(1) were treated as imposing an independent condition that the acquisition had to be by reason of employment as a matter of fact, paragraphs 7 and 14 would be redundant because they would always be satisfied. It is these paragraphs which set out the requirements as to the income tax position of the employee. Paragraph 14(1)(a) brings in the express requirement that the share acquisition gives rise to a chargeable event for the purposes of s476 ITEPA and in so doing by implication incorporates this wider definition of "by reason of the employment". Section 471(3) is thus embedded into a reading of Schedule 23. It is implicitly brought in through the requirement as to the employee's income tax position. Section 476, contended Mr James, can only function with s471 and paragraph 14 expressly incorporates s476.

9. It was fundamental, contended Mr James, that a charge to income tax can itself only arise on the acquisition of shares pursuant to an option if the option is obtained by reason of the employment (s471(1) ITEPA) and the option is deemed to be so acquired by s471(3) ITEPA if provided to an employee by his employer or a person connected with it, as was the case here.

10. The consequences of the Appellants' reading of the legislation is that the corporation tax deduction follows the income tax position. Paragraph 14(1)(a) gives corporation tax relief to the company where it can be matched by an income tax event of the employee. There is meant to be a symmetry in that the employee's charge to income tax is mirrored or matched in the company's right to relief. Mr James referred, in support of this contention, to the Explanatory Notes accompanying the Finance Bill 2003 which stated at paragraphs 62 and 63:

> "62. … This new relief … levels the playing field between cash and equity remuneration in terms of its corporation tax treatment. It removes the need for complex and expensive arrangements using trusts in order to obtain a Corporation Tax deduction for the cost of providing shares for employee share schemes.
>
> 62. The underlying policy objective of this provision is to recognise the use of shares as part of remuneration packages for employees. The aim is to match relief for the company with the taxation of the income on the employee. To do this eligibility to the relief is dependent on the employee being taxed or would be if the share acquisition was not from a tax relieved share scheme."

11. The intention of the legislators may well have been to give corporation tax relief for employee share schemes but the mechanism which they chose to effect this was to match it with the employee's charge to income. Once the conditions of paragraph 2

(incorporating paragraph 14) are met, the employment connection is made and the corporation tax relief follows.

12. Mr James also drew our attention to the Respondents' Business Income Manual section numbered BIM44270, which under the heading "requirements for relief" states:

> "For relief under FA03/SCH23 to be available requirements must be satisfied relating to:
>
> - The kind of shares acquired,
> - The company whose shares are acquired,
> - The income tax position of the employee,
> - The business for the purposes of which the share options were granted or the share awards were made."

This, submitted Mr James, set out the position correctly and clearly and was entirely contrary to the position of the Respondents in this case.

13. Mr James' final submission concerned the Rewrite of Schedule 23 into Part 12 Corporation Tax Act 2009. Section 1015 is headed "basic requirements for relief …". (i) then sets out the requirements and this sub-paragraph is in effect the Rewrite of paragraph 2. It contains five requirements, (c) being "the employee or another person obtains an option to acquire shares because of the relevant employment". Mr James contrasts this express requirement with the lack of it in Schedule 23. A specific requirement was being introduced whereas one had not existed previously.

The Respondents' Submissions

14. On the principal issue with which it is agreed we are dealing in this decision, the Respondents' case is that in construing Schedule 23 both purposively and in accordance with its express terms, corporation tax relief is only available where the option was, as a matter of fact, granted by reasons of employment. Mr Halford took us in some detail through the background to Schedule 23, its clear purpose being to encourage employee share ownership. He cited paragraphs 61 to 64 of the Explanatory Note (already referred to above). Paragraph 61, in particular, states:

> "The Government has decided to introduce this new relief as it wishes to encourage growth in productivity and believes that employee share ownership has a central role to play by motivating and encouraging employees to take a real interest in the success of their company."

He also cited the Introduction to Schedule 23 in its original form which reads as follows:

> "*Introduction*

> 1(1) This Schedule provides for corporation tax relief for a company where a person –
>
> (a) acquires shares by reason of his, or another person's employment with that company (an "award of shares": see Part 2 of this Schedule), or
>
> (b) obtains by reason of his, or another person's employment with that company an option to acquire shares and acquires shares in exercise of that option (the "grant of an option": see Part 3 of this Schedule)."

15. There was no support, argued Mr Halford, for the Appellants' contention that introductory words can be ignored as not imposing any particular conditions. Statutes should fall to be construed in accordance with their opening purposive sections (*Vestey v IRC (Nos. 1 & 2)* [1980] STC 10 (HL) at pages 20f and 36g-h). Mr Halford submitted that in fact it was not paragraph 1 which was introductory but paragraph 2 as the purpose of that paragraph was to summarise the conditions which were to follow. It was also incorrect to assert that the conditions do not refer back to any requirement in paragraph 1 as references in paragraphs 6 and 12 (cross-referred in paragraph 2(c)) refer to the "employing company" which is defined by reference to paragraph 1.

16. Mr Halford contended that it was not the case that Schedule 23 was intended to create, in all circumstances, symmetry. Symmetry could only apply where relief was available. Relief would not be available unless the employee was taxable (subject to exemption or non-residency rules) but the converse was not true in that relief was not available automatically just because or as a result merely of the employee being taxable.

17. In response to Mr James' contention that paragraphs 7 and 14 would be otiose on the Respondents' construction of Schedule 23, this was not necessarily so. First, paragraph 14 makes it a condition of relief that the employee was subject to a charge to income tax either in respect to the grant of the option or in respect to the gain realised on its exercise. Paragraph 14 would not be satisfied even though paragraph 1(1) would be in a case where an employee acquired shares on exercise of an option obtained by reason of employment but did not realise any gain. Secondly paragraph 1(1)(b) and paragraph 14 do different things. One imposes a condition that the option must be obtained by reason of employment. The second requires that the acquisition of the shares pursuant to the option should be a chargeable event in relation to the employee.

18. On the specific question of whether the deeming provision in s471(3) ITEPA could be mapped into a reading of Schedule 23, it could not. First, Schedule 23 had already been written and published before Schedule 22 (which introduced the ITEPA rules) had been drafted. Schedule 23 was drafted on the basis of the old provisions of ICTA 1988 which did not contain the deeming provision. Secondly, their wording is quite significantly different. The deeming provision in s471(3) provides that "a right or opportunity to acquire a securities option" which is "made available by a person's employer …" is to be regarded as "made available by reason of an employment of

that person". This wording is quite different from that contained in Schedule 23 and the deeming provisions in s471 are not therefore capable of applying to Schedule 23 because the words they extend do not even feature in the Schedule. Thirdly, Schedule 22 was however published before Schedule 23 was enacted. Mr Halford highlighted certain amendments which had been made to Schedule 23 to take account of some of the Part 7 ITEPA rules but the basic requirements in paragraph 1 of Schedule 23 were not amended to refer to s471. Specifically, the deeming provision was not expressly included and in Mr Halford's submission, it was inconceivable that the legislature would have relied on implication or an implied embedment to incorporate such a change.

Conclusions

19. We are dealing here with the one single issue, namely, whether in order for the Appellants to qualify for relief from corporation tax under Schedule 23 there has to be satisfied a condition that the option granted to Mr Ritchie was granted, as a matter of fact, by reason of his employment. We should say at this stage that both skeleton arguments and a major part of the submissions to us were put on the basis that we would also be considering the subsidiary issues which we referred to in paragraph 2. We have therefore in this decision tried to distil their arguments and focus on those which were central to the issue before us. We hope that the advocates will not therefore take it amiss that we have not included a number of their arguments and will accept that we have tried to do justice to those which we considered pertinent.

20. On the face of it, paragraph 1(1)(b) clearly provides for relief only where a person acquires an option "by reason of his … employment". Taken in isolation therefore this wording would debar the Appellants from qualifying relief as it is accepted that the option was not so acquired by Mr Ritchie. Mr James argued however that there should be read into Schedule 23 the deeming rule in s471(3) ITEPA and that is the crux of this appeal. Can and should this be done? We believe not and it is our view that this provision cannot be so incorporated and Schedule 23 should be read in its express and precise terms. We say this for the following reasons.

21. Schedule 23 and s471 address two different regimes. Schedule 23 provides a narrow and targeted relief by giving a corporation tax deduction to an employer where the employer has granted an employee a share award or option by reason of that employee's employment. The Part 7 ITEPA provisions are far reaching, widely drawn anti-avoidance measures. Section 471(1) states that the Chapter "applies to a securities option acquired by a person where the right or opportunity to acquire the securities option is available by reason of an employment of that person …". Section 471(3) specifies that the right or opportunity to acquire the option made available by the person's employer "is to be regarded for the purposes of subsection (1) as available by reason of an employment of that person …". This clearly specifies that the definition in s471(3) is to be so regarded for the purposes of subsection (1). There is nothing in this section which gives any grounds for importing that definition into Schedule 23. There is a defined limit to the deeming. It applies only for the purposes of subsection (1).

22. Neither is there in Schedule 23 any indication that it should be so incorporated or indeed any other similar deeming provision. Schedule 23 was written and published before Schedule 22. It was clearly therefore not intended as drafted that the deeming provisions be incorporated. They could not be because they had not then been devised. Schedule 23 was intended to apply in precisely the circumstances which are set out in paragraph 1. Mr Halford pointed out that subsequent amendments were made to Schedule 23 but this was not one of them. The legislators deliberately and expressly left paragraph 1 alone. If they had wished to widen the definition then would have been the opportunity to do it but they did not. It is not something which they would have overlooked and we share Mr Halford's view that it is inconceivable that the legislature would have left such a vital definition to implication. If it had been the intention that Schedule 23 should carry the wider meaning, we believe it would have been expressly stated. That it was not speaks for itself.

23. One cannot overlook the clear stated purpose of Schedule 23 which was to encourage employee share ownership and to encourage employees to take an interest in their employer company. This was the clear aim of Schedule 23 and to incorporate the wider definition suggested by Mr James, the nature of the Schedule would be radically altered. Its purpose would in fact, be negated.

24. We cannot accept Mr James' interpretation of the layout and structure of paragraphs 1 and 2 of Schedule 23. Paragraph 1(1) cannot be quite so easily written off or dismissed as merely an introduction and not containing any specific conditions or requirements. Paragraph 1 in fact is of critical importance because it sets out expressly the parameters of the scheme. It expressly states when relief is available. Schedule 23 applies where an option is acquired *by reason of an employee's employment*. There is nothing which we have heard to disturb that prerequisite. It is quite simply the foundation on which the Schedule rests. It is the employer's entry into the scheme. You don't even get as far as looking at the requirements for relief in paragraph 2 if paragraph 1 is not satisfied because if it is not, you do not fall within the Schedule.

25. Neither can we accept that paragraph 14, by implication embeds the wider definition into Schedule 23. Paragraph 14 provides the express requirement that there should have been a chargeable event in relation to the employee for the purposes of s476 ITEPA. It is quite specific and says nothing else expressly or impliedly. Whilst we accept that paragraph 14 will generally be satisfied where there has been a chargeable event in relation to the employee, we also accept Mr Halford's contention that they are two distinct requirements. Paragraph 1(1) requires the option to have been obtained by reason of employment. Paragraph 14 requires that there had been a chargeable event. That the two generally coincide does not render the second condition otiose. The mere reference to a s476 chargeable event does not bring s471 with it. Section 476 can function without s471(3) and whereas s471(2) has been expressly incorporated, s471(3) has not.

26. Mr James is clearly right, as indeed it sets out in the Explanatory Notes, paragraph 63, that the aim of Schedule 23 was to "match relief for the company with

the taxation of the income on the employee". As he contended a mirroring was clearly in the mind of the legislators. That is not to say however that the idea of the symmetry should rule all else. As Schedule 23 was originally drafted, there would more or less be a symmetry but that could never remain the case once you had the wide reaching anti-avoidance provisions on the one hand and the simple targeted narrow relief on the other. That however is just a consequence of the introduction of the anti- avoidance provisions. It does not mean that Schedule 23 should slavishly follow or have something read into it which is not there purely and simply to keep up the symmetry.

27. We feel that very little can be read into the HMRC Business Income Manual. That does little more than reiterate the provisions of paragraph 2.

28. It is our clear view that Schedule 23 should be read in its express and literal terms. There is a fundamental requirement in paragraph 1(1) that, for relief to be available, the option be obtained by reason of employment. Those words should be read literally and there is no justification in anything which we have heard to incorporate any wider meaning to them. The option has to be obtained, as a matter of fact, by reason of an employee's employment. The appeal therefore fails.

29. Whilst not being in any way determinative of our thinking or our decision, we do find support for our view in the Rewrite of Schedule 23 into s1015 Corporation Tax Act 2009. It was Mr James' contention that because s1015(1)(c) referred to the requirement of obtaining the shares because of the relevant employment, this implied that that had not been a precondition previously. In other words it had to be incorporated into the Rewrite because it was not a condition under Schedule 23. However, we take up Mr Halford's point that Rewrites do not change the law, except rarely and in the event that they do that will always be flagged up in footnotes to the relevant section. There is no such suggestion in s1015 and we take from that that the Rewrite did not change the law. It had always been the case that for corporation tax relief to be given, the option had to be acquired by the employee, as a matter of fact, by reason of his employment.

30. The appeal is dismissed.

31. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

LADY JUDITH MITTING
TRIBUNAL JUDGE

RELEASE DATE: 19 November 2013