TC03314

Appeal numbers: TC/2012/00573, TC/2012/00980 & TC/2012/01070

INCOME TAX — loss relief — admitted avoidance scheme — whether trade existed — no — if existed, when begun — whether manufactured payment representative of overseas dividend — no — whether payment an incidental cost of obtaining finance — no — scheme unsuccessful — whether if scheme succeeded it would fail on **Ramsay** *principles — yes — appeals dismissed*

FIRST-TIER TRIBUNAL
TAX CHAMBER

(1) EOGHAN FLANAGAN
(2) CHRISTOPHER DAVID MOYLES
(3) ALLAN STENNETT **Appellants**

- and –

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

TRIBUNAL: JUDGE COLIN BISHOPP

Sitting in public in London on 11, 12, 13, 14, 19 and 20 March 2013

Mr David Ewart QC and Ms Zizhen Yang, counsel, instructed by NT Advisors Limited, for the appellants

Ms Aparna Nathan, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The agreed statement of facts with which I was supplied provides a convenient summary of the background facts of these joined appeals. Slightly re-phrased, it is as follows:

> The three appellants all used a marketed tax avoidance scheme, known as "Working Wheels", promoted by NT Advisors Limited. The avoidance scheme was disclosed to HMRC's Anti-Avoidance Group, under the Disclosure of Tax Avoidance Schemes ("DOTAS") legislation in Part 7 of the Finance Act 2004, on 19 March 2007.
>
> HMRC acknowledged the disclosure on 30 April 2007 and allocated a tax avoidance scheme disclosure reference number to the scheme.
>
> The first appellant, Eoghan Flanagan, submitted his self-assessment tax return for the year ended 5 April 2007 on 15 January 2008. In that return, Mr Flanagan declared the following:
>
> (1) that he had used the scheme, quoting the DOTAS number and giving additional information about it in the "white space";
>
> (2) that during the year he had engaged in self-employment as a used car trader; and
>
> (3) that his turnover from the trade in used cars was nil, the cost of sales was £100, and he had incurred other finance costs and charges of £184 and £5,000,000 respectively, resulting in a total loss of £5,000,284.
>
> The second appellant, Christopher Moyles, declared in his self-assessment tax return for the year ended 5 April 2008:
>
> (1) that he had used the scheme, quoting the DOTAS number and giving additional information about it in the "white space";
>
> (2) that during the year he had engaged in self-employment as a used car trader; and
>
> (3) that his turnover from the trade in used cars was £3,731, that he had paid an interest charge of £63, the cost of goods sold was £3,827 and he had incurred other finance charges of £1,000,000, resulting in total loss of £1,000,159.
>
> The third appellant, Allan Stennett, declared in his self-assessment tax return for the year ended 5 April 2008:
>
> (1) that he had used the scheme, quoting the DOTAS number and giving additional information about it in the "white space";
>
> (2) that during the year he had engaged in self-employment as a used car trader; and
>
> (3) his turnover from the trade in used cars was £9,513, that he had paid bank interest of £141, total expenses of £9,564 and other finance charges of £14,500,000, resulting in total loss of £14,500,192.

2. The respondents opened enquiries into the appellants' returns and later issued closure notices which amended the returns. The effect of the amendments was, in essence, to disallow the loss claims. Each of the appellants has appealed against the conclusions stated in the closure notices and the amendments effected by them. The appellants are only three of about 450 users of the scheme (which has variants, such as dealing in watches or cash receivables). It is not disputed that the purpose of the scheme was to manufacture a tax loss much greater than any true economic loss at little or no financial risk to the user, whose exposure was limited to the cost of the promoters' fees and some other minor expenses. The loss was intended to be available by way of sideways relief against the users' general income or chargeable gains.

3. The principal issues which arise in the appeals are, first, whether each of the appellants was carrying on a trade in used cars during the relevant year of assessment and, second, whether in calculating the profits of that trade, if there was one, there should be allowed a deduction under s 58 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA") for the incidental costs of obtaining finance.

4. In summary, the appellants' position in respect of the first issue is based on the straightforward proposition that, as a matter of fact, they were buying and selling, and therefore trading in, used cars. The respondents' position is that there was no such trade in the relevant year, or any year; alternatively that if there was such a trade in any appellant's case it did not commence until a later year. As to the second, the appellants say that the expense was incurred, by the payment of a manufactured overseas dividend to the provider of a loan facility, as a necessary pre-condition for drawing down an advance under that facility, and that the amount advanced was used in the trade. HMRC's response is that the argument is flawed; the payment was not representative of the overseas dividend and consequently the provisions on which the appellants rely (to which I shall come later) are not engaged. In short, they say that the scheme does not work. As a further alternative, HMRC contend that the scheme was an abuse in the sense developed in *W T Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300 ("*Ramsay*").

5. I should add that legislation designed to prevent the use of schemes of this kind was introduced by the Finance Act 2008, which inserted ss 74A to 74D into the Income Tax Act 2007. That amendment does not affect these appellants, and what follows leaves the new sections out of account. There were, however some other differences between the legislative provisions relating to the two years with which I am concerned, which I shall describe later.

6. The appellants were represented by Mr David Ewart QC, leading Ms Zizhen Yang, and the respondents by Ms Aparna Nathan. I heard the oral evidence (in this order, though I shall describe their evidence in a more convenient sequence) of Mr Stennett; Mr Flanagan; Mr Derek Smith, a chartered accountant and chartered tax adviser who acted for Mr Moyles; Mrs Penelope Warneken, an employee of Masters Nominees Limited ("MNL"), which performed various administrative functions described below; Mr Matthew Jenner, one of the directors of NT Advisors Limited ("NTA") and a promoter and user of the scheme; Mr Simon Barre, formerly a director of a car dealership, Langrop Anstey

Limited, who undertook the buying and selling of some of the cars; Mr Richard Styrin, a director of Styrin Motors Limited, who performed the same function as Mr Barre; Mr Anthony Mehigan, also a director of NTA and a user of the scheme; Mr Simon Ballands, a chartered accountant based in Jersey who provided trustee services; and Mr Stuart Gower, an employee of SG Hambros Bank (Channel Islands) Limited ("SGH"), registered in Jersey, which provided finance for the scheme. All of them had made one or more witness statements. Mr Moyles too had made a brief witness statement, which I have read, but he did not give oral evidence. I was provided in addition with the statement of Dr Colin Masters, a solicitor and director of MNL, who also did not give oral evidence, and a considerable volume of documentation.

The scheme

7. Although the parties differ on the consequences of the arrangements into which each of the appellants entered, they do not disagree on the structure of the scheme. I adopt Mr Flanagan's implementation of it for illustration; details of the differences, which are of no significance for the outcome of the appeals, between his implementation and that of the other appellants follow.

8. The events relevant for present purposes began on 12 March 2007, when Mr Mehigan sent to Mr Flanagan an email, attached to which were several documents which he was required to sign and return. These were:

(a) A letter of engagement with NTA and TSB Holdings Ltd ("TSB") headed "Income Tax Planning". TSB, a company registered in the British Virgin Islands ("BVI") though Singapore-based is or was apparently independent of NTA and it seems it was this company, with Mr Jenner and Mr Mehigan, which had devised the scheme. Among other things, the letter set out the fees payable by Mr Flanagan to NTA for the implementation of the scheme, which comprised two elements, a non-contingent fee and a contingent fee. The non-contingent fee, payable immediately, was 5% (though certain other costs of no present importance could be deducted from it) of the "Sheltered Amount", which was equivalent to a "Loan Finance Fee" of, in Mr Flanagan's case, £5 million. The contingent fee was fixed at 2% of the sheltered amount and was payable, in effect, when HMRC had allowed the relief Mr Flanagan was seeking or their challenge to the claim had failed. In other words, NTA received 5% in any event, and an additional 2% if the scheme worked. Mr Mehigan asked Mr Flanagan to transfer the non-contingent fee—5% of £5 million, or £250,000—to NTA's account.

(b) A letter appointing NT Advisors (Ancillary) Limited ("NTAA") to act as his agent with authority to enter into an agreement for a trade loan and to deal on his behalf with the money borrowed.

(c) A Trade Loan Application Letter, addressed to Courland Holdings Limited ("Courland"), also a BVI company, by which Mr Flanagan applied for a term loan facility for a maximum of £5 million "to assist with any payment I am required to make to Philario Enterprises Limited" ("Philario"). Philario was a wholly-owned subsidiary of Courland and was also registered in the BVI.

(d) A Repayment Loan Application Letter, addressed to SGH, applying for a term loan facility for a maximum sum of £5 million "to assist with the repayment of any loan I may (or may have) obtained from Courland Holdings Limited".

(e) A "Power of Attorney – Bare Trustee", by which Mr Flanagan appointed Mr Jenner and Mr Mehigan to act as his attorneys in respect of a bare trust, defined as "any trust whatsoever of which I am (or it is proposed that I will become) a beneficiary entitled to at least 95% of that trust's trust assets"; the Bare Trustee was the trustee from time to time of that trust. The power of attorney expressly instructed the attorneys that "any monies due to me from such Bare Trustee to be used wholly or in part to repay any liabilities of mine with SG Hambros Bank (Channel Islands) Limited or other lenders."

(f) A letter to NTA, confirming that the monies to be paid by Mr Flanagan into the NTA "Holding Account" were to be disbursed by NTA, on his behalf and without further reference to or authority from him, in the making of various identified payments, including loan arrangement fees payable to Courland or SGH, interest on the loans, the repayment of part of the loans outstanding at any time, NTA's and TSB's fees, and various miscellaneous items of no present importance.

(g) A "Power of Attorney — Joint Arrangement", also appointing Mr Jenner and Mr Mehigan as Mr Flanagan's attorneys, in this case authorised to sign any document "in relation to the Joint Arrangement Agreement to be entered into during March 2007 between myself, Working Wheels Admin Limited and Working Wheels BTC Limited". I come to that agreement at para 18 below. Working Wheels Admin Limited ("WW Admin") and Working Wheels BTC Limited ("WW BTC") are or were special-purpose companies which performed various functions in the scheme arrangements.

(h) A further letter to NTA, confirming Mr Flanagan's willingness "to borrow funds to be employed (via the contribution of cars) in a joint arrangement with Working Wheels Admin Limited (amongst others)".

(i) A "Power of Attorney – Main" which appointed Mr Jenner, Mr Mehigan and NTA, jointly and severally, as his attorneys with authority to execute documents relating to, in particular, Mr Flanagan's loan facility agreement with Philario.

9. On 14 March 2007 Mr Jenner, as Mr Flanagan's attorney, engaged MNL as his bare trustee in respect of his loans from SGH or any other lender. Two days later, Mr Flanagan transferred £225,000 to NTA's Holding Account. I assume that the amount paid was less than the amount requested because of the permissible deductions to which I have referred. SGH then made a loan facility offer to Greenleaf Finance Limited ("Greenleaf"), for an aggregate principal amount not exceeding £790,000. Greenleaf was, I was told, wholly owned by the Sovereign Charitable Trust, a Jersey-based charitable trust. The purpose of the facility was to enable Greenleaf to acquire £790,000 Redeemable 2007 Loan Notes ("the 2007 Notes"), issued by Vanderveer Investing Limited ("Vanderveer"), also a BVI-registered company. Vanderveer was also owned by a Jersey-based charitable

trust. Any advance under the loan facility was to be made only to a specified SGH account of Vanderveer.

10. On the same day SGH offered a loan facility to Courland, for an aggregate principal amount not exceeding £40,155,000. The purpose of the facility was, the offer stated, to enable Courland itself to make a loan to NTAA, as agent for and on behalf of each of a number of persons. They were, in summary, persons identified to SGH and listed in a schedule to the offer who, on or about the same day, each entered into a joint arrangement agreement with WW Admin. Mr Flanagan was one of the persons listed in the schedule. The underlying purpose, as the facility made clear, was that the person concerned would use the money advanced to him "in the payment of a manufactured overseas payment to Philario". Mr Flanagan incurred the obligation to make such a payment in accordance with a loan agreement to which I shall come very shortly. The money could be used only for that purpose, and had to be paid into an identified SGH account of Philario.

11. The boards of Courland, Philario, Vanderveer and Greenleaf immediately passed resolutions the effect of which was to approve the execution of various documents by which the loan arrangements were implemented. Those documents, with only two of which I need to deal in any detail, were then executed and the funds became available. Of the two documents I need to describe the first was a certificate issued by Vanderveer showing that Greenleaf was the registered holder of £7,500 of the 2007 Notes. In later documents they were referred to as "the Debt Securities", a term I shall adopt. The second document was an instrument by which Greenleaf lent the Debt Securities to Mr Flanagan, to which I shall return at para 22 below.

12. Also on 16 March, Mr Flanagan and Philario entered into a loan agreement which incorporated a deed of charge over securities. By this agreement, Philario offered to Mr Flanagan a loan facility of the greater of either £3,000 or the aggregate of the face value of the Debt Securities and the value (as determined by Philario) of any securities other than the Debt Securities which Philario agreed to accept from Mr Flanagan as additional security, subject to a maximum amount of £5 million. The loan was to be interest-bearing. The advance would not become available until the Debt Securities had been transferred, *cum div*, to Philario, Philario had received a certificate confirming that the loan was to be used in Mr Flanagan's trade pursuant to the joint arrangement agreement with WW Admin, and the payment (the manufactured overseas payment to which the facility referred) due from Mr Flanagan had been received by Philario. The advance had to be paid into Mr Flanagan's sub-account in a specified SGH account of WW BTC, to be held by WW BTC as Mr Flanagan's trustee.

13. Clause 2.3 of the loan agreement contained the trigger for the manufactured overseas payment. It was in these terms:

> "2.3 Manufactured Overseas Dividend
>
> (a) If an Interest Amount is paid during the Deferred Transfer Period, the Trader shall pay to the Lender an amount representative of that Interest Amount.

(b) In order to discharge its obligation under clause 2.3(a) above, The Trader shall pay to the Lender on the Security Transfer Date an amount calculated as the product (that is, the multiplication) of:

(1) the Interest Amount

and

(2) 81,111.11

such resultant amount being the 'Manufactured Overseas Dividend', being a payment for the account of the Lender absolutely (both legally and beneficially) free from any encumbrance or any security rights of the Trader."

14. "Interest Amount" had a somewhat convoluted definition, but in essence it meant Mr Flanagan's share of the amount of interest paid or payable by Vanderveer to Greenleaf on the 2007 Notes. The "Deferred Transfer Period" was the period between the date of the loan agreement (16 March) and the transfer of the Debt Securities to Philario (19 March). The interest was also paid on 19 March. Whether it was, as a matter of fact, paid before the transfer of the Debt Securities to Philario is unclear since, although the copy documents produced to me are dated, they are not timed. However, as the clause contemplates payment of the interest before transfer of the securities (and the efficacy of the scheme depends on it) I shall assume in the absence of evidence to the contrary that payment preceded transfer.

15. The interest paid on the entire £790,000 of the 2007 Notes was £6,493. Mr Flanagan's share of that interest, that is the amount attributable to the Debt Securities to be allotted to him, with a face value of £7,500, was £61.64. Clause 2.3, however, obliged him to pay to Philario that sum multiplied by 81,111.11, or almost exactly £5 million. For reasons which neither Mr Jenner nor Mr Mehigan was able to explain, the arithmetical relation between the face value of the Debt Securities allotted to each participant and the amount of the loss he or she wished to generate differed, as did the multiplier. However, in every case the multiplier, which was invariably a very large number, was so determined that the product of the user's share of the interest and the multiplier was always equivalent to the desired loss.

16. In accordance with the arrangements described at para 10 above, Courland then offered a loan facility to NTAA, as agent for each of the relevant participants in the scheme. As will be apparent, several participants ("Traders" in this context), including Mr Flanagan, entered into the scheme at the same time. The facility offered was for an amount of up to £40,155,000—that is, the same amount in respect of which Courland had secured the facility with SGH. The offer stipulated that the loan proceeds were to be used by each of the Traders only in order to pay the manufactured overseas dividend due from him to Philario. There were provisions for repayment to which I return at para 27 below.

17. Courland undertook with NTAA (in its capacity as the Traders' agent) that if, while any part of the advance to a Trader was outstanding, Philario received a manufactured payment from that Trader in accordance with the agreement between them, in an amount equal to at least 99% of the aggregate amount owed by the Trader to Courland, Courland would assign all its rights in respect of the

advance to any person the Trader might nominate, or to his bare trustee. The rather unusual consideration for that assignment was to consist of the payment of £100, and attendance by the assignee before a solicitor practising in London in order to recite the name of the Trader, "pray to the God of the Christian church for World Peace" and obtain from the no doubt bemused solicitor a certificate that those actions had been performed ("the Prayer Condition").

18. WW Admin, WW BTC and Mr Flanagan then entered into the joint arrangement agreement to which I have already referred. It provided that Mr Flanagan and WW Admin were to enter into a joint venture to trade in used cars: WW Admin was to contribute administrative services and Mr Flanagan was to contribute the stock of used cars, or the benefit of certain options to purchase used cars, for which purpose WW BTC was to act as his bare trustee. He was in addition to issue various instructions about the buying and selling of cars when necessary. WW Admin's obligations were to employ sales managers to undertake the trade in used cars, to secure licences to use parking and office premises, and to purchase a motor trader's combined insurance policy from an insurer. Further agreements with Mr Barre and his company, Langrop (Anstey) Limited ("Langrop") secured Mr Barre's services as sales manager at an annual salary of £30,000 and a licence to occupy Langrop's forecourt (in common with Langrop) for a monthly fee of £100. WW Admin obtained a suitable insurance policy from Allianz Cornhill for a premium of £5,548.23. It is agreed that all those sums have been paid. As I understand the matter, the cost has been borne by NTA.

19. WW BTC, as Mr Flanagan's bare trustee, entered into an option agreement with Langrop pursuant to which, in return for consideration of £100, Langrop granted to WW BTC two options, each to buy a used car with a maximum cost of £8,000. A further condition of the option agreement was that, within 5 days of its date (also 16 March), WW BTC was to pay to WW Admin the sum of at least £7,500, to be held by WW Admin as a deposit in respect of WW BTC's obligations under the option agreement. The appellants' case is that as WW BTC was a bare trustee, the obligations were in reality and substance Mr Flanagan's.

20. On 19 March 2007 MNL declared a bare trust ("the EF Bare Trust") the assets of which were to be held as to 99% for Mr Flanagan. The sum of £100 was paid in—it was not clear to me by whom—as the initial trust fund.

21. On the same day, Vanderveer offered a loan facility to Philario for an amount not exceeding £85,000. The stated purpose of the loan was to enable Philario to make the advances requested by Traders, including Mr Flanagan, pursuant to the loan agreement between Philario and each Trader. The £85,000 could be paid only to a specified Philario account with SGH. Mr Flanagan's share of that sum was £7,500.

22. Greenleaf and Mr Flanagan entered into an agreement setting out the terms and conditions on which the Debt Securities would be lent by Greenleaf to Mr Flanagan: Mr Flanagan was to pay a cash collateral of £7,500, and the redelivery date of equivalent securities was to be 14 May 2007. Mr Flanagan paid the collateral of £7,500, and Greenleaf thereupon executed an instrument transferring all its rights, title and interest in the Debt Securities to Mr Flanagan. Vanderveer issued a certificate identifying Mr Flanagan as the registered holder of the Debt

Securities. Mr Flanagan immediately transferred the Debt Securities to Philario, and Vanderveer issued a further certificate identifying Philario as the registered holder.

23. Courland then issued a drawdown notice to SGH, requesting payment of the entirety of the advance of £40,155,000 for which the loan facility offered on 16 March provided. Courland paid the requisite arrangement fee of £184,300. NTAA, as agent for the Traders including Mr Flanagan, issued a drawdown notice to Courland requesting advances in accordance with their respective loan agreements (in the form described at para 12 above). An advance of £5 million was requested in respect of Mr Flanagan. NTAA paid Courland an arrangement fee of £200,775.

24. Courland then credited Philario's bank account with £40,155,000. That credit represented the combined effect of SGH's loan to Courland of £40,155,000, Courland's loan of the same amount to NTAA as agent for the Traders, and the aggregate of the manufactured payments due from the Traders to Philario in accordance with their respective loan agreements. The aggregate payment included the £5 million which Mr Flanagan was required to pay.

25. Philario's board immediately approved the declaration and payment to Courland of a dividend of £40,136,879. SGH was instructed to make the dividend payment from Philario's account to Courland's account, and the payment was duly made (in the sense that SGH recorded a transfer from one account to the other). Courland forthwith repaid the loan of £40,155,000 SGH had made to it earlier the same day. In reality, the money simply passed from one SGH account to another, never leaving SGH's control.

26. On the following day, 20 March, Philario issued a drawdown notice to Vanderveer pursuant to the loan facility granted on the preceding day, for the whole amount of £85,000, and paid the prescribed arrangement fee of £2,494. Vanderveer instructed SGH to transfer the £85,000 from its account to Philario's account, and that was duly done. At the same time, Mr Flanagan issued a drawdown notice to Philario in respect of the loan of £7,500 agreed on 16 March (again, the agreement described at para 12). The drawdown notice stipulated that the loan proceeds were to be used wholly and exclusively by Mr Flanagan in his trade. Philario instructed SGH to transfer £7,500 from its account to WW BTC's account, in order that WW BTC could hold the money on trust for Mr Flanagan, as the agreement provided. That transfer, too, was duly made. The money was used by Mr Flanagan to pay the £7,500 deposit required by the option agreement (see para 19 above) to WW Admin.

27. Then, in accordance with the terms of the loan facility agreement by which Courland had offered a total of £40,155,000 to NTAA as agent for the Traders (see para 16 above), and in consideration of a payment of £100 from the EF Bare Trust, Courland assigned to MNL (as trustee of the EF Bare Trust) all of Courland's rights in the loan of £5,000,000 to Mr Flanagan. Courland gave notice of that assignment to Mr Flanagan.

28. Immediately thereafter SGH offered a loan facility offer to NTAA (again as agent for each of the Traders, including Mr Flanagan) for a maximum amount of £40,155,000 in aggregate, of which £5 million related to Mr Flanagan. The stated

purpose of the loan was to enable the Traders to repay the loans they had obtained from Courland. NTAA, as Mr Flanagan's agent, instructed SGH to advance £5 million to MNL, as trustee of the EF Bare Trust, in order that Mr Flanagan could repay the loan from Courland which had just been assigned to MNL. NTAA paid an arrangement fee of £217,250 to SGH. The £5 million was duly transferred. NTA then instructed SGH to debit £50,000 from an NTA holding account, designated for Mr Flanagan, as part repayment of the £5 million loan which had been drawn down earlier in the day. Mr Mehigan, as Mr Flanagan's attorney, instructed MNL to use the £5 million repayment of the Courland loan to repay the balance of the £5 million loan from SGH, and to transfer the remaining £50,000 (representing 1% of the sum assigned to MNL) to "Beneficiary B" of the EF Bare Trust.

29. MNL issued appropriate instructions to SGH: £4,950,000 was duly withdrawn from MNL's EF Bare Trust sub-account to repay the balance of the SGH loan, and £50,000 was withdrawn from the same account and paid to Beneficiary B. In Mr Flanagan's case Beneficiary B was "S G Hambros Trust Company (Channel Islands) Limited as trustee of the John A Mehigan 2006-01 Life Interest Trust".

30. On 26 March Mr Masters and Mrs Warneken, on behalf of MNL, which in turn was acting as trustee of the EF Bare Trust, duly performed the Prayer Condition as the consideration for the assignment from Courland of its rights in respect of the £5 million loan to Mr Flanagan.

31. On 4 April 2007, Langrop, WW BTC and Mr Mehigan entered into a Master Agreement providing for Langrop to sell and WW BTC to buy (on behalf of Mr Mehigan) certain used cars. Although he was described in it as the "principal", in fact Mr Mehigan entered into the Master Agreement as agent for a number of participants in the Working Wheels scheme, including Mr Flanagan.

32. There were no further relevant events until 14 May 2007, when Philario's board of directors agreed, after receiving a guarantee from NTA, that its loan of £7,500 to Mr Flanagan could remain outstanding notwithstanding the discharge of the security for the loan (that is, the Debt Securities). Philario transferred all its rights in the Debt Securities to Mr Flanagan, and Vanderveer issued a certificate identifying Mr Flanagan as their registered holder. Mr Flanagan immediately transferred all his rights in the Debt Securities to Greenleaf, and Vanderveer issued another certificate, identifying Greenleaf as the registered holder.

33. Greenleaf borrowed £790,000 from NTA in order to fund the repayment of their collateral to the Traders; Mr Flanagan's collateral (equalling the deposit payable pursuant to the option agreement with Langrop—see para 19 above) was £7,500. The collateral repayments were duly made, by crediting NTA's Holding Account.

34. On the following day, Vanderveer borrowed £796,277 from NTA in order to fund the redemption of the 2007 Notes, together with interest. Greenleaf, as I have related, was by then the registered holder and its account was credited with £796,277 transferred from Vanderveer's account. Greenleaf repaid the £790,000 loan from NTA which it had taken on the previous day.

35. The flows of money and securities are very well illustrated by a chart provided by counsel, a copy of which is annexed to this decision. I repeat the note of caution that it is not entirely clear in what order the events occurred. However, what the chart clearly shows is that, in Mr Flanagan's case, there were in fact two distinct flows, one of the £7,500 (part of the aggregate of £790,000) initially lent by SGH to Greenleaf which found its way via Vanderveer and Philario to Mr Flanagan and was used by him in his trade (or, if HMRC are right, purported trade) in cars; and the other, in two "loops", of the £5 million (part of the aggregate of £40,155,000): in the first from SGH via Courland to Mr Flanagan, before passing from Mr Flanagan via Philario and Courland and back to SGH; and in the second from SGH to Mr Flanagan and, via his bare trust, back to SGH. The link between the two flows lies in steps 7 and 10, as they are identified in the chart: the payment of interest by Vanderveer to Greenleaf at step 7 was the trigger for the payment of the manufactured overseas dividend and the irregular payment at step 10.

36. In his return for the 2006-07 tax year Mr Flanagan stated that on 16 March 2007 he began to trade in buying and selling used cars, that the cost of sales, in the purchase of cars for resale, amounted to £100, but that his turnover in the year was nil as no cars had been sold. He had incurred, he said, interest of £184 and other finance charges of £5 million. He claimed a loss of the aggregate of those sums, £5,000,284, in the year from his trade. His total income from other sources, principally an investment management business in which he was a partner, was disclosed as £5,902,112. He claimed relief for the loss in the car trade against that income.

37. In his return for the following year, 2007-08, Mr Flanagan stated that his turnover in used cars was £15,000, with costs of sales amounting to £14,900. His gross profit from the trading activity was therefore £100. The pattern was similar in the following years: in 2008-09 turnover in sales of used cars amounted to £7,245, with costs of sales amounting to £7,187, leaving a gross profit of £58; and in 2009-10 turnover was £13,822, cost of sales £13,756 and gross profit £66. In all those years he also disclosed substantial income from other activities.

38. In June 2007 Mr Stennett entered into a similar arrangement. The dealer which provided forecourt facilities was Styrin Motors Ltd, and it was Mr Styrin who was appointed as sales manager. The role of NTAA was taken by Masters Tax LLP, and Mrs Warneken and Ms Jinnie Strydom replaced Mr Mehigan and Mr Jenner as Mr Stennett's attorneys. Greenleaf and Vanderveer took the same parts, but Courland's position was taken instead by Pennistone Limited, a BVI company which I was told was owned by a charitable trust, and Pennistone's wholly-owned subsidiary, Tiziana Assets Limited, also a BVI company, replaced Philario. There were some minor differences in the documentation and amounts (in Mr Stennett's case the advance was £14.5 million and the deposit £10,000) but the essential nature of the scheme was the same. Mr Moyles entered into another iteration of the scheme in November and December 2007. There were some further changes of participants but, again, the arrangement was essentially identical. The advance in Mr Moyles' case was £1 million and the deposit £5,000. In their tax returns Mr Stennett and Mr Moyles made statements similar to those made by Mr Flanagan, although of course the figures and other details differed.

Copies of the helpful charts prepared by counsel showing the flows in their cases are also annexed to this decision.

39. I mention, though only for completeness, that there was some question during the course of the hearing whether the schemes had been correctly implemented, in that it seemed that some of the necessary documents had not been signed, or had been signed with important details missing or incorrectly inserted. Mrs Warneken in particular assured me that the documents had all been correctly prepared, and that she had taken care to ensure that they were. Ms Nathan did not, in fact, press the point in closing, and I proceed upon the basis that the relevant documents were all correctly executed, or at least that any omissions or errors are insignificant.

The witnesses' evidence

40. Mr Stennett made no secret of the fact that his purpose in entering into the scheme was to reduce his liability to tax. In his witness statement he said that he "wished to seek to potentially make a tax loss equal to £14,500,000 and so I would require a loan sufficient to have an obligation which would be treated as a tax deductible fee of about £14,500,000." It is quite clear from both that statement and from his oral evidence that he took no real interest in the car dealing; indeed it was important to him that it involved him in no time commitment. Thus he did not concern himself with, or have any input into decisions about, the nature of the cars bought and sold, or indeed with any detail of what was done, and he did not even know whether or not his trading in any given year had resulted in a profit or loss. He agreed that he had put in money at the outset, but knew that he would not have to put in any more whatever the success or otherwise of the trading. He also had very little understanding of the structure of the scheme—in essence he merely followed the advice of his financial advisers, and signed the documents he was asked to sign.

41. He did say that he was concerned when the scheme was first described to him about the risk that he might be exposed to repayment of the loan but was reassured by the existence of leading counsel's opinion on the efficacy and lawfulness of the scheme, and by what he was told by his advisers, and regarded the risk as slight and acceptable. The risk was, in reality, non-existent.

42. When asked why he had not simply invested £10,000 (the amount of the deposit in his case) in a car business, but had instead incurred fees (that is, the fees payable to NTA) in the order of £460,000, he answered, very candidly, that he had entered into what he emphasised was a lawful tax avoidance scheme. He accepted that the loss he had "suffered" was neither genuine nor commercially driven.

43. Mr Flanagan, too, was open about his motives—he had, he said, looked around for a tax avoidance scheme in conjunction with his financial advisers, and had rejected several schemes because he did not feel comfortable with them. He chose this scheme because of the favourable opinion of leading counsel, and because he too received reassurances from his advisers about the extent of his exposure to risk, which he recognised to be very limited. He had what he described as a layman's understanding of the scheme, as he had seen a slideshow presentation of it, but like Mr Stennett he took no interest and played no part in

the trading activities, and was indifferent about whether or not they were profitable; the £7,500 he had injected was money he was quite willing to lose as it was a small sum in comparison with the potential tax saving, and he knew he would not have to inject more. He agreed that the size of the loan he took was dictated solely by the scale of the tax deduction he wished to achieve, and had no commercial rationale. He accepted too that he could easily have paid the £7,500 used as a deposit without any borrowing.

44. Mr Moyles, as I have said, did not give oral evidence, and I had from him only a very brief and rather uninformative statement. It is however quite clear from the statement that he, too, entered the scheme for no purpose other than to achieve a tax saving, and that he took no interest in the trade. His evidence was supplemented by that of Mr Smith, his accountant and tax adviser, who evidently did have some understanding of the workings of the scheme. He agreed that it had no real purpose other than a saving of tax, and that Mr Moyles entered into it on that basis. He was not concerned, said Mr Smith, about the risk that he would be exposed to a large borrowing, but was anxious to be reassured that the scheme was lawful, and that he would not have to undertake any trading himself. He agreed that the scale of Mr Moyles' borrowing was driven solely by the amount of the tax loss he wanted to achieve, in his case £1 million, and that the trading was not carried on for its own sake but was merely a means to an end; this was not, he agreed, a commercial means of borrowing for the purposes of an intended trade. I had no direct evidence that Mr Moyles could provide a deposit of £5,000, as it was in his case, without borrowing, but as he paid fees of £95,000 from a bank account in his name it is an obvious inference that he could have done.

45. Mrs Warneken's evidence related primarily to the execution of the various documents and, as I have accepted that any errors or omissions were inconsequential, there is no purpose in my setting that part of her evidence out in detail. She had, however, another role, in that she was one of the attorneys in some iterations, and charged with the task of overseeing the trading activities. She told me she was initially worried, not least for her own reputation, about her responsibilities, particularly as she had no experience of trading in cars, but became reassured after a short time as it became apparent that the trading was proceeding smoothly. The day to day organisation of the trading was delegated to Mr Mehigan once Mrs Warneken was satisfied that he was capable of it, but she said she would have intervened had there been any need to do so. She told me that a few of the participants in the scheme asked about the trading (I had the impression the enquiries were rather casual) but, as I have said, none of the appellants took any interest in it.

46. Mr Jenner described the structure of the scheme, but as I have dealt with that topic elsewhere there is no need to set out his evidence about it. He added that there were some differences between the scheme on which leading counsel had provided his opinion and the scheme as implemented, in particular in that it was originally intended that there would be two lenders rather than one, but said he could not recall why those changes had occurred. It does not seem to me that they are significant, since I must consider the scheme as it was, and not as it might have been. He readily accepted that none of the participants had made the manufactured payment from their own resources, that none had truly suffered any

loss, and that the only reason the participants had made a very large payment in order to obtain a much smaller borrowing which they did not need was that they had entered into a tax avoidance scheme, and that was the way in which the scheme worked.

47. The risk that any participant would be required to repay the large borrowing from his own resources was negligible since SGH maintained control over the money and the security for it at every stage—the money was always kept in one or another SGH account, and the agreements with SGH provided that the borrowed money could be used only for the stated purpose.

48. Mr Jenner was taken to various provisions of the agreements which imposed, or appeared to impose, obligations on the participants to engage in trade in cars, and to do so actively. He accepted that in reality none of the participants had engaged actively in any aspect of the car dealing (and such actions as they needed to take would be undertaken for them by their attorneys) but maintained that any of them could have done had he wished. In practice, as he agreed, WW BTC received lists of cars bought and sold by the dealers and allocated them to the participants, without any reference to them.

49. Mr Mehigan, like Mr Jenner, was candid about the true purpose of the scheme, and open about its mechanics. In his witness statements (he made one in each appeal, in very similar terms) he said this:

> "The plan relied on combining 2 rules in the tax code in a novel way. Under the detailed rules on stock lending in Schedule 23A ICTA where a taxpayer paid an amount as a 'manufactured dividend' that was much larger than the actual dividend it represented, an anti-avoidance rule in paragraph 7 thereof mandated that it was not to be a manufactured dividend (which might be tax deductible) and instead was to be treated as a fee. The rule confirmed that the amount was a fee for 'all purposes of the Tax Acts …'.
>
> So long as the client taxpayer who paid the fee was trading we could then come within section 58 ITTOIA and the fee would be tax deductible. It was crucial also that section 58 replaced the usual tax deductibility test (being 'wholly and exclusively for the purposes of the trade') with a much wider test which was easier to satisfy (being 'wholly and exclusively for the purpose of obtaining finance'). Therefore the size of the fee did not have to be commensurate with the scale of the trading activities, so the fee could be very large."

50. Mr Mehigan acknowledged that the borrowed money—in Mr Flanagan's case the £5 million—went round in a circle, and that Courland, Philario, Greenleaf and Vanderveer (and their equivalents in other cases) were special purpose vehicles brought into existence for no reason other than to participate in the scheme arrangements.

51. Mr Mehigan had no experience in the motor trade and recognised before the scheme was first implemented that it would be necessary to enlist the help of established motor dealers. He also recognised that in practice the dealers would handle all of the buying and selling, and that it was very unlikely that any participant in the scheme would wish to undertake the activity himself. He accepted that none of the options had ever been exercised, and that instead WW

BTC had simply told each dealer how many cars were required in any given period. He had concluded, he said, that the options were an unnecessary complication. He concurred in Mr Jenner’s evidence that when the weekly sales lists arrived, the cars listed were allocated in his office to scheme users, without reference to them at the end of each tax year, and they found out which cars they were to be regarded as having bought and sold only then. He accepted that, because the dealers did not know the identity of the scheme users to whom the cars were to be allocated, they issued sales invoices in the name of WW BTC; he thought that an acceptable way of running the trade. He also agreed that none of the profits of the trading had ever been paid to participants, but said that he would pay it if it was requested.

52. Nevertheless, he would not accept that this was a pure tax avoidance scheme, even though he acknowledged that the participants entered into it for that reason; they were, he maintained, engaged in genuine trade.

53. Evidence about the manner in which the cars were bought and sold came from Mr Barre and Mr Styrin. Each had met Mr Mehigan in early 2007, and had agreed at his request to participate in the scheme by supplying the service of buying and selling used cars. Each knew that they were doing so as part of a tax avoidance scheme, though neither understood how the scheme worked—they knew only that trading in cars formed a part of it. Each took professional advice before agreeing to Mr Mehigan’s request. From their perspective, participation represented a business opportunity, a way of earning additional money; it does not seem to me from the description which follows that participation could have led to a significant, or indeed any, increase in volumes of trade. The financial benefit to Mr Barre and Mr Styrin lay, instead, in the salaries they received from WW BTC.

54. Mr Barre explained that on 16 March 2007 he had entered into a large number of option agreements by which more than 100 individuals, all participants in the scheme (among them Mr Flanagan), were granted an option to buy two cars. In fact, as Mr Mehigan had said, none of the options was ever exercised. Instead, the cars, typically but not invariably of low value, were sold by Mr Barre to WW BTC at cost price, and then sold, on behalf of WW BTC, to a customer. Only Mr Barre undertook the sales and purchases—he did not involve his company’s staff—and no part of his company’s premises was set aside for WW BTC business (nor, of course, for the business of any individual participant).

55. The number of cars bought and sold was dictated by Mr Mehigan. Most commonly the purchaser of the car was another trader, since by that means the need to provide a warranty could be avoided. There was always a small profit, typically £100 but sometimes less, which was passed to WW BTC. The loss of the profit which would otherwise have accrued to the dealership was of no lasting concern since a side agreement, or understanding, between Mr Barre and Mr Mehigan provided for the payment by Mr Mehigan to Mr Barre of an equivalent sum to the foregone profit. Mr Mehigan told us that the money came from the fees payable by the participants, and the payment was effectively an expense borne by NTA. WW BTC never queried the prices of the cars, and seemed interested only in the margins. Mr Barre provided a weekly spreadsheet of purchases and sales (the list to which Mr Jenner and Mr Mehigan had referred) which was sent to WW

BTC; the spreadsheet did not allocate the cars to individual scheme users—Mr Barre did not know their identity, and it was not communicated to him after the cars had been allocated. He ceased to participate in September 2008 because, it seems, he could not offer a sufficient volume of suitable cars.

56. There were a few differences, most it seems of little significance, in the manner in which Mr Styrin bought and sold cars. The one difference which appears to me to be of importance is that in some cases the car was sold to a retail customer, in which case a warranty was provided by Styrin Motors Ltd, in exactly the same form as a warranty supplied to a customer of the company. If there was a claim on the warranty, Styrin Motors Ltd dealt with it, without cost to WW BTC. The accounting system was also administered differently but the effect was the same—Mr Styrin paid the net profit to WW BTC (which he too said was interested only in the margin) and received reimbursement of the same amount, to make up the profit otherwise foregone. He also bought and sold as many cars as WW BTC required, and did not know the identities of the scheme users.

57. Mr Ballands is a director of Plectron Trust Company Ltd, which is licensed by the Jersey authorities to undertake trust company business. At the relevant time he was also a director of numerous companies, including Philario, Greenleaf, Courland, Vanderveer and their equivalents in the other iterations of the scheme; they had been formed, and were used, only in the scheme. Mr Ballands said that he and his firm undertook little tax avoidance work but that he had agreed to participate at the request of Mr Gower of SGH, when SGH discovered that the trust company it customarily used had a conflict of interest. He was keen to satisfy himself that the scheme was lawful and free of risk, and did so, and also took comfort from the fact that SGH was participating.

58. He accepted that none of the companies needed to borrow funds, that the borrowings had no commercial basis and that the loan notes were created for no reason other than to facilitate some stock lending for the purposes of the scheme. He also agreed that the large borrowings simply went round in a circle, never leaving SGH's control, that SGH was therefore fully protected, and that there was no risk that the special purpose companies would suffer losses since their liabilities were always exactly matched by assets.

59. Mr Ballands' role, as it emerged, was to do little more than execute large numbers of documents which were provided to him. I accept that he understood their purpose and meaning, and satisfied himself that each was appropriate before he executed it, and I intend him no disrespect in saying that, despite his understanding, in truth he was no more than a functionary.

60. Mr Gower was, at the material time, the head of SGH's offshore tax services department. In early 2007 he was approached by NTA, which proposed the Working Wheels scheme as one in which SGH might participate. SGH agreed to do so, having satisfied itself that there was no potential leakage—that is to say, the funds put into the scheme by SGH would not, in fact, actually leave its hands—and Mr Gower executed the necessary documents on SGH's behalf. I am satisfied that he understood the scheme and the documents he signed. I also record for completeness that I accept that SGH undertook appropriate "know your client"

enquiries about the individual participants, although neither Mr Gower nor Mr Ballands ever met any of them.

The claimed tax consequences

61. The essence of the appellants' case is that in the relevant years of assessment, 2006-07 for Mr Flanagan and 2007-08 for Mr Moyles and Mr Stennett:

(a) each of them had commenced and carried on a trade in used cars, before paying the irregular payment;

(b) that they each made that payment to the lender—Philario in Mr Flanagan's implementation—pursuant to the terms of the loan agreement between the lender and the appellant;

(c) that the excess of the irregular payment over the interest whose payment triggered it is to be treated, in accordance with para 7(1) of Sch 23A to the Income and Corporation Taxes Act 1988 ("ICTA") (for the tax year 2006-07) or s 583 of ITA 2007 (for the tax year 2007-08), as a separate fee for entering into the loan with the lender; and

(d) by application of s 58 of ITTOIA, the fee is an incidental cost of obtaining finance and, therefore, deductible for that year of assessment in computing the profits of the trade carried on by each appellant.

62. I set out the relevant legislation at this stage, for ease of reference. The relieving provisions on which the appellants rely are either s 380 of ICTA (since re-written to ITA 2007) or s 261B of the Taxation of Chargeable Gains Act 1992 but as nothing turns on them for present purposes I do not need to deal with them. The starting point for the appellants' case is ITTOIA s 58, which is entitled "Incidental costs of obtaining finance", and is in these terms:

> "(1) In calculating the profits of a trade, a deduction is allowed for incidental costs of obtaining finance by means of–
>
> (a) a loan, or
>
> (b) the issue of loan stock,
>
> if the interest on the loan or stock is deductible in calculating the profits of the trade.
>
> (2) 'Incidental costs of obtaining finance' means expenses–
>
> (a) which are incurred on fees, commissions, advertising, printing and other incidental matters, and
>
> (b) which are incurred wholly and exclusively for the purpose of obtaining the finance, providing security for it or repaying it.
>
> (3) Expenses incurred wholly and exclusively for the purpose of–
>
> (a) obtaining finance, or
>
> (b) providing security for it,
>
> are incidental costs of obtaining the finance even if it is not in fact obtained.

(4) But the following are not incidental costs of obtaining finance–

(a) sums paid because of losses resulting from movements in the rate of exchange between different currencies,

(b) sums paid for the purpose of protecting against such losses,

(c) the cost of repaying a loan or loan stock so far as attributable to its being repayable at a premium or having been obtained or issued at a discount, and

(d) stamp duty.

(5) This section needs to be read with section 59 (which provides for restrictions in relation to convertible loans and loan stock etc.)."

63. It is common ground that s 59 is of no relevance in these cases.

64. Section 736A of ICTA, entitled "Manufactured dividends and interest", (since repealed and replaced by the Corporation Tax Act 2010) was as follows:

"Schedule 23A to this Act shall have effect in relation to certain cases where under a contract or other arrangements for the transfer of shares or other securities a person is required to pay to the other party an amount representative of a dividend or payment of interest on the securities."

65. It is necessary for understanding to set out several parts of Sch 23A. The Schedule, too, has been repealed and replaced by the 2010 Act. As it was in force at the material time, the relevant provisions of the Schedule were as follows:

"**1—**

(1) In this Schedule—

'manufactured dividend'… and 'manufactured overseas dividend' shall be construed respectively in accordance with paragraphs 2 … and 4 below, as shall references to the gross amount thereof;

...

'overseas dividend' means any interest, dividend or other annual payment payable in respect of any overseas securities;

'overseas dividend manufacturer' has the meaning given by paragraph 4(1) below;

'overseas securities' means—

(a) shares, stock or other securities issued by a government or public or local authority of a territory outside the United Kingdom or by any other body of persons not resident in the United Kingdom; ...

...

'securities' includes any loan stock or similar security;

'transfer' includes any sale or other disposal ….

4—

(1) This paragraph applies in any case where, under a contract or other arrangements for the transfer of overseas securities, one of the parties (the 'overseas dividend manufacturer') is required to pay to the other ('the

recipient') an amount representative of an overseas dividend on the overseas securities; and in this Schedule the 'manufactured overseas dividend' means any payment which the overseas dividend manufacturer makes in discharge of that requirement.

7—

(1) in any case where (apart from this paragraph)—

(a) an amount paid by way of manufactured dividend would exceed the amount of the dividend of which it is representative, or

(b) the aggregation of—

(i) an amount paid by way of manufactured interest or manufactured overseas dividend, and

(ii) the tax required to be accounted for in connection with the making of that payment,

would exceed the gross amount (as determined in accordance with paragraph 3 or 4 above) of the interest or overseas dividend of which it is representative, as the case may be,

the payment shall, to the extent of an amount equal to the excess, not be regarded for the purposes of this Schedule as made in discharge of the requirement referred to in paragraph 2(1), 3(1) or 4(1) above, as the case may be, but shall instead to that extent be taken for all purposes of the Tax Acts to constitute a separate fee for entering into the contract or other arrangements under which it was made, notwithstanding anything in paragraphs 2 or 3 above or anything in paragraph 4 other than in sub-paragraph (1A)."

66. Mr Flanagan's case is that para 7(1) is engaged and that £5 million, being the amount of the excess of the irregular payment over the Interest Amount, is "a separate fee for entering into the contract or other arrangements under which it was made" falling within s 58(2) and available to him to set off against his other income for the year by way of sideways relief.

67. In the 2007-08 tax year (in which Mr Moyles and Mr Stennett entered into the scheme) the relevant statutory provisions were ss 567, 572, 581, 583, 589 and 591 of ITA. They were as follows :

"**567 Meaning of 'overseas securities' and 'overseas dividend'**

(1) This section applies for the purposes of this Part.

(2) 'Overseas securities' means shares, stock or other securities issued by–

(a) a government, local authority or other public authority of a territory outside the United Kingdom, or

(b) another non-UK resident body of persons.

(3) 'Overseas dividend' means any interest, dividend or other annual payment payable in respect of overseas securities.

(4) In this section 'securities' includes loan stock or any similar security."

"**572 Overview of Chapter**

This Chapter is about the situation where a person–

(a) pays another person an amount which is representative of–

(i) dividends on UK shares,

(ii) periodical payments of interest on UK securities, or

(iii) overseas dividends on overseas securities, and

(b) does so under a requirement of an arrangement between them for the transfer of the UK shares, UK securities or overseas securities concerned.”

“**581 Manufactured overseas dividends**

(1) This section applies if–

(a) a person (‘the payer’) pays another person an amount (‘manufactured overseas dividend’) which is representative of an overseas dividend on overseas securities,

(b) the payer does so under a requirement of an arrangement between them for the transfer of the securities, and

the condition in subsection (2) is met.

(2) The condition is that–

(a) in a case within section 922(1) (manufactured overseas dividends: payments by UK residents etc), the amount required to be deducted as a result of that section has been deducted, or

(b) in a case within section 923(1) (foreign payers of manufactured overseas dividends: the reverse charge), the amount of income tax required to be accounted for and paid as a result of that section has been accounted for and paid.

(3) Subsections (4) and (5) apply in relation to the recipient, and all persons claiming title through or under the recipient, for all relevant income tax purposes.

(4) The manufactured overseas dividend is treated as if it were–

(a) an overseas dividend of an amount equal to the gross amount of the manufactured overseas dividend, but

(b) paid after the withholding from it, on account of overseas tax, of the amount deducted as a result of section 922 or (as the case may be) accounted for and paid as a result of section 923.

(5) The amount deducted or accounted for and paid is accordingly to be treated as an amount withheld on account of overseas tax instead of as an amount on account of income tax.

(6) In this section ‘relevant income tax purposes’ means the purposes of the Income Tax Acts as they apply in relation to—

(a) UK residents, and

(b) persons carrying on business through a branch or agency in the United Kingdom.”

“**583 Manufactured payments exceeding underlying payments**

(1) This section applies if—

(a) an amount paid by way of manufactured dividend would otherwise exceed the amount of the dividend of which it is representative, or

(b) the sum of—

(i) an amount paid by way of manufactured interest or manufactured overseas dividend, and

(ii) the income tax required to be accounted for and paid in connection with the making of the payment,

would otherwise exceed the gross amount of the interest or overseas dividend of which it is representative.

(2) The payment, to the extent of an amount equal to the excess, is treated for the purposes of this Chapter and Chapter 9 of Part 15 as not made under the requirement mentioned in section 573(1)(b), 578(1)(b) or 581(1)(b) (criteria for application of provisions about manufactured payments).

(3) Instead it is treated, to that extent, for income tax purposes as a separate fee for entering into the arrangement under which it was made.

(4) Subsection (3) applies despite anything in—

(a) sections 572 to 582 (main rules about manufactured payments), or

(b) Chapter 9 of Part 15 (deduction of income tax at source: manufactured payments)."

"**589 Meaning of 'gross amount': interest and manufactured overseas dividends**

(1) This section applies for the purposes of this Chapter.

(2) …

(3) The gross amount of a manufactured overseas dividend is an amount equal to the gross amount of the overseas dividend of which the manufactured overseas dividend is representative.

(4) The gross amount of an overseas dividend is the sum of—

(a) so much of the overseas dividend as remains after the deduction of any overseas tax chargeable on it,

(b) the amount of any overseas tax so deducted, and

(c) the amount of any overseas tax credit in respect of the overseas dividend."

"**591 Interpretation of other terms used in Chapter**

(1) In this Chapter—

…

'transfer' includes a sale or other disposal.…"

68. Although the earlier and later provisions are differently worded, it is undisputed that for present purposes they are to the same effect.

The trade in used cars

69. It is a necessary part of the appellants' case that they began their used car trading before they each made the irregular payment. This proposition breaks down into two questions: first, was there a trade in used cars at all?; and second, if so, when did it begin?

The appellants' submissions

70. The appellants' starting point was the analysis of a Special Commissioner, Mr (now Judge) Hellier, in *Mansell v Revenue and Customs Commissioners* [2006] STC (SCD) 605 at [95]-[96], an analysis approved by Henderson J *in Tower MCashback LLP 1 and another v Revenue and Customs Commissioners* [2008] STC 3366 at [95]. It is, Judge Hellier said, necessary to distinguish between the setting up of a trade and the commencement of a trade. It is not always necessary that a sale is made before a trade can be said to have begun, but there must be both a reasonably firm concept of the type of profit-making activities to be carried on, and steps must have been taken with a view to converting the concept to reality. In the ordinary case trade can be said to start when the trader undertakes some operational activities, most commonly by dealing with third parties (for example by negotiations to enter into contracts intended to culminate in obligations or assets, and which give rise to a real possibility of loss or gain), in a manner which is immediately and directly related to the supplies to be made, which it is hoped will give rise to profits, and which require the trader to put money at risk. The acquisition of goods to sell or to turn into items to be sold is another example of operational activity, and the kind of activity which contributes to the potential profit of the enterprise.

71. The appellants' case is that each of them had formed the intention to trade in used cars, had begun "operational activities", in that he had started to contract with third parties in a manner which was immediately and directly related to the supplies to be made (that is, the buying and selling of used cars), and which, it was hoped, would give rise to profits. Each of the appellants had entered into a joint venture agreement with WW Admin, had authorised WW BTC, as his bare trustee, to enter into an option agreement with a dealer, which provided for the acquisition of used cars as trading stock, and had put his money at risk by the payment of £100 to the dealer for the grant of the options, and of the deposit to WW Admin.

72. These, said Mr Ewart, were genuine obligations. Each appellant acquired real rights under those agreements, and subjected himself to the real possibility of loss or gain. All those factors showed that a trade had begun, even if no cars had been bought or sold. But as a matter of fact, each appellant did buy and sell used cars in the course of his trade, and continued to do so in the years of assessment after the year in which his claim for relief was made.

73. Further guidance on the indicia of a trade are to be found in the analysis of Millet J, as he then was, in *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1989] STC 705 at 762:

> "Whether a given transaction or series of transactions is in the nature of trade is a question of fact … If the transaction is of a commercial nature and has a

genuine commercial purpose, the presence of a collateral or ulterior purpose to obtain a tax advantage does not 'denature' what is essentially a commercial transaction. If, however, the sole purpose of the transaction is to obtain a fiscal advantage, it is logically impossible to postulate the existence of any commercial purpose … Where commercial and fiscal purposes are both present, questions of fact and degree may arise, and these are for the commissioners. Nevertheless, the question is not which purpose was predominant, but whether the transaction can fairly be described as being in the nature of trade … The purpose or object of the transaction must not be confused with the motive of the taxpayer in entering into it. The question is not why he was trading, but whether he was trading. … The test is an objective one."

74. That case proceeded to the House of Lords ([1992] 1 AC 655). At p 677 Lord Templeman said:

"The principles of *Ramsay* and subsequent cases do not compel or authorise the court to disregard all the fiscal consequences of a single composite transaction read as a whole on the grounds that it appears that the transaction is a tax avoidance scheme …

… in the view of Sir Nicolas Browne-Wilkinson V-C, the taxpayer is deprived of all the beneficial effects of the scheme if the scheme was entered into 'essentially for the purpose of obtaining a fiscal advantage under the guise of a commercial transaction': …

> 'if the commissioners find as a fact that the sole object of the transaction was fiscal advantage, that finding can in law only lead to one conclusion, *viz* that it was not a trading transaction. … if the commissioners find as a fact only that the paramount intention was fiscal advantage … the commissioners have to weigh the paramount fiscal intention against the non-fiscal elements and decide as a question of fact whether in essence the transaction constitutes trading for commercial purposes.'

My Lords, I do not consider that the commissioners or the courts are competent or obliged to decide whether there was a sole object or paramount intention nor to weigh fiscal intentions against non-fiscal elements. The task of the commissioners is to find the facts and to apply the law, subject to correction by the courts if they misapply the law. The facts are undisputed and the law is clear. Victory Partnership expended capital of $3¼ m. for the purpose of producing and exploiting a commercial film. The production and exploitation of a film is a trading activity. The expenditure of capital for the purpose of producing and exploiting a commercial film is a trading purpose. By section 41 of the [Finance] Act of 1971 capital expenditure for a trading purpose generates a first year allowance. The section is not concerned with the purpose of the transaction but with the purpose of the expenditure."

75. There is a misconception, Mr Ewart added, in HMRC's argument, based on the decision of this tribunal in *Eclipse Film Partners No 35 LLP v Revenue and Customs Commissioners* [2012] UKFTT 270 (TC), that there was no "real" trade carried on by any of the appellants. In that case the tribunal held that a purposive construction of the concept of "trade", as the word is used in the Corporation Tax Acts, must take account of the definition in ICTA s 832(1), namely "every trade, manufacture, adventure or concern in the nature of a trade". The tribunal

concluded, at [398], that “an element of speculation is a characteristic of the concept of trade—if a taxpayer is trading, what he does must, normally at any rate, be speculative in the sense that he takes a risk that the transaction(s) may not be as profitable as expected (or may indeed give rise to a loss).”

76. The tribunal in *Eclipse Film Partners* reached its conclusion that the transactions in issue there did not have a sufficient speculative character on the specific facts of the case. In particular, as it made clear, it regarded it as significant that the profit which was to accrue to the participants, year by year, was determined at the outset without any reference to the success or otherwise of the “trade”, and anything which happened to be received in addition was considered by everyone involved as a bonus, rather than as something which might reasonably be expected.

77. In these cases, by contrast, there was an element of speculation on the part of the appellants. The profit (or loss) that each appellant might achieve from his purchase and sale of a used car was not determined at the outset, and there was a reasonable expectation of profit. At the same time, each appellant took a genuine risk that the profitability of his trade would decline through, for example, a decrease in the number of cars that he could acquire because the dealer offered fewer cars. There is no true parallel between this case and *Eclipse Film Partners*.

The respondents’ submissions

78. The respondents’ case is that relief within s 58 of ITTOIA is available only when there is a real trade, that is one which is genuine and not merely a pretence. The meaning of “trade” was defined, as I have said (see para 75 above), by ICTA s 832 as “every trade, manufacture, adventure or concern in the nature of a trade”. That provision applied in 2006-07, but from 6 April 2007 onwards was replaced, in briefer terms but without any evident change of meaning, by ITA s 989: “‘trade’ includes any venture in the nature of trade”. Here, the arrangements entered into by each appellant created little more than the illusion of a trade in which, through a joint venture agreement, he appeared to purchase and then sell a small number of cars in order to seek to fulfil the requirements of the legislation, rather than with any true intention of ever dealing in cars.

79. In *Ransom v Higgs* [1974] STC 539 at 545 Lord Reid said that the word “trade” is commonly used to denote “operations of a commercial character by which the trader provides to customers for reward some kind of goods or services”. It is trite law, Ms Nathan said, that whether a trade exists is a mixed question of fact and law and that, as Millet J said in *Ensign Tankers v Stokes*, it is necessary when determining whether a trade exists, that the “part of the transaction which is alleged to constitute trading must not be viewed in isolation, but in the context of all the surrounding circumstances”. The respondents accept that the activity of buying and selling second hand cars is capable of constituting a trade, but say that in this case it was the dealers—Langrop and Styrin—which carried on such trade as there was and, taking a realistic view of the evidence, that none of the appellants carried on a trade. None of them was aware, either personally or through their bare trustee, until after they were informed by the dealer of important facts such as the type of car which was being acquired as stock, at what price it was being acquired, when it was to be acquired, when, to

whom and at what price it was to be sold, and the level of profit on each car. Complete ignorance of that kind is, Ms Nathan said, inconsistent with the proposition that the appellants were each carrying on a trade in second hand cars.

80. There were also several features of the supposed trade which were inconsistent with its being a genuine trade pursued with the intention of making profits. The nominal gross profit was invariably very small, typically £100. It is a reasonable assumption, when one takes account of the compensatory payments to the dealers, that the profit margins were engineered; but even if they were not it is plain that the cars were not bought and sold with any real aim of maximising, or even making any, profits; whether the supposed trade made a small profit or a small loss was a matter of no concern. The appellants assumed no financial risk, since their exposure was limited to the initial amount invested with no need of further investment, and they earned no real reward since such profits as were earned were not paid to them but simply ploughed back or retained. It is quite clear that the appellants were wholly indifferent to the success or otherwise of their claimed trading.

81. In addition, it is not sufficient to point, as the appellants do, to the agreements with the dealerships to demonstrate that there was a trade. The clear purpose of those documents was merely to create the illusion of a trade; the reality is rather different. The mere presence of the characteristics commonly found in a trade does not of itself show that there is a trade—there must be some real trading purpose to the activity. The appellants have accepted that the scheme was entered into for tax avoidance purposes; the evidence shows that the purported trade was, as Lord Morris of Borth-y-Gest put it in *Lupton (Inspector of Taxes) v FA & AB Ltd* [1972] AC 634 at 647, "so inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction". The supposed car dealing was nothing more than the "hook" the appellants needed in order to bring themselves within s 58.

82. Even if the respondents are wrong and there was a trade in any appellant's case, it cannot properly be said to have begun in the relevant year of assessment. The evidence shows only that various documents were signed by, or in most cases on behalf of, the appellants, but no operational activities in any meaningful sense took place in that year. The signing of the agreements was merely an action which created the infrastructure for the trade. The appellants had not passed from the concept to reality, assuming there was ever any reality. Moreover, the option agreement each appellant entered into was never brought into effect. The cars were acquired by the car dealers without any reference to the appellants, their agent or their bare trustee. Thus the claim in the appellants' skeleton argument that the appellants each "started to deal with third parties immediately and directly" was not borne out by the evidence.

Discussion

83. In my judgment Ms Nathan is right in respect of the first of the two questions I have identified, and broadly for the reasons she gave. The joint venture agreement provided that each appellant should "contribute the stock of used cars, or the benefit of certain options to purchase used cars", and give various instructions: see para 18 above. In reality, none of the appellants

performed any of those obligations. They did not exercise the options at all, and they can be left to one side. Nor did they ever supply any cars. Had a particular car been allocated to an identified or identifiable participant before the dealer—Mr Barre or Mr Styrin—acquired it, or even as he was acquiring it, it might be said that the participant so identified was trading in that car through the agency of the dealer. But that is not what happened. Not only did the participant not know any detail of the car at the time of the purchase and sale, as Ms Nathan said, he could not know contemporaneously, even if he had enquired, whether on any particular day he had bought or sold a car, and if so what was the car and what were the purchase and selling prices. Those details were available to him only long after the event, when WW BTC allocated the transactions to the participants, and did so moreover in a manner which had no purpose, as is perfectly clear, other than to ensure that each participant could claim to have bought and sold enough cars in a tax year to be able to argue that he was trading. A participant could not, therefore, possibly have given any instructions in relation to any such purchase or sale. Equally, he did not give consideration, whether directly or through an agent, for the car as it was bought, nor receive the proceeds as it was sold. I should add for completeness that I do not accept Mr Ewart's argument that there is any analogy between this case and *Scott & Horton v Godfrey* [1901] 2 KB 726. There is a fundamental difference between dealing in choses in action, as in that case, and dealing in goods, as here.

84. It is perhaps a small point but it is nevertheless conspicuous that, although WW BTC was acting as the participant's bare trustee, there is no provision in the joint venture agreement which provides for it to acquire, and therefore put itself in a position to pass on, title to the cars—yet it was purporting to sell them as principal by allowing the dealer to issue invoices in its, rather than the participant's name. It is also conspicuous that Mr Barre sought to avoid having to provide a warranty, and that Mr Styrin's company provided and honoured warranties, facts which are consistent with Ms Nathan's argument that it was in reality the dealer which was trading.

85. Their evidence showed, as I have said, that none of the appellants took any interest whatever in the details of the purchases and sales, that they were indifferent to whether a profit or loss was made, and that they obtained the bare minimum of information solely in order that that information could be entered on their tax returns. Even had the cars been allocated in advance to named participants, it is impossible to reach the conclusion that, "in the context of all the surrounding circumstances", to borrow Millet J's phrase, this was a trade seriously pursued with a view to profit when the supposed traders care nothing about the profit and, moreover, have not in reality put any money at risk. The payment of £100 for the options was not, in my view, money at risk, since it could never be recovered, but an expense; and, since the options were never exercised there appears to be no risk to the deposit of £7500, which could be returned at any moment. The joint venture agreement was, as both Mr Flanagan and Mr Stennett accepted, something they entered into because the scheme required it, and which they would not have contemplated for any other reason. From their perspective, this was not a trade but a means of securing tax relief.

86. In my view, what Lord Morris said in *Lupton v FA & AB* is directly in point: the fiscal drivers for the so-called trade were so great that the "shape and character of the transaction is no longer that of a trading transaction". I am satisfied that none of the appellants was trading in the proper sense of that word, but that they were instead engaged in an arrangement designed only to give the illusion of trading, and that the appeals must be dismissed on that ground alone.

87. As I have concluded that there was no trade the second of the two questions does not arise, but in case I am wrong in my answer to the first question I should deal with it briefly. If it is accepted that the fact of a purchase and sale made in the manner I have described, and later allocated to a particular participant, amounts to trading then it seems to me that even one such purchase or sale necessarily implies that trading has started. The statement of agreed facts shows that both Mr Moyles and Mr Stennett made at least one purchase and sale in the tax year in which they joined the scheme, and this question (if it arose) should be determined in their favour.

88. Mr Flanagan, however, is in the position that he had entered into all the necessary agreements, but as I understand the matter had not made a purchase or sale: the cost of sales disclosed in his tax return represented the price paid for the options. He entered into the joint venture agreement on 16 March 2007, but I agree with Ms Nathan that such an agreement is consistent with an intention to enter into business, but is not an indication that trade has begun. It is true that on the same day WW Admin obtained forecourt facilities and an insurance policy, although it did so in order to discharge its obligations to all of the relevant participants and not Mr Flanagan alone. Mr Flanagan paid his option fee of £100 on 18 March, and his deposit of £7,500 was paid on 20 March. But it does not seem to me that these steps were enough to enable Mr Flanagan to start trading (again, assuming there was a trade at all) in the chosen manner since it was not until 4 April that the Master Agreement with Langrop was made, and it was only at this point that Mr Flanagan had put himself in a position to trade. There was, however, no evidence of any further activity on that or the following day (which was of course the last day of the tax year). In my judgment Mr Flanagan had put himself in a position to trade but has not demonstrated that he had begun trading, and this issue, if it arose, should be decided against him.

Whether the excess irregular payment was a "fee" within the meaning of ITTOIA s 58

89. My conclusion on the first issue is, of course, fatal to the appellants' case, but I deal with the second issue in case I should be found elsewhere to have erred. This issue too requires to be divided into several questions: did each of the appellants pay a manufactured overseas dividend within the meaning of the applicable legislation?; if so, is it to be treated as a separate fee for the lending facility (the borrowing of £7,500 from Philario in Mr Flanagan's case)?; and, if so, was the fee an incidental cost of obtaining finance?

The appellants' submissions

90. Mr Ewart began by arguing that it is clear that each appellant made the payment to the lender as a matter of fact. So much was demonstrated by Ms

Nathan's charts, and by HMRC's acceptance, in the statement of case served in respect of each appellant, that provided each appellant can demonstrate that all the requisite steps were effected, "every transaction was genuinely carried out and was exactly what it purported to be". As I have accepted that the requisite steps were carried out, I need not investigate this point further.

91. The character of each appellant's payment to the lender was a "manufactured overseas dividend" which satisfied the definition set out in para 4 of Sch 23A to ICTA (for the first appellant) and s 581(1) of ITA (for the second and third appellants), because, as is common ground, the Debt Securities were "overseas securities" in respect of which an "overseas dividend"—described in the documents as the Interest Amount—was paid by Vanderveer to Greenleaf, the facility offered by Philario (as before I use Mr Flanagan's iteration for illustration) was "a contract or other arrangement for the transfer of overseas securities", and the facility required the appellant to pay to Philario, as he did, an amount (that is, the manufactured overseas dividend) which was representative of the overseas dividend. That, said Mr Ewart, was all that was required.

92. HMRC's position, as it is set out in their statements of case, is that the manufactured payment was not "representative" of the overseas dividend, because there must be a correlation between the two in both character and amount. There is no merit in that position. The term "representative" is not defined in the legislation, but it is apparent from it that an amount paid as a manufactured dividend can exceed the value of the dividend of which it is representative. This is expressly recognised in para 7(1)(a) of Sch 23A, and in s 583(1)(a). There is no provision which limits the amount by which the one might exceed the other. Instead, the legislation simply provides for all of the excess, whatever it might be, to be treated in a particular manner. HMRC's argument, properly analysed, focuses on the word "representative" but disregards the clear indication of the legislation that the scale of the excess is immaterial. If it were otherwise a manufactured payment which was not equivalent in value to the underlying payment could never qualify, but in that case para 7(1)(a) of the Schedule would be otiose.

93. Once it is accepted that the size of the excess is irrelevant, the mere fact that there is an excess engages para 7(1) of Sch 23A, or s 583(2). They each provide, albeit in slightly different words, that "an amount equal to the excess" shall be taken or treated, for income tax purposes, as (to take the s 583(3) version) "a separate fee for entering into the arrangements under which [the payment] was made". It cannot, therefore, be seriously disputed that the excess in these cases is to be treated for income tax purposes as a separate fee for entering into the facility. The facility was an agreement whose only purpose was the obtaining of finance. Clause 2.1 of the facility agreement provided that the loan would be made available only after receipt by the lender of the manufactured payment. It necessarily follows that the excess of the manufactured payment over the Interest Amount is to be treated as having been incurred wholly and exclusively for the purpose of obtaining the finance: without it, there would have been no finance. This, said Mr Ewart, is a straightforward analysis which respects and gives effect to the legislative purpose of para 7 and s 583.

94. The whole point of those provisions is that they are deeming provisions, and they necessarily import an element of artificiality. In *Jenks v Dickinson (Inspector of Taxes)* [1997] STC 853 at 878 Neuberger J, as he then was, said this:

> "… one can, indeed one should, take into account the fact that one is construing a deeming provision. This is not to say that normal principles of construction somehow cease to apply when one is concerned with interpreting a deeming provision; there is no basis in principle or authority for such a proposition. It is more that, by its very nature, a deeming provision involves artificial assumptions. It will frequently be difficult or unrealistic to expect the legislature to be able satisfactorily to [prescribe] the precise limit to the circumstances in which, or the extent to which, the artificial assumptions are to be made."

95. If the legislation says that something, say *x*, is to be treated for "all purposes of the Tax Acts" as *y* it is not open to HMRC to say that it must instead be treated as *z*. The excess was, therefore, an expense which is to be treated as a fee (sub-s (2)(a)) and was incurred wholly and exclusively for the purpose of obtaining the finance (sub-s (2)(b)). It was correspondingly an "incidental cost of obtaining finance", within the meaning of s 58(2). The amount borrowed was required to be used by each appellant, and in fact used, in his trade by way of paying the deposit which was a condition of the option agreement, and the interest payable on the loan was deductible in calculating the profits of each appellant's trade in used cars. It thus met the condition imposed by s 58(1).

HMRC's submissions

96. Ms Nathan began with the requirement of para 7 of Sch 23A that a manufactured overseas dividend which was to come within its scope must be "representative" of the underlying overseas dividend. "Representative" is an ordinary English word and should be given its natural meaning. The Shorter Oxford English Dictionary defines "representative" as:

> "A *adj*. 1. Serving to represent, figure, portray or symbolise…
>
> 2. Standing for, or in place of, another or others especially in a permanent or comprehensive manner;…
>
> 4. Taking the place of, replacing, other forms or species."

97. HMRC maintain their argument that, in order to be "representative", the manufactured payment must reflect the overseas dividend in character and quantum: there must be reasonable equivalence. That test is not met if the two are substantially different in character or substantially different in value. Here, the only correlation between the two is that the manufactured payment is the product of multiplying the overseas dividend by a very large number, but multiplication has nothing to do with representation.

98. Ms Nathan referred me to the International Swaps and Derivatives Association ("ISDA") Global Master Securities Lending Agreement, an industry standard document used for stock lending transactions. Clause 6.1 of the agreement provides for a manufactured payment in this way:

> "Where Income is paid in relation to any Loaned Securities … on or by reference to an Income Payment Date Borrower, in the case of Loaned

> Securities … shall, on the date of the payment of such Income … pay and deliver a sum or money or property equivalent to the type and amount of such Income that, in the case of Loaned Securities, Lender would have been entitled to receive had such Securities not been loaned to Borrower and had been retained by Lender on the Income Payment Date.…"

99. That, she continued, is the formula by which a compensatory payment, to be made by a borrower of stock who receives a dividend on that stock to the owner of the stock, is calculated: it is "equivalent to the type and amount" of the dividend the lender would have received but for the stock loan. It is, she added, much more likely that the draftsman had in mind equivalence, even if not exact equivalence, and used the word "representative" in that sense, than that he contemplated a payment far greater than the value of the overseas dividend it supposedly represented. I was taken to the *Hansard* report of the debates on the Finance Bill 1991, by which (when it became an Act) Sch 23A was introduced, and it is plain that Parliament proceeded upon the footing that a manufactured dividend was intended to compensate for the non-receipt of the underlying dividend, and was normally independent of any stock lending fee which might be charged. Irrespective of the *Hansard* report, Ms Nathan said, the plain purpose of the legislation is not to relieve artificial payments of this kind. That was also the conclusion of this tribunal in *Chappell v HMRC* [2013] UKFTT 098 (TC) in which, at [179]-[180], it described a true, representative, manufactured payment as "compensatory". It follows that if a payment cannot properly be regarded as compensatory, it cannot be representative.

100. In this case, the agreement provided that the Debt Securities were to be transferred to Philario *cum div* but the arrangements were so constructed that a dividend would always in fact be paid, and moreover to Greenleaf rather than Mr Flanagan or Philario, in the brief interval between the agreement to transfer and the transfer itself. It was that payment which triggered what should have been no more than a compensatory payment to Philario, to make up for the dividend of £61.64 it had not received, and now would not receive. Instead it received £5 million. That differential demonstrated the error in the appellants' interpretation of the statutory provisions: they were treating "representative" as if it meant no more than "connected to" or "triggered by".

101. In *Chappell*, at [179], the tribunal additionally expressed the view that, when the maker of the manufactured payment is not entitled to receive the overseas dividend (as in this case: the dividend was always paid to Greenleaf), the payer is not entitled to relief in respect of the payment at all, since the draftsman intended to provide (although the legislation does not expressly say so) only for a situation in which the recipient of the overseas dividend made the manufactured payment. None of the appellants could ever have received the dividend since the scheme structure did not allow for it.

102. She also argued that the appellants' assertion that s 58 imposes no requirement that the amount sought to be deducted is incurred wholly and exclusively for the purposes of the trade, but need only have been incurred for the purpose of obtaining finance, is misconceived. Section 58(1) allows deductions for the incidental costs of obtaining finance, as they are defined by sub-s (2), "if the interest on the loan … is deductible in calculating the profits of the trade". But

if interest is to be deductible in calculating profits it must be an expense incurred wholly and exclusively for the purposes of the trade: see ITTOIA s 34(1). Here, the interest on the loan had nothing to do with any trade there might have been but, like the loan itself, was merely a means of generating a tax loss. The scheme was entered into, and the interest incurred, solely for the purpose of tax avoidance; it follows that no part of the interest was incurred "wholly and exclusively for the purpose of the trade". Therefore the interest on the loan is not deductible and, consequently, the "incidental costs of obtaining finance" too are not deductible.

103. Even if, contrary to those submissions, I should find that the manufactured payment was representative of the overseas dividend, and consequently a "fee" within the meaning of para 7 of Sch 23A to ICTA, it was not of the kind intended to be deductible in accordance with ITTOIA s 58. What the section contemplates is a real, meaning genuine, fee, incurred on an arm's length basis as a lender's or intermediary's fee for providing finance used in the business. Here, the arrangements were a pre-planned series of transactions which took place over the course of a few days, and which consisted of little more than the signing of various pieces of paper and the making of bookkeeping entries. The loan stock was created, and the obligation to pay the manufactured payment came into existence, solely for the purposes of the scheme: no other plausible reason for their existence has been suggested and none is apparent. The amount of the loan stock actually borrowed by each appellant and used as collateral for the so-called "trade loan" was merely a device to enable a large manufactured payment to be payable to the lender.

Discussion

104. I agree with Mr Ewart that the legislation clearly contemplates the possibility that a manufactured payment will exceed the "dividend of which it is representative", and that there is no evident limitation on the magnitude of the excess. The proposition that there is an implied limitation, namely that if the manufactured payment is to be representative of the dividend there must be a broad equivalence of value between them, must therefore be discarded. Thus although I agree with the tribunal in *Chappell* that a manufactured payment may commonly amount to a compensatory payment, of the kind for which the ISDA agreement provides, and one can discern from the legislation an assumption that this will be the case, I am bound to agree with Mr Ewart that the mere fact that the manufactured payment can exceed the underlying dividend must lead to the conclusion that "representative" is not always synonymous with "compensatory".

105. One must therefore search for a different meaning. One of the dictionary definitions suggested by Ms Nathan is "Taking the place of, replacing", and in my view, of all the possibilities offered, that is the most apposite. Adopting that meaning, a dividend payable in sterling might be represented by a manufactured payment in euros, or a variable dividend might be represented by the payment of a pre-determined sum; and in the latter case the pre-determined sum might well exceed the variable dividend by design, as a form of stock lending fee. To achieve the same end the parties to such an agreement could provide for a manufactured

payment of, say, double the dividend. Treating the excess in such circumstances as a fee for the facility is logical.

106. But in my judgment one can take that argument only so far, and there must be an upper limit to the disparity in value between the two payments beyond which it cannot realistically be said that one is representative of the other. In the circumstances of these appeals, it does not seem to me, however much permissible violence one does to the language, that it is possible to say that £5 million is representative of £61.64. The difference in scale is simply too great. The reality is that the manufactured payment did not, and was not intended to, represent the dividend; the relationship between them is that of trigger and event, rather than of one being the replacement of the other. I do not need to, and do not, decide whether the fact that the dividend was paid to Greenleaf rather than each appellant is material.

107. It follows that, were this a live issue, I would determine it in HMRC's favour. I add for completeness that, if I had instead concluded the first of the questions I have identified which arise in respect of this issue in the appellants' favour, I would be driven to agree with Mr Ewart, absurd though it is to treat a payment of £5 million as a fee for the borrowing of £7,500, that that is what the legislation demands.

108. However, I agree with Ms Nathan that the fee (assuming it to be a fee) does not satisfy the requirements of s 58(2). As I have just said, it would be absurd to pay a fee of £5 million to borrow £7,500, and it is perfectly clear that the appellants did not pay the huge "fees", as s 58(2)(b) requires, "wholly and exclusively for the purpose of obtaining the finance"; they paid them in order to gain a tax advantage. It is, of course, true that the agreements provided for such fees, and that the loans would not have been forthcoming if the manufactured payments were not made; but the agreements themselves were an integral part of a structure whose admitted purpose was the creation of an artificial tax loss, and not the raising of finance. Treating them as if they were finance-raising arrangements elevates form over substance.

109. I would therefore determine this issue, were it to arise, in HMRC's favour.

The *Ramsay* argument

110. This issue, too, does not arise in view of my earlier conclusions but it is nevertheless appropriate that I deal with it, albeit fairly briefly. As the burden of establishing that a scheme fails on *Ramsay* grounds lies on HMRC, I shall deal with Ms Nathan's submissions first.

HMRC's submissions

111. Ms Nathan's starting point was the proposition that the principles established in *Ramsay* are principles by which statutory provisions are to be construed in accordance with their purpose rather than by over-literal attention to the words used. The principles have been developed and refined in many cases, of which the most notable are *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2003] 1 AC 311, [2001] STC 237, *Barclays Mercantile Business Finance Ltd v Mawson* [2005] STC 1 ("*BMBF*"), in which Lord Nicholls provided

an extensive analysis of the line of authority, and the more recent analysis of Lewison J, as he was, in *Berry v Revenue and Customs Commissioners* [2011] STC 1057. A straightforward statement adopted with approval in many of the cases is that of Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46, (2004) 6 ITLR 454 at [35]:

> "[T]he driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."

112. A further pertinent observation was made by Hallett LJ in *Schofield v Revenue and Customs Commissioners* [2012] STC 2019 at [43]:

> "The relevant transaction here is plainly the scheme as a whole: namely a series of interdependent and linked transactions, with a guaranteed outcome. Under the scheme as a whole, the options were created merely to be destroyed. They were self cancelling. Thus, for capital gains purposes, there was no asset and no disposal. There was no real loss and certainly no loss to which the Taxation of Chargeable Gains Act 1992 ('TCGA') applies. There is in truth no significant difference between this scheme and the scheme in *Ramsay*, other than the nature of the 'asset'. A consideration of the scheme 'asset by asset' (or step by step) as urged on us by Mr Schofield ignores the reality of the scheme, the findings of the First-tier Tribunal and the *Ramsay* principle."

113. What s 58 is aimed at can be derived from its opening words: "In calculating the profits of a trade, a deduction is allowed for incidental costs of obtaining finance…". The meaning and purpose of the section are plain: a deduction is allowed for the incidental costs of obtaining finance, not for a grossly inflated payment which, viewed realistically, had nothing to do with raising finance. The appellants had conceded that the arrangements had no commercial purpose, but were designed only in order to gain a tax advantage. In fact, as the evidence showed, they amounted to a pre-planned series of transactions which took place over the space of a few days and which required little more than signing pieces of paper and making entries in accounts. The loan stock and the obligation to pay the manufactured payment were created solely for the purposes of the scheme, and had no other reason to exist. The maximum that could ever be lent for use in the putative trade was an amount equal to the collateral, invariably a small amount (in Mr Flanagan's case £7,500). There was no commercial rationale for the very large figure by which the Interest Amount had to be multiplied; it was determined by, and only by, the desired size of the tax deduction.

114. Adopting the approach of Hallett LJ, therefore, it was apparent that the scheme represented "a series of interdependent and linked transactions, with a guaranteed outcome". The large borrowing, equivalent to the desired tax loss, was always guaranteed to end up where it started, passing in the meantime only notionally (since it never left the hands of SGH) through a series of accounts. The legislative provisions were plainly not intended to apply to an arrangement of this kind, and I should decline so to apply them.

The appellants' submissions

115. Mr Ewart pointed out that the deeming by para 7 of Sch 23A and by s 583 of the excess of a manufactured payment over the overseas dividend of which it was representative as a fee was the manifest purpose of those provisions. They were, in fact, anti-avoidance provisions designed to restrict the deductibility of the excess as an expense. It could not be offensive in the *Ramsay* sense to interpret them in accordance with that purpose. They were plainly intended to create a statutory fiction in circumstances where the taxpayer was doing something artificial, such as paying a manufactured overseas dividend payment which exceeds the value of the overseas dividend of which it is representative (something for which the provisions expressly provide), and that fiction is to apply for all income tax purposes. A purposive construction of the provisions could lead only to the conclusion that the excess must be treated for the purposes of s 58(2)(a) as a fee for the borrowing from Philario. A similar conclusion was reached by this tribunal in *Land Securities plc v Revenue and Customs Commissioners* [2012] SFTD 215, especially at [63] to [66]. I interpose that I agree with Ms Nathan that there is no true analogy between that case and this, and I derive nothing of assistance from it.

116. The nebulous argument that, because this was a tax avoidance scheme, the appellants ought, on some sort of general principle, to be denied the tax consequence sought by them had no merit. The mere fact that a transaction is part of a tax avoidance scheme, even one which is circular or self-cancelling and without commercial purpose, is not a sufficient ground for denying the tax advantage. There are several warnings to this effect at a high level. In *BMBF*, on which Ms Nathan relied, Lord Nicholls identified, at [35], a number of cases dealing with avoidance arrangements and then, at [36], said

> "Cases such as these gave rise to the view that, in the application of *any* taxing statute, transactions or elements of transactions which had no commercial purpose were to be disregarded. But that is going too far." [original emphasis]

117. Similarly, in *Mayes v Revenue and Customs Commissioners* [2011] STC 1269, Mummery LJ said, at [68],

> "Instinct informed by experience plays a role in decision-making, but does not relieve the court of the duty to reach a decision that is based on a proper understanding of the meaning of the legislation and of the facts that make up the transaction."

118. In *Tower MCashback LLP 1 v Revenue and Customs Commissioners* [2011] AC 457, at [77], Lord Walker of Gestingthorpe said:

> "One of the lessons of the [*BMBF*] case is that it is not enough for the revenue, in attacking a scheme of this sort, to point to the money going round in a circle. Closer analysis is required."

119. The fact that the appellants took part in a tax avoidance scheme does not change the approach that the tribunal should adopt which, as Mr Ewart accepted, is to construe the legislation purposively and to apply it to the facts as viewed realistically. Once it is recognised that it is the legislation itself which deems the excess of the manufactured payment over the Interest Amount to be a fee, and that

without payment of the fee the loan would not have been forthcoming, it becomes clear that there is nothing in the *Ramsay* argument.

Discussion

120. Ms Nathan, as I have said, referred me to dicta of Lord Morris of Borth-y-Gest in *Lupton (Inspector of Taxes) v FA & AB Ltd*. In my view it is also worth adding what Lord Donovan said in the same case (which was concerned with supposed trading in shares) at p 657:

> "…the ordinary trader in stocks and shares normally makes his purchases on the attractions of the investments as a merchantable commodity: *eg* the soundness of the underlying assets, the potentiality for growth, the quality of the relevant management, the interim yield, and so on. The purchase of the Oakroyd shares was not decided upon by the present appellants as the result of any such commercial appraisement. They were bought pursuant to a plan having as its objects (a) to provide the Gill family with the equivalent in capital of certain undistributed profits which if taken by way of dividend would attract surtax: and (b) to provide the appellants with an opportunity to compel the revenue to pay to them a large sum of money which they, the appellants, had never themselves disbursed in tax, and which on recovery they would share with the vendors of the shares.
>
> I say that this is not trading in stocks and shares. If I am asked what it is, I would reply that it is the planning and execution of a raid on the Treasury using the technicalities of revenue law and company law as the necessary weapons."

121. In similar vein, Lord Goff of Chieveley said this, in *Ensign Tankers v Stokes* at p 684:

> "In short, this is indeed a case in which, as though by magic, the appearance is given that the taxpayer has incurred capital expenditure, but the truth is otherwise. The structure created to achieve the conjuring trick is, as usual in such cases, both complex and artificial. Here the trick consists of, first, the pre-arranged self-cancelling transactions under which LPI purported to advance money to VP, and VP immediately repaid identical sums, on the same day; and second, the characterisation of part of LPI's share of the net profits from the film as repayment of the so-called loans by LPI to VP. The self-cancelling payments by LPI to VP and repayments by VP to LPI are typical examples of artificial transactions, the sole purpose of which is the avoidance of tax. They can, in my opinion, be properly disregarded for the purposes of tax."

122. In my judgment, and without disregarding the warnings to which Mr Ewart directed me, both of those observations are very much in point in this case. If I may paraphrase Lord Donovan, "the size of the manufactured payment was not decided upon by the present appellants as the result of any commercial appraisement. It was determined pursuant to a plan." A realistic view of the facts shows that the aim was that the appellants, "as though by magic", should appear to have incurred vast fees as a condition of borrowing modest amounts of money they did not need in order to invest it in a "trade" they had no desire to pursue. The supposed fee for the loan bore no relation to the size of the loan, but was merely the amount of the artificial loss the user wished to generate. As Mr

Mehigan's own evidence showed (see para 49 above) the "trade" was no more than a device, necessary if the scheme was to work. The structure of the scheme shows that the large "borrowing" from SGH—I use inverted commas because, as I have explained, SGH never actually handed over any money—was, like the structure in *Ensign Tankers v Stokes*, self-cancelling: it was pre-ordained that the large "loan" would be repaid by nothing more than a series of bookkeeping entries. I see no meaningful distinction between the facts of this case and those of *Schofield*: in each case the various steps required for the working of the scheme were, to borrow the words of Hallett LJ, "a series of interdependent and linked transactions, with a guaranteed outcome". As Ribeiro PJ might have put it, the relevant statutory provisions, construed purposively, were not intended to apply to the transaction, viewed realistically.

123. In my judgment it follows from the various authorities to which I have referred that, had the scheme worked, it would be necessary to disregard its intended fiscal consequences.

Disposition

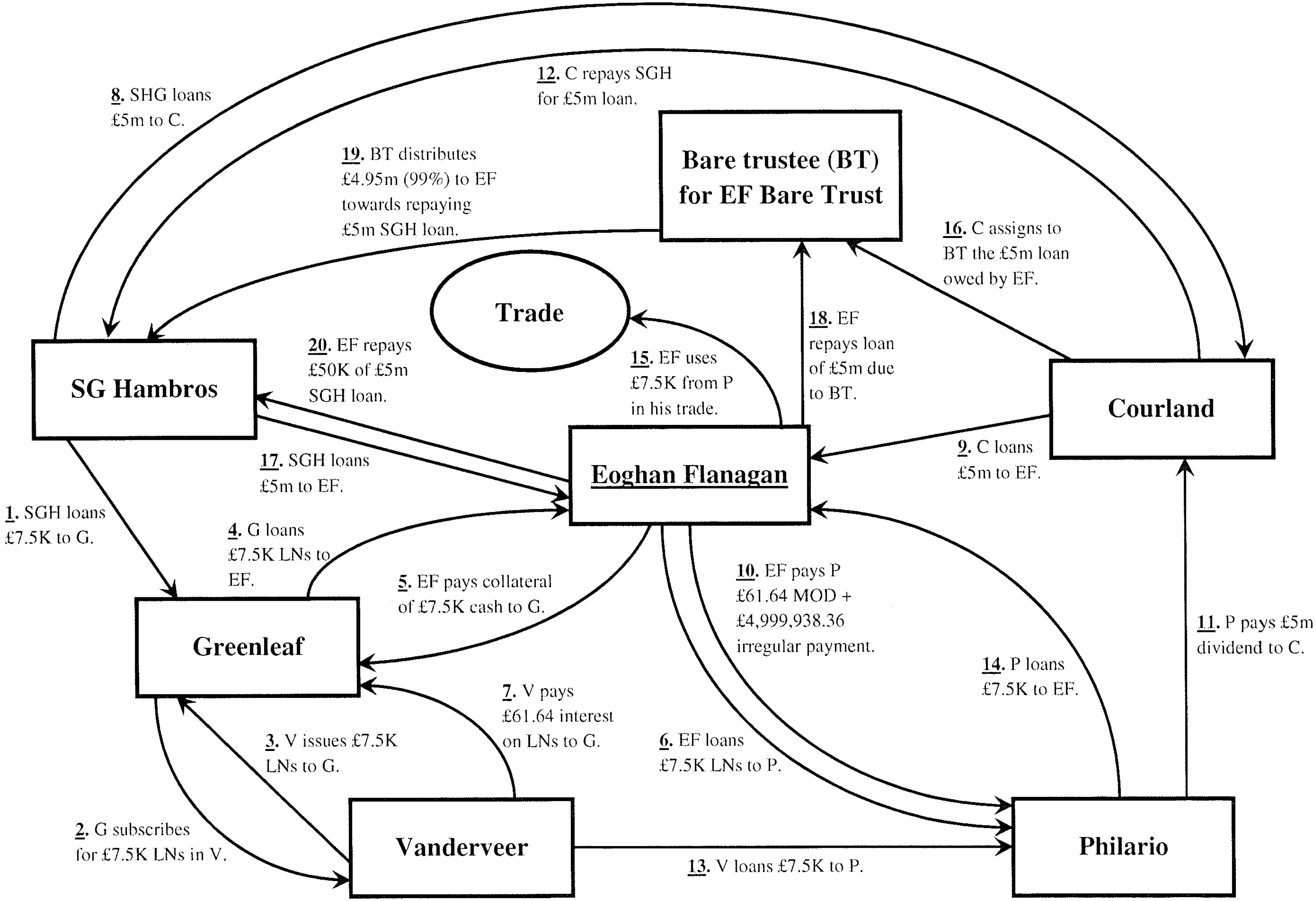
124. The appeals are dismissed.

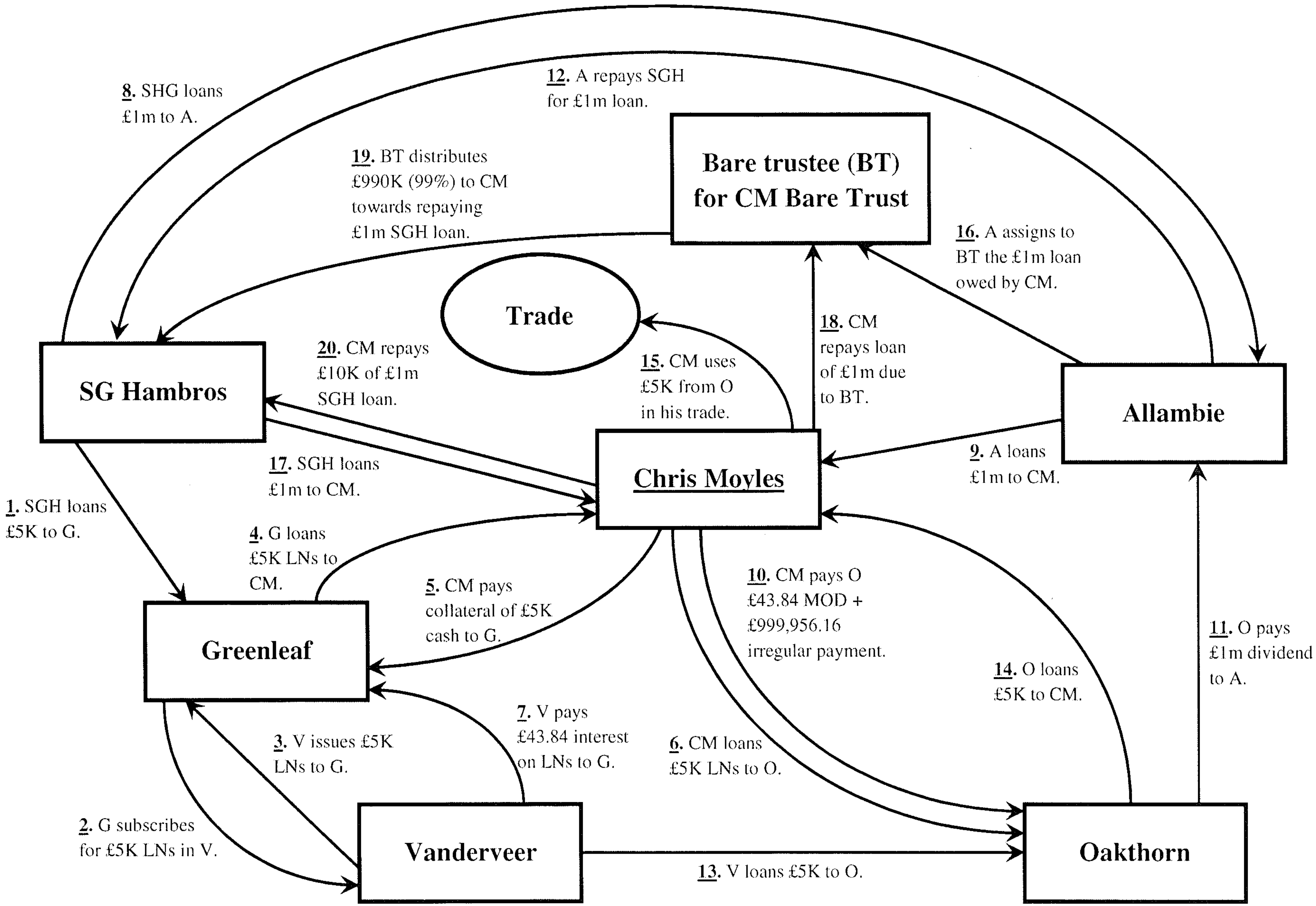
125. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received 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.

COLIN BISHOPP

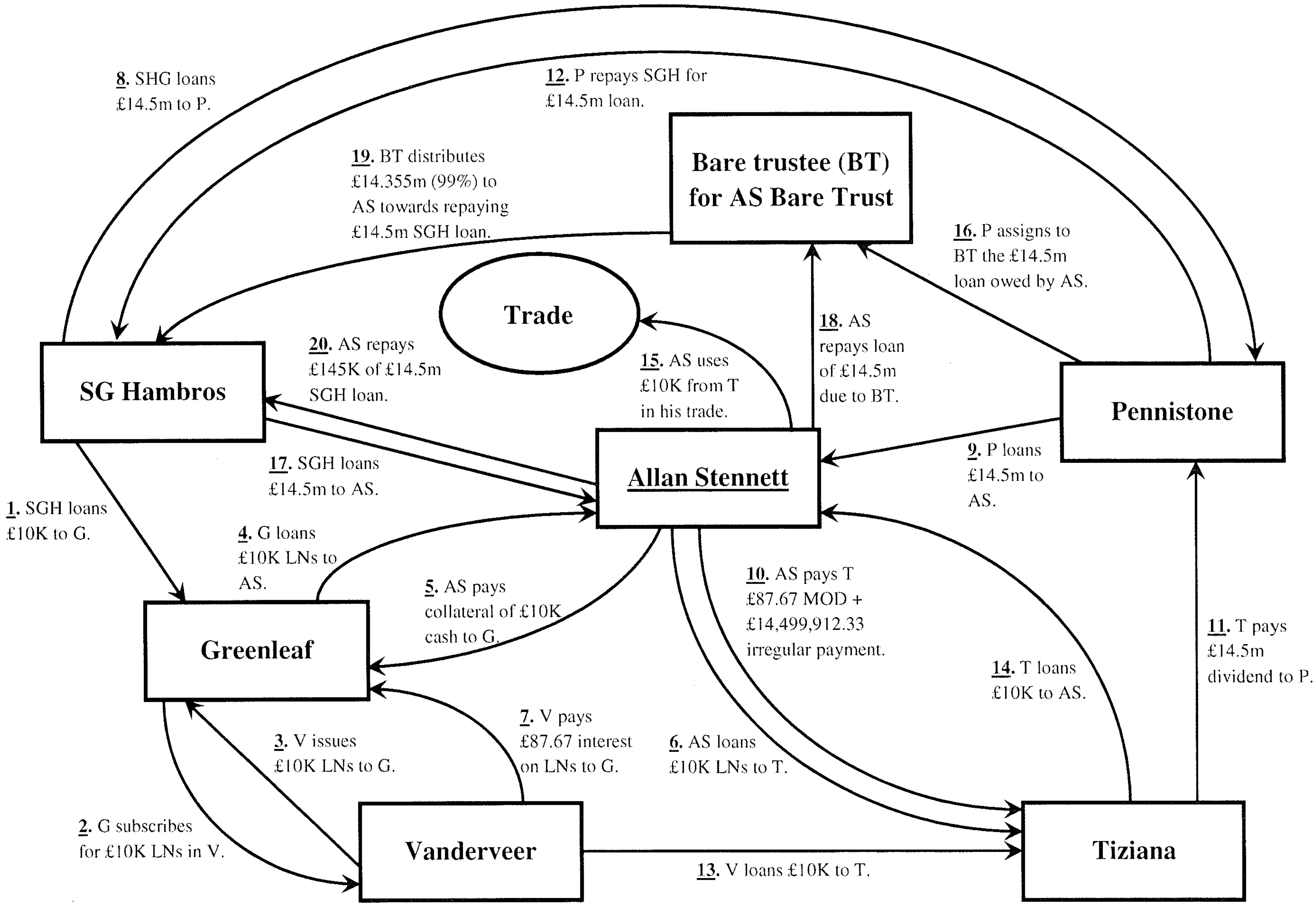
TRIBUNAL JUDGE

RELEASE DATE: 20 February 2014


Bare trustee (BT) for EF Bare Trust
Trade
SG Hambros
Eoghan Flanagan
Courland
Greenleaf
Vanderveer
Philario
1. SGH loans £7.5K to G.
2. G subscribes for £7.5K LNs in V.
3. V issues £7.5K LNs to G.
4. G loans £7.5K LNs to EF.
5. EF pays collateral of £7.5K cash to G.
6. EF loans £7.5K LNs to P.
7. V pays £61.64 interest on LNs to G.
8. SHG loans £5m to C.
9. C loans £5m to EF.
10. EF pays P £61.64 MOD + £4,999,938.36 irregular payment.
11. P pays £5m dividend to C.
12. C repays SGH for £5m loan.
13. V loans £7.5K to P.
14. P loans £7.5K to EF.
15. EF uses £7.5K from P in his trade.
16. C assigns to BT the £5m loan owed by EF.
17. SGH loans £5m to EF.
18. EF repays loan of £5m due to BT.
19. BT distributes £4.95m (99%) to EF towards repaying £5m SGH loan.
20. EF repays £50K of £5m SGH loan.



Bare trustee (BT) for CM Bare Trust
Trade
SG Hambros
Allambie
Chris Moyles
Greenleaf
Vanderveer
Oakthorn
8. SHG loans £1m to A.
12. A repays SGH for £1m loan.
19. BT distributes £990K (99%) to CM towards repaying £1m SGH loan.
16. A assigns to BT the £1m loan owed by CM.
18. CM repays loan of £1m due to BT.
15. CM uses £5K from O in his trade.
20. CM repays £10K of £1m SGH loan.
17. SGH loans £1m to CM.
9. A loans £1m to CM.
1. SGH loans £5K to G.
4. G loans £5K LNs to CM.
5. CM pays collateral of £5K cash to G.
10. CM pays O £43.84 MOD + £999,956.16 irregular payment.
11. O pays £1m dividend to A.
14. O loans £5K to CM.
7. V pays £43.84 interest on LNs to G.
3. V issues £5K LNs to G.
6. CM loans £5K LNs to O.
2. G subscribes for £5K LNs in V.
13. V loans £5K to O.


Bare trustee (BT) for AS Bare Trust
Trade
SG Hambros
Pennistone
Allan Stennett
Greenleaf
Vanderveer
Tiziana
1. SGH loans £10K to G.
2. G subscribes for £10K LNs in V.
3. V issues £10K LNs to G.
4. G loans £10K LNs to AS.
5. AS pays collateral of £10K cash to G.
6. AS loans £10K LNs to T.
7. V pays £87.67 interest on LNs to G.
8. SHG loans £14.5m to P.
9. P loans £14.5m to AS.
10. AS pays T £87.67 MOD + £14,499,912.33 irregular payment.
11. T pays £14.5m dividend to P.
12. P repays SGH for £14.5m loan.
13. V loans £10K to T.
14. T loans £10K to AS.
15. AS uses £10K from T in his trade.
16. P assigns to BT the £14.5m loan owed by AS.
17. SGH loans £14.5m to AS.
18. AS repays loan of £14.5m due to BT.
19. BT distributes £14.355m (99%) to AS towards repaying £14.5m SGH loan.
20. AS repays £145K of £14.5m SGH loan.