[2020] UKFTT 362 (TC)

TC07840

INCOME TAX – compensation paid to a person carrying on a property rental business for an interest rate swap mis-sold to him – whether the basic part of the compensation payable to him was taxable as income (because it was paid as compensation for revenue expenditure under the swap) or capital (because it was paid as compensation for the capital asset which would have been acquired by him instead if the swap had not been acquired) – held that the former was the case – whether the remaining part of the compensation payable to him, which was described as interest, was properly interest so called and taxable as such - yes

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2017/04466

BETWEEN

MR DARREN WILKINSON **Appellant**

-and-

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

TRIBUNAL: JUDGE TONY BEARE

The hearing took place on 1 and 2 September 2020 by way of a video hearing on the Tribunal Video Platform with the following people in attendance in addition to the Appellant's representative and the Respondents' counsel specified below:

Ms Sophie Garcia – Officer of the Respondents;

Mr Sean Stone – Officer of the Respondents;

Ms Georgina Mills - Officer of the Respondents (for part);

Mr Simon Pooley – Officer of the Respondents (for part);

Ms Mary Franklin – Officer of the Respondents;

Mr Jeremy Roe – representing the campaign group Bully-Banks (in part); and

The Appellant

A face to face hearing was not held because of the COVID 19 pandemic and because the matters at issue were considered appropriate to be dealt with by way of a video hearing.

The documents to which I was referred comprised two bundles – a documents bundle (including an associated index) of 684 pages, containing, inter alia, the review conclusion letter of 15 May 2017, the notice of appeal of 18 May 2017 and the letter setting out the terms of the redress offer which was made by Barclays Bank PLC to the Appellant on 23 December 2013 and an authorities bundle (including an associated index) of 328 pages, setting out the legislation and case law relevant to the hearing.

Mr Andrew Bowe of Rational Tax, the representative of the Appellant, for the Appellant

Mr Charles Bradley, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. This decision relates to an appeal against an amendment made to the Appellant's self-assessment tax return for the tax year ending 5 April 2015 pursuant to a closure notice issued on 19 January 2017 under Section 28A of the Taxes Management Act 1970. The amendment in question increased the amount of income tax which was due from the Appellant in respect of that tax year by £173,695.64.

2. The dispute between the parties relates to the correct tax treatment of a sum of £466,306.69 (the "Compensation") which was paid by Barclays Bank PLC ("Barclays") to the Appellant by way of compensation for the mis-selling of an interest rate swap (the "Swap"). That sum was made up of two elements as follows:

(1) £384,837.07 – which was quantified by reference to the difference between:

(a) the sums paid by the Appellant to Barclays under the terms of the Swap; and

(b) the sums which the Appellant would have paid to Barclays under the terms of an alternative interest rate hedging product, which is described in more detail below

(the "Basic Redress Element"); and

(2) £81,469.62 – which was quantified by reference to an amount equal to interest at 8% per annum on the Basic Redress Element, and which was paid subject to the deduction of income tax at the basic rate (the "Interest Element").

3. The Appellant contends that the entire Compensation was a capital receipt in the hands of the Appellant. He accepts that he originally reported the Interest Element of the Compensation in his return as interest income but now maintains that he was wrong to do so.

4. In contrast, the Respondents contend that the entire Compensation was taxable as income in the hands of the Appellant. The Respondents submit that the Basic Redress Element was a receipt of the Appellant's UK property business and that it is therefore subject to income tax pursuant to Sections 268 and 269(1) of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA"), whilst the Interest Element was interest and is therefore subject to income tax as such pursuant to Section 369 of the ITTOIA.

5. The above dispute is the sole matter which I am required to resolve in the course of this decision. The parties have agreed that, if I conclude that the Appellant is correct in saying that either or both elements of the Compensation amounted to a capital receipt in the hands of the Appellant, then the question of whether the Appellant is liable to capital gains tax on that capital receipt because it arose from the disposal by the Appellant of a chargeable asset – namely, the right of the Appellant to make the claim against Barclays - will need to be addressed at another hearing.

6. The First-tier Tribunal has previously considered the question which I am required to address in a case involving materially similar facts – *Gadhavi & Others v The Commissioners for Her Majesty's Revenue and Customs* [2018] UKFTT 600 (TC) ("*Gadhavi*"). The decision in *Gadhavi* is not binding on me but the Respondents submit that that case was correctly decided and have urged me to follow the decision in that case. The Appellant maintains that *Gadhavi* was wrongly decided, largely because the First-tier Tribunal in that case did not have the benefit of hearing the arguments which the Appellant has advanced at the hearing in the present case.

7. This case is a lead case in respect of a number of other appeals which relate to similar facts.

THE RELEVANT FACTS

8. There is no material dispute between the parties as to the relevant facts in this case, which are as follows:

(1) the Appellant carries on a UK property rental business;

(2) pursuant to an offer letter issued by Barclays on 9 August 2005, the Appellant borrowed the sum of £840,000 from Barclays to refinance the Appellant's existing borrowing from The Royal Bank of Scotland and to fund the acquisition of a property at 66 Charnley Road, Blackpool (the "2005 Loan");

(3) pursuant to an offer letter issued by Barclays on 7 September 2006, the Appellant borrowed the sum of £980,000 from Barclays to fund the acquisition of the Beechfield Hotel in Blackpool (the "2007 Loan");

(4) each of the 2005 Loan and the 2007 Loan carried interest at 1.9% over the base rate of Barclays – that is to say, they carried interest at a floating rate;

(5) it was a condition of the 2007 Loan that the Appellant would take out some interest rate protection in relation to both the 2005 Loan and the 2007 Loan for a period of at least 5 years. Accordingly, pursuant to a confirmation dated 9 February 2007, the Appellant and Barclays entered into the Swap, the material terms of which were as follows:

(a) the effective date of the transaction was 31 July 2007 and the transaction would run for 10 years;

(b) during the term of the transaction, the Appellant would pay to Barclays, on the last day of October, January, April and July each year, an amount equal to 5.51% on a notional amount which was initially £1,818,000 but which amortised in accordance with a pre-agreed amortisation schedule and Barclays would pay to the Appellant an amount equal to interest at a floating rate (based on the Bank of England base rate) on the same amortising notional amount; and

(c) on each payment date, the amount due from the Appellant to Barclays and the amount due from Barclays to the Appellant would be the subject of netting, with the result that the only payment which would be made on each such date would be the difference between the two sums described in paragraph 8(5)(b) above and that payment would be made by the party owing the greater amount to the party owing the lesser amount.

In relation to the Swap, the parties have agreed that, for the purposes of this decision, I can assume that, at all times when the Swap was in existence, (i) the notional principal amount under the Swap from time to time was exactly the same as the then outstanding aggregate balance under the 2005 Loan and the 2007 Loan at the relevant time and (ii) the Barclays' base rate (which was the basis for the floating rate payable under the two loans) from time to time was exactly the same as the Bank of England base rate (which was the basis for the floating rate payable under the Swap) at the relevant time. Nothing turns on the existence of this precise symmetry in terms of the issues which I am required to address in this decision but making those assumptions helps to simplify the exposition of the issues which are in dispute between the parties;

(6) there was at least one quarter in which the floating rate payable under the Swap exceeded the fixed rate payable under the Swap but, as a result of a general downward trend in the Bank of England base rate in the years which followed the execution of the Swap, the Appellant became obliged to make considerable payments to Barclays under the Swap;

(7) in June 2012, as a result of findings by the Financial Services Authority (the "FSA") to the effect that the High Street banks had adopted poor practices in selling interest rate hedging products ("IRHPs" and each an "IRHP"), such as the Swap, to unsophisticated customers, four major banks, including Barclays, agreed to conduct a review, supervised by KPMG as an independent reviewer, into their sales of IRHPs to such customers between 2001 and 2012. The banks were required, inter alia, to identify unsophisticated customers to whom they had sold the relevant products, to write to those customers to ask them if they wanted their sales reviewed and, if a breach of the relevant regulatory requirements was identified, to determine and provide to those customers appropriate redress on the basis of what was fair and reasonable in the circumstances;

(8) in the course of its review, Barclays offered the Appellant a review of the sale of the Swap, which the Appellant accepted;

(9) on 23 December 2013, Barclays wrote to the Appellant (care of the Appellant's wife) notifying him of the conclusions of the review, which were that the sale of the Swap did not meet the relevant regulatory requirements and that, if the sale had met the relevant regulatory requirements, the Appellant would have purchased an alternative IRHP. That alternative IRHP would have been an interest rate cap with a term of 5 years over a notional amount of £1,500,000 for which the Appellant would have been required to pay

a premium of £18,748.92 and which would have required Barclays to compensate the Appellant whenever the floating rate of interest which was payable under the 2005 Loan and the 2007 Loan exceeded 6.28% (the "Cap").

In consequence of its failure to meet the relevant regulatory requirements in selling the Swap to the Appellant, Barclays offered to terminate the Swap for no consideration and to pay the Compensation to the Appellant.

Since the dispute between the parties turns on the nature of the Compensation which was paid pursuant to the offer contained in the letter described above, I should at this stage refer in some detail to the precise terms of the letter.

Barclays started by saying that, as a result of its review, it was offering to pay to the Appellant, as its redress offer, the sum of £450,012.77 (which was an amount equal to the Compensation net of basic rate income tax on the Interest Element). The letter went on as follows:

"This is inclusive of compensatory interest (which is offered as compensation for the opportunity cost of being deprived of money you paid in relation to your mis-sold IRHP and with a deduction made for income tax….

The redress offer before any deductions consists of:

i. A refund of the difference between the payments you have made under your IRHP, compared with the payments you would have made under the replacement IRHP my point of sale review has determined you should originally have been sold by the Bank;

ii. Interest at 8% simple per year on the refunded IRHP amounts under this redress offer, for a period up to and including 90 days following the date of this letter. The interest amount is included in the figures set out in the enclosed 'Redress Offer Summary' and, if you accept this redress offer, will not change regardless of the date on which you accept it. Please refer to section 5.1 of the enclosed 'Customer Guidance on Consequential Losses' which explains how this 8% simple interest per year is calculated.

These redress amounts reflect IRHP payments paid by you up to 26/11/2013. If you have made subsequent IRHP payment(s), these will be refunded with interest at 8% simple per year, for a period up to and including 90 days following the date of this letter…

The following sections provide you with more details about the Bank's decision, the next steps and choices you have in regard to our redress offer…

I set out in this letter the decision to replace your IRHP with an alternative IRHP that the Bank considers you would have most likely entered into if the sales process had met the relevant regulatory standards and principles.

Having taken into account that the Bank had imposed a requirement that you enter into an IRHP in order to limit your exposure to interest rate changes, my point of sale review decision is that the Bank will terminate your £1,818,000, 10 year, Interest Rate Swap and replace it with a matured £1,500,000, 5 year, Interest Rate Cap. The term and notional of the replacement IRHP has been agreed in line with the shorter of your original condition of lending or a term and/or notional determined according to the principles of the review. The economic effect of this will be applied from the date of the original sale.

This means that whilst we will be terminating your existing IRHP, we will not be putting in place the replacement IRHP as it would have matured. The Bank will shortly suspend future payments

under your IRHP (which means that you will not need to make further payments under your IRHP whilst you are considering the Bank's redress offer).

You will not incur any of the breakage costs which would ordinarily be associated with terminating the IRHP. The Bank will bear these costs."

Then, after setting out the terms of the alternative IRHP, which is to say the Cap, Barclays went on to deal with consequential loss claims as follows:

"This redress offer includes interest at a rate of 8% simple per year on all refunded IRHP amounts. This is intended to compensate you for (i) any interest on money you have had to borrow to make payments under a missold IRHP; and/or (ii) lost profits or opportunities incurred because you were required to make payments under a missold IRHP.

On 4 September 2013, the FCA published guidance on the assessment of consequential losses in this review which can be found at www.fca.org.uk/consumers/financial-services-products/banking/interest-rate-hedging-products/fair-and-reasonable-redress.

You will see that the FCA guidance explains that, in respect of the opportunity cost of customers being deprived of money, customers can choose between either: (i) accepting the offer of interest at a rate of 8% simple per year on the amounts refunded in respect of the missold IRHP; or (ii) submitting a specific claim for consequential loss in respect of identifiable costs incurred or interest rate not earned as a result of the missale of the IRHP.

In addition to the FCA guidance on assessment of consequential losses, the Bank has produced the enclosed "Customer Guidance on Consequential Losses" to provide further information to customers. We suggest you consider this carefully."

Barclays then outlined the steps which the Appellant could take in relation to the redress offer. In the course of that section of the letter, it said as follows:

"This redress offer includes interest at a rate of 8% simple per year, for a period up to and including 90 days following the date of this letter. The interest amount is included in the figures set out in the Redress Offer Summary and will not change regardless of the date on which you accept our redress offer.

Should you accept our redress offer after this 90 day period, whilst you will remain entitled to the 90 days' interest described above, no additional interest will accrue or be paid to you….

If you choose not to accept this redress offer from the Bank which includes 8% simple interest per year on all refunded IRHP amounts, you can submit a claim for consequential losses – the enclosed 'Customer Guidance on Consequential Losses' provides details of your choices and the tests such claims will need to meet to be successful.

You can choose to submit a claim for any category of consequential loss as outlined in the enclosed 'Customer Guidance on Consequential Losses'. You should note however that if you decide to make a consequential loss claim for loss of profits/opportunity and/or interest on borrowings, you may give up the 8% simple interest offer the Bank has made in this offer letter as this compensatory interest is intended to cover such lost profits/opportunity and/or interest on borrowings claims. You will still be able to claim for out of pocket expenses, bank charges, professional advisors' fees and tax, as explained further in the Customer Guidance on Consequential Losses'. If you decide to claim for loss of profits/opportunity and/or interest on borrowings, the Bank will make an assessment of your claim which may result in you being awarded less than, more than or the same as the 8% simple interest offered by the Bank…."

Finally, in the "Redress offer summary" at the end of the letter, Barclays said as follows:

"I set out below your Redress Offer which includes the redress offered to you under Barclays Bank PLC's (the "Bank") point of sale review decision and the Bank's offer of compensatory interest at a rate of 8% simple per year on all refunded IRHP amounts in satisfaction of your claim for consequential loss.

We have calculated the difference between what you have actually paid and what you would have paid if you had entered into the replacement IRHP.

These amounts reflect IRHP payments paid by you up to 26/11/2013. If you have made subsequent IRHP payment(s), your redress offer will change…".

The summary concluded with the following table:

	Interest rate Swap Trade date – 08/02/2007
Redress Offer	Replacement with Interest Rate Cap
Refund of difference in past IRHP payments	£384,837.07
Compensatory interest on difference in past IRHP payments up to 23/12/2013	£73,878.31
Compensatory interest for an additional period of 90 days from 23/12/2013, ie up to 23/03/2014	£7,591.31
Total compensatory interest	**£81,469.62**
Deduction for income tax from compensatory interest	(£16,293.92)
Redress offer	**£450.012.77**

and

(10) following his receipt of the above letter, the Appellant initially made a claim for compensation based on his consequential loss but that claim was rejected by Barclays. Accordingly, the Appellant ultimately accepted the offer set out in Barclays' letter and received the Compensation in July 2014 pursuant to his acceptance of the terms of the offer contained in the letter.

9. The letter from Barclays setting out the terms of its redress offer referred to information contained on the website of the Financial Conduct Authority (the "FCA"), the body which succeeded the FSA as the relevant regulator in this context. The FCA described the various elements of the compensation payable in respect of the mis-selling of IRHPs as follows on its website:

"How the banks agreed to calculate redress under the review:

Basic redress: The difference between actual payments made on the Interest Rate Hedging Product and those that the customer would have made if the breaches of relevant regulatory requirements had not occurred.

Interest: The opportunity cost (loss of profits or interest) of being deprived of the money awarded as basic redress.

The banks will either pay 8% a year of simple interest, or an interest level in line with:

1. an identifiable cost that the customer incurred as a result of having to borrow money; or

2. an identifiable interest rate that a customer has not earned as a result of having less money in the bank.

Taking into account the economic environment over the last five years, interest will avoid many customers from having to put together consequential loss claims.

Consequential loss: There are different types of consequential loss. A few examples are set out below:

1. Loss of profits over and above the interest paid on basic redress–: Customers should be aware that claims for loss of profits will require customers to show that they would have used the funds in question to generate a profit (for example, through a specific investment in the business). Any money invested in this way could not also have been earning interest in the bank at the same time and customers will not be able to 'double recover'. Claims for loss of profits could result in the customer receiving an amount that is less than 8% simple interest on their basic redress if this is their actual loss.

2. Bank charges

3. Certain legal expenses

4. Tax (if a customer has to pay tax on their redress and this differs to what they would have paid had there not been a mis-sale)

For each consequential loss claim, the onus is on the customer to demonstrate that the 'legal tests' are met (see below)…

Basic Redress

The objective of the review is to put customers back in the position that they would have been in, had it not been for the mis-sale. Our principles of fair and reasonable redress give rise to three possible basic redress outcomes for customers:

1. Some customers would never have purchased a hedging product and will receive a "full tear up" of their interest rate hedging product (IRHP). These customers will receive a full refund of all payments on their IRHP.

2. Some customers would have chosen the same product they originally purchased whilst some customers may not have suffered any loss. These customers will receive no redress.

3. Some customers would still have sought or been required to enter into a product that provided protection against interest rate movements, but would have chosen an alternative product. These customers will receive redress based on the difference between the payments they would have made on the alternative product, compared with the payments they did make...

Consequential losses (the cost of being deprived of money and other losses suffered)

Banks agreed to automatically add 8% annual interest on top of basic redress payments to reflect opportunity costs (loss of profits or interest). Given the economic context over the past years, this has represented a straightforward and fair alternative to putting together consequential loss claims for most customers.

If customers believe their lost opportunity amounts to more than the 8% simple interest they can put together a claim for consequential loss. All customers are invited to do this following the basic redress offer and there is no need to go to a claims management company.

Consequential losses are assessed by reference to established legal principles relating to claims in tort and breach of statutory duty...".

10. There is no dispute between the parties as to any of the above facts.

11. In addition, it is common ground between the parties that:

(1) each of the 2005 Loan, the 2007 Loan and the Swap was entered into by the Appellant for the purposes of, and in the course of carrying on, his property rental business and that that business was a "UK property business", as defined in Section 264 of the ITTOIA and, hence, a "property business", as defined in Section 263(6) of the ITTOIA;

(2) the profits of the Appellant's property rental business in each tax year were subject to income tax in accordance with Section 270 of the ITTOIA;

(3) those profits were required to be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorized by law in calculating profits for income tax purposes – pursuant to Section 25 of the ITTOIA, as imported into Part 3 of the ITTOIA by Section 272 of the ITTOIA;

(4) in his accounts for each relevant tax year, the Appellant took into account the fact that the floating rate payments under the Swap matched the aggregate interest payments under the 2005 Loan and the 2007 Loan, with the result that the income statement forming part of his accounts showed, as interest expense, the appropriate portion of the fixed rate payments under the Swap which had accrued in the relevant tax year. The result was that the accounts were prepared on the same basis as if each of the 2005 Loan and the 2007 Loan carried a rate of interest equal to the fixed rate amounts which were due from the Appellant under the Swap, and the accrual of those fixed rate amounts over the relevant tax year were therefore treated as revenue expenses in calculating the profits of the business in the relevant tax year which appeared in the accounts; and

(5) the receipt of the Compensation was wholly reflected in the accounts of the Appellant for the tax year ending 5 April 2015 – the tax year in which the Compensation was received – so that, if I conclude that all or any part of the Compensation is subject to income tax, it is subject to income tax in respect of that tax year.

THE RELEVANT LEGISLATION

12. There is no dispute between the parties as to the terms of the relevant legislation in this case.

13. This may be summarized as follows.

14. Sections 268 and 269(1) of the ITTOIA impose a charge to income tax on the profits of a UK property business. Section 264 of the ITTOIA provides that "[a] person's UK property business consists of - (a) every business which the person carries on for generating income from land in the United Kingdom and (b) every transaction which the person enters into for that purpose otherwise than in the course of such a business". Section 272(1) of the ITTOIA 2005 provides that "[t]he profits of a [UK] property business are calculated in the same way as the profits of a trade" but Section 272(2) of the ITTOIA then limits the provisions which are applicable in calculating the charge on that basis to certain specified provisions in the part of the ITTOIA which relates to trading profits.

15. Section 369 of the ITTOIA imposes a charge to income tax on interest.

DISCUSSION

Introduction

16. As I have noted in paragraphs 2 to 5 above, there are two issues which I need to address in this decision.

17. The first is whether the Basic Redress Element was capital in nature, as Mr Bowe on behalf of the Appellant contends, or was revenue in nature, as Mr Bradley on behalf of the Respondents contends.

18. The second is whether the Interest Element was not "interest" properly so called and was therefore a capital receipt for the same reason as the Basic Redress Element was capital in nature, as Mr Bowe contends, or was "interest" properly so called, as Mr Bradley contends.

19. I now turn to address each of those issues in turn.

The Basic Redress Element

The relevant principles

20. There is no dispute between the parties as to the principles which are to be derived from the case law that is relevant to the tax treatment of the Basic Redress Element.

21. Both parties are agreed that, if the Basic Redress Element was paid as compensation to the Appellant for expenditure which the Appellant deducted in calculating the profits of his property rental trade, then the Basic Redress Element is subject to income tax in the hands of the Appellant. In contrast, if the Basic Redress Element was paid as compensation for something other than expenditure which the Appellant deducted in calculating the profits of his property rental trade – for example, as compensation for a decline in the value of a capital asset or, specifically in this case, a failure to obtain a capital asset which the Appellant would have received if the mis-selling had not occurred – then the Basic Redress Element was capital in nature and is not subject to income tax in the hands of the Appellant.

22. The principle that compensation received by the Appellant for expenditure which was deducted in computing the Appellant's profits is founded on:

> (1) the judgment of Diplock LJ in *London & Thames Haven Oil Wharves Ltd v Attwooll* [1967] Ch 772 ("*Attwooll*") to the effect that compensation received in respect of a failure to receive sums which would have been taxable trading receipts in the hands of the relevant taxpayer should be subject to tax as trading income; and
>
> (2) the decision of the Court of Appeal in *Donald Fisher (Ealing) Limited v Spencer (Inspector of Taxes)* [1989] STC 256 ("*Spencer*") which demonstrates that the same principle applies to compensation received in respect of expenses which have been treated as deductible trading expenses and which would not have been incurred but for the action which gave rise to the claim to compensation.

23. The correlation between compensation for foregone trading income and compensation for additional trading expenses was noted by Lord Hoffman in his decision in *Deeny and others v Gooda Walker Ltd (in voluntary liquidation) and others (Inland Revenue Commissioners third party) and related appeals* [1996] 1 STC 299 ("*Gooda Walker*") when he said:

"Although Diplock LJ refers to the trader's failure to receive a sum of money which would have been a revenue receipt, his principle must apply equally to compensation for his liability to pay a sum of money which was a revenue expense (see Donald Fisher (Ealing) Ltd v Spencer [1989] STC 256)."

24. Strictly speaking, all three of the above cases concerned the receipt of compensatory amounts by a taxpayer who was carrying on a trade and not a taxpayer who was carrying on a property rental business. However, it is common ground – and rightly so - that the principles described in those cases are equally applicable to a person carrying on a property rental

business because such businesses are taxed on the same basis as trades pursuant to Section 272 of the ITTOIA.

25. In *Attwooll*, the taxpayer owned a jetty which was damaged by the negligent handling of a tanker owned by a company (H Limited). H Limited paid a sum by way of damages to the taxpayer partly in respect of the cost incurred by the taxpayer in repairing the jetty and partly in respect of the consequential loss which the taxpayer had suffered because the jetty was out of use for an extended period while the repairs were carried out. The taxpayer also received a sum from its insurers in respect of the damage to the jetty and legal expenses which it had incurred. The taxpayer was assessed to income tax on such part of the aggregate sums in question as exceeded the cost of repairing the physical damage to the jetty. This was on the basis that such amount represented a payment to the taxpayer for loss of profits and should therefore have been included in the taxpayer's trading receipts. The taxpayer appealed on the grounds that the jetty was a capital asset and therefore that the amount in question had a capital nature as it was in respect of the damage to, and consequent sterilization of, that capital asset.

26. In finding against the taxpayer, the Court of Appeal held that a distinction should be drawn between the part of the aggregate sum which related to repairing the damage to the jetty and the part of the aggregate sum which related to the loss of the use of the jetty. The latter fell to be treated as income and not capital and, as such, amounted to a taxable revenue receipt.

27. The main significance of the case in the context of the present appeal is that Diplock LJ, in his judgement, set out a rule for determining the income or capital nature of monies received by a trader by way of compensation as follows:

"Where, pursuant to a legal right, a trader receives from another person compensation for the trader's failure to receive a sum of money which, if it had been received, would have been credited to the amount of profits (if any) arising in any year from the trade carried on by him at the time when the compensation is so received, the compensation is to be treated for income tax purposes in the same way as that sum of money would have been treated if it had been received, instead of the compensation.
The rule is applicable whatever the source of the legal right of the trader to recover the compensation. It may arise from a primary obligation under a contract, such as a contract of insurance, from a secondary obligation arising out of non-performance of a contract, such as a right to damages, either liquidated, as under the demurrage clause in a charterparty, or unliquidated, from an obligation to pay damages for tort, as in the present case, from a statutory obligation, or in any other way in which legal obligations arise.
But the source of a legal right is relevant to the first problem involved in the application of the rule to the particular case, namely, to identify what the compensation was paid for. If the solution to the first problem is that the compensation was paid for the failure of the trader to receive a sum of money, the second problem involved is to decide whether, if that sum of money had been received by the trader, it would have been credited to the amount of profits (if any) arising in any year from the trade carried on by him at the date of receipt, that is, would have been what I shall call for brevity an income receipt of that trade. The source of the legal right to the compensation is irrelevant to the second problem.
The method by which the compensation has been assessed in the particular case does not identify what it was paid for; it is no more than a factor which may assist in the solution of the problem of identification."

28. In *Spencer*, the taxpayer had a 15-year lease of business premises which were subject to a 5-year rent review. The landlord served a notice of increase suggesting a rent which was well in excess of the then current market rent for the property and the taxpayer instructed an estate agent to serve a counter-notice objecting to that figure. As a result of the estate agent's negligence, that counter-notice was not served and, consequently, the taxpayer incurred significantly more rent than it would otherwise have done. The Court of Appeal held that the compensation which was paid by the estate agent to the taxpayer in respect of that negligence was subject to corporation tax as a receipt of the taxpayer's trade because it was paid for the

loss suffered by the taxpayer in the form of increased rental payments (which were deductible expenses of the trade) and not for the diminution in value of the lease to the taxpayer.

29. In *Gooda Walker*, the relevant taxpayers were Lloyd's names who were awarded damages against their managing agents and member's agents for negligence in carrying out underwriting on their behalf. The principal source of the taxpayers' loss was that the agents had failed to secure protection for the losses which the taxpayers then incurred in the course of their trade. Accordingly, the damages awarded to the names were such amounts as would have put the taxpayers in the same position as if the agents had arranged reinsurance in respect of those losses. The House of Lords held that the damages in question were taxable revenue receipts of the taxpayers' trades because the taxpayers had entered into their contracts with the agents in the course of carrying on their underwriting trade.

30. However, Lord Hoffmann went further than the other Law Lords in his judgement in saying that another reason why the compensation was subject to tax as trading income in the hands of the taxpayers was that it had been received as compensation for a liability to pay sums of money which were deductible trading expenses.

31. The principles to be derived from the above cases are as follows:

(1) in determining the tax treatment of a sum received for a failure to receive a sum of money, one must first determine what the compensation was paid for (Diplock LJ's "first problem") and then decide whether the money in respect of which the sum has been paid would have been taxable as an income receipt had it been received (Diplock LJ's "second problem");

(2) the source of the legal right to the compensation is relevant only to the first problem and not the second problem;

(3) the method by which the compensation has been calculated does not identify what the compensation was paid for. The method is no more than a factor which may assist in identifying the answer to that question;

(4) a sum of money received in respect of a failure to receive a sum of money which, had it been received, would have been a taxable trading receipt is itself subject to tax as a trading receipt; and

(5) similarly, a sum of money received in respect of an expense which has been incurred as a deductible trading expense is subject to tax as a trading receipt.

32. There is no dispute between the parties as to any of the above. This leads naturally to the question of why, if the parties are ad idem on the events which have occurred and on the relevant legal principle to apply, they disagree on the correct tax treatment of the Basic Redress Element?

33. The answer to that question turns on the differences in the ways that the parties are analysing the reason why the Basic Redress Element was paid – Diplock LJ's first problem.

The arguments of the Appellant

34. The Appellant's position, as articulated by Mr Bowe, is based on a proposition of economics which Mr Bowe said was straightforward and simple to understand.

35. The starting point of his submission was a distinction between explicit costs and implicit costs, and, correspondingly, a distinction between accounting profit and economic profit. In summary, Mr Bowe explained that an explicit cost was a cost which required an outlay of money or an asset and which therefore appeared in the accounts of the person who incurred it, whereas an implicit cost was something which did not appear in those accounts – most

relevantly in this case, the opportunity cost inherent in that person's being in the position it was actually in or, to put it another way, the value that the relevant person gave up in order to reach the position it was actually in. As an implicit cost, unlike an explicit cost, did not appear in the person's accounts, it was not taken into account in determining the person's accounting profit.

36. In this case, said Mr Bowe, the Swap was "at the money" at the time when it was executed. In other words, before there was any change in the prevailing market rates of interest following the execution of the Swap, the Swap had neither a positive value nor a negative value for either of the Appellant or Barclays. It followed from this, said Mr Bowe, that the only cost to which the Swap gave rise was an implicit cost – namely, the opportunity cost incurred by the Appellant in entering into the Swap and therefore being deprived of the opportunity to pursue an alternative strategy instead – such as, in this case, entering into the Cap. Thus, when Barclays paid the Basic Redress Element to the Appellant, it was compensating the Appellant for the implicit cost of the Appellant's entering into the Swap – which was the inability of the Appellant to enter into the Cap instead. Since that implicit cost was never reflected in the accounts of the Appellant, the Basic Redress Element was not referable to any revenue item which appeared in those accounts. Instead, it was capital in nature. As such, that element could not be subject to income tax. Putting it in another way, Mr Bowe said that, if entering into the mis-sold asset – ie the Swap – meant that the Appellant was unable to enter into an alternative IRHP – ie the Cap – then the damage sustained by the Appellant, and the reason why Barclays paid the Basic Redress Element, was the Appellant's inability to enter into the Cap. The Basic Redress Element was not being paid to compensate the Appellant for any expenses which were incurred under the Swap and which appeared in the Appellant's accounts.

37. Mr Bowe advanced this proposition in several different ways and at some length but that was the essence of his position.

38. In support of his view that the Basic Redress Element was compensation for the implicit cost of entering into the Swap and not for the payments which the Appellant had made under the Swap, Mr Bowe made the following points:

(1) first, he referred to the part of the redress offer letter which said that Barclays' point of sale review decision was "that the Bank will terminate your £1,818,000, 10 year, Interest Rate Swap and replace it with a matured £1,500,000, 5 year, Interest Rate Cap". This, he said, was indicative of the fact that the Basic Redress Element was attributable to the Appellant's failure to obtain the Cap, as opposed to the fact that the Appellant had had to make payments under the Swap, as a result of Barclays' mis-selling;

(2) secondly, he reiterated that, because an interest rate swap which is "at the money" at the time when it was executed (such as the Swap) gave rise to neither a gain nor a loss at the time when it was executed, the only cost to which such an interest rate swap could give rise as a matter of economic analysis was the opportunity cost of not pursuing the course of action which was the alternative to entering into the interest rate swap, whether that alternative be retaining an exposure to floating rates of interest or, as would have been the alternative position in this case, retaining an exposure to floating rates of interest but purchasing a cap to avoid exposure to floating rates which exceeded a specified amount;

(3) thirdly, he distinguished between an interest rate swap which was entered into in order to hedge an exposure under a loan (as was the case here) and an interest rate swap which was entered into as a speculation. He said that the latter might well give rise to a profit or loss whereas the former would not because it would always be matched by an equal and opposite loss or profit under the loan which was being hedged;

(4) fourthly, he made the point that, even if the Basic Redress Element was expressed to be a refund of payments previously made by the Appellant under the Swap, that was merely a description of the payments which Barclays was making and said nothing about the source of (or reason for) such payments - in the same way that a restaurant which damaged a diner's suit during the course of a meal might describe the compensation which it paid to the diner for the damage to the suit as a refund of the monies paid by the diner for his or her meal. In the latter case, the source of the compensation would be the damage to the suit and not the meal for which the diner had paid and yet the compensation might still be described as a refund of the price which the diner had paid for the meal;

(5) fifthly, and in a similar vein, he made the point that, as noted by Diplock LJ in *Attwooll*, the mere fact that a compensation payment was calculated by reference to something did not mean that that was the source of the compensation. In other words, the method by which compensation was calculated did not identify what the compensation was paid for. The method of calculation was no more than a factor which might assist in identifying the answer to that question;

(6) sixthly, he provided, as an analogous case to this one, the example of a taxpayer who, as a result of mis-selling, entered into a £100 loan carrying a 5% fixed rate of interest for a year, instead of a £100 loan carrying a floating rate of interest for the year. In that case, he said, assuming that floating rates for the year dropped to 1% on the day after the loan was made, the cost incurred by the taxpayer as a result of the mis-selling would be solely the implicit cost (or the opportunity cost) of having given up his or her opportunity to borrow at the floating rate when entering into the fixed-rate loan. Although the compensation payable to the taxpayer of 4 would be calculated by reference to the excess of the interest actually paid by him or her (of 5) over the interest which he or she would have paid if he or she had not given up that opportunity (of 1), the source of the compensation would be solely the implicit cost of having given up that floating rate opportunity and that would not be a cost which was reflected in the accounting profits of the taxpayer. Hence, the compensation would not be taxable as income; and

(7) finally, he said that the principles of basic redress which were set out on the FCA website showed that this analysis was correct because, in a case where a customer would have chosen the same IRHP even if the mis-selling had not occurred, the FCA specified that no redress would be received. This, he said, demonstrated that, in each case, the basic redress was founded on the opportunity which was lost by reason of the mis-selling. The fact that no alternative IRHP would have existed in such cases was the reason why no compensation was due to customers falling within this category.

Conclusion

39. In reaching my conclusion on this point, I cannot help but think of the words with which Willmer LJ started his judgment in *Attwooll* as follows:

> "In the course of the argument this has been made to appear to be a difficult and complicated case, but it is in fact a very simple case, and in my judgment a very plain case."

40. I have had the very same thoughts in considering the present point.

41. I have no reason to doubt Mr Bowe's proposition to the effect that, as a matter of basic economic theory, in calculating the economic profit which arises from any transaction or activity, it is necessary to take into account the implicit costs of that transaction or activity in addition to the explicit ones and that those implicit costs include the opportunity costs of undertaking the relevant transaction or activity.

42. But, with the greatest of respect to Mr Bowe, that is not the question which I am required to answer in this case. Instead I need to identify the reason why Barclays offered to pay, and ultimately did pay, the Basic Redress Element to the Appellant. In other words, to adopt the language used by Diplock LJ in *Attwooll*, I need to identify the source of that element of the Compensation.

43. In cases where one person sustains a loss as a result of the tortious act of another person, it is commonly the case that the loss in question can be described in more than one way. A good example of this is *Spencer*, where the event which gave rise to the compensation payment to the taxpayer was the negligent failure by the estate agent to serve the counter-notice. The consequence of that failure was that the rent payable under the lease became greater than the market rent which the taxpayer was entitled to pay under the terms of the lease. It was possible to describe the loss incurred by the taxpayer in that instance as the increased rent which the taxpayer became liable to pay as a result of the estate agent's negligence or, alternatively, as the decline in the value to the taxpayer of the taxpayer's lease caused by that additional rent. Both of those descriptions would have been accurate. However, the Court of Appeal held that the correct approach was to identify the reason for the compensation which was paid to the taxpayer. Thus, Kerr LJ said the following:

"In the present case the question is: On which side of the line does this payment of compensation fall? How is it to be characterised? As the judge pointed out, one can obviously say that the payment was made to compensate the tenant for the additional rent which it had to pay due to the negligence of the agent. That is a simple and obvious approach. Or one could look at it in another way by saying, as counsel for the taxpayer company would say, that the lease is now onerous and of lesser capital value because more rent is payable under it; therefore it has diminished its value as a capital asset. But for myself, there is no doubt that the conclusion of Walton J was correct and that there was no error of law in the same conclusion of the Special Commissioner. This compensation was paid in the context of a dispute as to what rent was payable by the taxpayer company to the landlord for the second period of the lease, having regard to the events which occurred in relation to the rent review clause. The failure to serve the counter-notice had the direct effect of increasing the rent. So if one asks oneself: What was the nature of the loss for which the compensation was paid—what was it paid for; what was its purpose?—it seems to me that it was obviously paid for the increased rent which the taxpayer company had to pay as the result of the negligence. That was the basis of the tenant's claim in negligence against Mr Clay, and the payment was made to settle that claim. The predominant feature or characterisation of this payment and of its purpose follow from these considerations….

Accordingly, I conclude that the judge was right in upholding the Special Commissioner. I think I should briefly refer to the way in which he put it, with which I agree. He said ([1987] STC 423 at 430):

'Now what was the £14,000 paid for? It was undoubtedly paid by the agent as damages for the agent's negligence which led to the damage which was suffered by the taxpayer company. And what was the damage suffered by the taxpayer company? The damage suffered by the taxpayer company was that for the remaining five years of the lease (or something of that order) the taxpayer company would have to pay a rent of £11,500 per annum in lieu of whatever the proper rent ought to have been.'

Pausing there, as counsel for the taxpayer company has pointed out, there is a slight factual error. It was not the remaining five years, but the second five years, with possible consequences for the last five years.

The judge continued:

'It is of course possible to put the matter in the alternative form—and this is indeed what counsel for the taxpayer company, has attempted to do—and to say that the sum of £14,000 was damages for the diminution in value of the lease in the hands of the taxpayer company. That is undoubtedly the case, but why had the lease diminished in value in the hands of the taxpayer company? The answer to that

question can only be that it was because there was more rent payable thereunder than would have been payable had the agent not been negligent. So it appears to me that, although there is an alternative way of putting the damage caused to the taxpayer company, there is no real difference in principle whatsoever. The damage is that from then on the taxpayer company had to pay more rent than otherwise it would have done."'

44. Similarly, in this case, whilst one description of the loss sustained by the Appellant as a result of the mis-selling is that the Appellant was unable to enter into the Cap and was instead bound by the terms of the Swap, the relevant question is not how the Appellant's loss is capable of being described but rather what was the reason why the Basic Redress Element was paid to him. And, in my view, it is absolutely clear that the Basic Redress Element in this case was paid in order to compensate the Appellant for the fact that, by entering into the Swap as a result of Barclays' mis-selling, the Appellant incurred more expenses than he would have done if that mis-selling had not occurred. In the words of Kerr LJ in *Spencer*, that is the "simple and obvious approach".

45. In short, however compelling Mr Bowe's proposition may be as a matter of the economic analysis of the events which transpired, it is simply not the case that the Basic Redress Element was paid in order to compensate the Appellant for his inability to obtain the Cap. Instead, the Basic Redress Element was paid in order to compensate the Appellant for the expenses which he incurred under the Swap – to the extent that those exceeded the expenses which he would have incurred under the Cap – and therefore the Appellant is subject to income tax in respect of his receipt of the Basic Redress Element.

46. My reasons for reaching this conclusion are basically the reasons put forward by Mr Bradley on behalf of the Respondents at the hearing and may be summarised as follows:

(1) the starting point in identifying the reason why the Basic Redress Element was paid is to consider the background to the making of the payment and the terms of the redress offer which Barclays made to the Appellant;

(2) under the terms of the review which the FSA agreed with the banks, small and medium sized businesses ("SMEs" and each an "SME") who were mis-sold IRHPs were entitled to fair and reasonable redress. As with any other tortious act, the legal principle involved was to put the relevant SME in the position in which it would have been had the mis-selling not occurred;

(3) that is why the FCA in the extract from its website which is set out in paragraph 9 above referred to three distinct categories of SMEs which had been mis-sold IRHPs. The first category was those SMEs who would not have bought an IRHP at all if the mis-selling had not occurred. SMEs in that category were to be entitled to "receive a full refund of all payments under their IRHP". The second category was those SMEs who would have chosen precisely the same IRHP even if no mis-selling had occurred and also those SMEs who had suffered no loss as a result of entering into their mis-sold IRHP. SMEs in that category were not entitled to receive any redress. The final category of SMEs was the category into which the Appellant fell – those SMEs who would have chosen an alternative IRHP if the mis-selling had not occurred. Those SMEs were to be entitled to "receive redress based on the difference between the payments they would have made on the alternative product, compared with the payments they did make";

(4) just pausing there, and particularly because Mr Bowe claimed that the absence of any entitlement to redress for the second category of SMEs described above supported his case, I believe that, on the contrary, the language used by the FCA in that extract clearly supports the arguments of the Respondents.

In the first place, the language used in relation to the category of SMEs which is pertinent to this appeal – the final category – referred to the difference between the payments made by the relevant SME under the mis-sold IRHP and the payments which the relevant SME would have been required to make under the alternative IRHP. In other words, it was focused on the actual payments made by the relevant SME as compared to the actual payments which the relevant SME would have made if the mis-selling had not occurred. It was not expressed in terms of compensation for a foregone asset – namely, compensation for the failure to receive the alternative IRHP of which the relevant SME had been deprived as a result of the mis-selling.

In the second place, the same approach can be observed in relation to the first category of SMEs. The FCA did not say – as Mr Bowe's approach would have it say – that that category of SMEs was to be compensated for the benefit which they would have obtained if the mis-selling had not occurred and they had not entered into the mis-sold IRHPs – which is to say, the benefit of retaining an exposure to the floating rates of which they had been deprived as a result of entering into the mis-sold IRHPs. Instead, in keeping with the approach in relation to the third category of SMEs noted above, the FCA simply expressed the redress to be based on the payments which had been made under the mis-sold IRHPs.

Finally, in relation to the second category of SMEs, the fact that no redress was payable at all is not in any way supportive of the proposition that the compensation paid to SMEs in the third category must have been attributable to a failure to obtain the alternative IRHPs. Instead, it is merely indicative of the fact that SMEs in that category suffered no loss at all as a result of entering into the relevant IRHPs. Those SMEs in that category who had incurred losses under the relevant IRHPs but would have entered into the relevant IRHPs in any event were not entitled to compensation not because, in each case, there was no alternative IRHP for which the relevant SME deserved compensation but rather because, under general principles of tort law, the mis-selling had given rise to no loss. In that case, the losses which the relevant SME had suffered under the IRHP into which it had entered would have been suffered in any event in the absence of the mis-selling;

(5) just as the terms of the above extract from the FCA website made it clear that the reference to the alternative IRHP in relation to the third category of SMEs was merely to quantify the extent to which the mis-selling had given rise to excess payments by the relevant SME, so too did the terms of Barclays' redress offer letter.

In my view, that letter could not be clearer in stipulating that the offer which was being made to the Appellant was to reimburse the Appellant for the payments which he had made under the Swap but to do so only to the extent that those payments exceeded the payments which the Appellant would have incurred under the Cap had the mis-selling not occurred. That is apparent from the language in paragraph i at the start of the letter and in the redress offer summary, both of which are set out in paragraph 8(9) above. The reason for the deduction, in quantifying the Basic Redress Element, of the payments which would have been made under the Cap had the Appellant entered into the Cap was obvious. That was because the Appellant would have incurred expenses of that amount in any event even if the mis-selling had not occurred. It would therefore have been inappropriate for the Appellant to be compensated for all of his expenses under the Swap, as was the case for an SME falling within the first category of SMEs described in the extract from the FCA website. Instead, the expenses under the notional Cap had to be deducted before the true measure of the loss sustained by the Appellant by virtue of the mis-selling could be quantified.

In that context, I do not consider that the language used by Barclays in referring at one point in the redress offer letter to replacing the Swap with the Cap carries the weight which Mr Bowe alleges that it had. That reference needs to be construed in the light of the content of the whole redress offer letter and the FCA guidance (to which the letter referred) and, viewed in that context, that passage was doing no more than saying that the Basic Redress Element had been calculated by reference to the excess of the actual expenses incurred by the Appellant under the Swap over the expenses which the Appellant would have incurred under the Cap had the mis-selling not occurred;

(6) the fact that the redress offer letter referred to the Basic Redress Element as a "refund" and that the relevant element was calculated by reference to the payments which the Appellant had made under the Swap is entirely consistent with my interpretation of the terms of the redress offer letter. I accept both Mr Bowe's submission that the fact that a compensation payment is described as a "refund" does not in itself mean that the source of the compensation is the matter to which the refunded payment related – as in the case of the diner's ruined suit – and Mr Bowe's submission that the manner in which compensation has been calculated is not in itself conclusive of the reason why the compensation has been paid. The latter of course was a point made by Diplock LJ in *Attwooll*, albeit with the caveat that the method by which compensation was assessed in any particular case was "a factor which may assist in the solution of the problem of identification". However, the mere fact that, in any particular case, neither the description of the compensation as a "refund" of payments previously made nor the calculation of the compensation by reference to payments previously made is determinative of the fact that the compensation relates to the matter for which those previously-made payments were incurred does not mean that there are not cases where those two elements are indicative that the compensation does relate to the matter for which the previously-made payments were incurred and, in my view, this is one such case; and

(7) in the light of the above, I do not think that the point made by Mr Bowe as set out in paragraph 38(3) above is particularly enlightening in the context of the present dispute although I would just say that, in my view, an interest rate swap which is entered into for hedging purposes is just as capable of giving rise to a profit or a loss as an interest rate swap which is entered into as a speculation. The fact that there is an equal and opposite loss or profit on the loan which is being hedged so that the overall effect is neutral does not mean that, as a separate asset or liability, the interest rate swap is incapable of giving rise to a profit or loss, as can be demonstrated by the result if the interest rate swap is terminated and the underlying loan is left on foot.

47. For the reasons set out in paragraphs 46(1) to 46(7) above, I consider that the Basic Redress Element was paid in respect of the payments which the Appellant had incurred under the Swap – to the extent that those payments exceeded the payments which the Appellant would have incurred under the Cap – and that those payments were therefore the source of the Basic Redress Element. The Basic Redress Element was therefore a taxable revenue receipt of the Appellant's property rental business and was properly subject to income tax in the hands of the Appellant, as determined by the Respondents in their closure notice.

48. However, I wish to add the following. Although it does not form part of the reasons for my decision, I am reinforced in the above conclusion by the following three observations:

(1) the first is the "striking consequence" (to paraphrase Kerr LJ in *Spencer* at page 259g) that if, in a case such as this one, the compensation were not to be subject to tax as income, then the recipient of the compensation would be better off than if the event which

has given rise to the compensation had not occurred. And that seems intuitively to be the wrong result. At the hearing, Mr Bowe was at pains to point out that, on the particular facts of this case, the Appellant would be worse off if I were to decide that the compensation was taxable as income because the marginal rate of income tax applicable to the Appellant in the tax year in which the Compensation was received was higher than the marginal rate of income tax applicable to the Appellant in the tax years in which the payments under the Swap accrued. That may well be so but, as a matter of principle, and disregarding the peculiar feature of there being different applicable marginal rates in the relevant tax years in this case, it seems entirely appropriate that compensation which, to put it neutrally, has been quantified by reference to expenses that were deducted as revenue items should be taxable as income in order to preserve symmetry;

(2) the second arises out of the fact that, in many cases which concern compensation for revenue expenses, it will be possible to identify either damage to an existing capital asset – as was the case in *Spencer* – or a failure to receive a capital asset – as is the case here – or the disposal of a capital asset – as Mr Bowe analysed to be the cost arising to the Appellant as a result of entering into the analogous fixed rate loan as described in paragraph 38(6) above - as the corollary of those revenue expenses. The latter is a particularly helpful example of a case where an over-zealous approach to economic theory serves only to obfuscate what I would consider to be the clear and obvious true position. If a person is mis-sold a fixed rate loan and, in consequence, receives compensation which is calculated by reference to the greater interest costs which he or she has incurred under that fixed-rate loan than he or she would have incurred had the loan carried a floating rate, then the most natural way to characterise the source of that compensation is that it is compensation for the additional interest costs which have been incurred as a result of the mis-selling. To describe the source of that compensation as being the implicit cost of having been deprived of the opportunity to enter into a floating-rate loan seems to me to be counter-intuitive and therefore misconceived; and

(3) the final point arises out of a fatal circularity which is an inevitable consequence of Mr Bowe's submission. This is attributable to the fact that the notional Cap, when valued by reference to the payments and receipts to which it would have given rise for the Appellant had it existed, never had a value which was remotely close to the amount of the Basic Redress Element. On the contrary, the Cap would have given rise to no payments at all for the Appellant if it had existed. It would just have given rise to an expense – namely, the initial premium which the Appellant paid on entry. This means that the Cap can be said to have had a value equal to the Basic Redress Element only by taking into account the fact that, by entering into the Cap, the Appellant would not have entered into the Swap. And the value to the Appellant of his not entering into the Swap was, of course, the amount by which the payments made by the Appellant under the Swap exceeded the payments which the Appellant would have made under the Cap, if the Cap had existed. This then becomes entirely circular. In other words, if one says that the loss to the Appellant of his entering into the Swap was that he was unable to enter into the Cap, as Mr Bowe alleges, then it is not possible to identify the value of that Cap solely by reference to the payments which would have been made and received by the Appellant under the Cap. Instead, that value has to be calculated by taking into account the cost to the Appellant of his having had to enter into the Swap. Everything then goes back to the fact that the expenses incurred by the Appellant under the Swap were greater than the expenses which the Appellant would have incurred under the Cap. The Cap had no objective value to the Appellant other than that. And, in my view, that very strongly suggests that the compensation in this case must ultimately be identified as being attributable to those excess revenue expenses under the Swap.

The Interest Element

The arguments of the Appellant

49. Unlike the position which pertains in respect of the Basic Redress Element, there is a difference between the parties in relation to their respective analyses of the legal principles which are applicable when it comes to identifying amounts that properly constitute "interest" for tax purposes.

50. Mr Bowe submitted that, before an amount could constitute "interest", it needed to be calculated by reference to an amount which was due. In this case, he said, no amount became due from Barclays until the offer to pay the Basic Redress Element was accepted and that amount became a debt. However, the Interest Element was calculated by reference to periods which largely fell well before that time. It followed that the Interest Element could not be "interest" properly so called.

51. Mr Bowe added that the 8% simple rate which was the basis for the calculation of the Interest Element could not be described as anything like an appropriate rate of compensation for the time value of money in this case as it was considerably in excess of the rate at which Barclays' was generally able to borrow, given its credit risk. The Interest Element therefore had to be compensation for something else.

52. In addition, on the facts in this case, if the mis-selling had not occurred and the Appellant had had the benefit of the Cap, the benefits enjoyed by the Appellant would all have been passed down to the company owned by the Appellant and to whom the Appellant leased the relevant properties. Thus, if one was identifying the person who had suffered any detriment as a result of the mis-selling, that person was the company and not the Appellant. It therefore made no sense to compensate the Appellant for the time value of money in this case.

53. It followed from the above that the Interest Element in this case was no more than additional compensation for the failure on the part of the Appellant to be able to enter into the Cap as a result of the mis-selling. That analysis was supported by the terms of the FCA guidance and the redress offer letter, which made it clear that, in each case, the so-called "interest" on the basic redress amount was no more than an estimate of the consequential loss which had been suffered by the victim of the mis-selling, which the victim could accept in lieu of having to undergo the complex process of calculating its actual consequential losses.

Conclusion

54. I fundamentally disagree with Mr Bowe's analysis of the position in relation to the Interest Element, again largely for reasons which were articulated by Mr Bradley at the hearing.

55. Before I turn to deal with the specific facts of this case, it is incumbent on me to elaborate on the case law in relation to the meaning of the word "interest", as I believe that Mr Bowe's analysis of the law in this area is erroneous.

56. The three cases whose principles inform the analysis of what amounts to "interest" for tax purposes are *Riches v Westminster Bank Ltd* [1947] AC 390 ("*Westminster*"), *Re Euro Hotels (Belgravia)* Limited [1975] STC 682 ("*Euro Hotels*") and *Chevron Petroleum (UK) Ltd & others v BP Petroleum Development Ltd & others* (57 TC 137) ("*Chevron*").

57. In *Westminster*, a person who received damages for a failure to receive a sum of money which would have been due to him had the defendant not acted fraudulently received, as part of those damages, an amount equal to interest on the sum to which he would have been entitled if he had not been defrauded. That sum was calculated by applying an interest rate to the sum which the relevant person should have received from the defendant from the date when the sum should have been received down to the date of the judgement. The House of Lords held that

the part of the overall damages payment which was the amount equal to interest was "interest" for the purposes of the schedule of the tax legislation under which interest was subject to tax. It rejected the argument for the taxpayer that the relevant sum could not be interest for that purpose because it was damages. Viscount Simon said the following in relation to that argument:

"The appellant contends that the additional sum of 10,028l., though awarded under a power to add interest to the amount of the debt, and though called interest in the judgment, is not really interest such as attracts income tax, but is damages. The short answer to this is that there is no essential incompatibility between the two conceptions. The real question, for the purpose of deciding whether the Income Tax Acts apply, is whether the added sum is capital or income, not whether the sum is damages or interest. Before the coming into force of the Act of 1934, the rule at comon (sic) law prevailed that when an action for the payment of a debt succeeded the court could not add interest on the debt down to judgment unless interest was payable as of right under a contract expressed or implied. Provisoes (b) and (c) of s. 3 show that these exceptions were not touched by the Act of 1934 and the discretion conferred on the court by the enacting words is a direction to add interest when judgment is given for a debt or damages, although there is no contractual right to interest. The added amount may be regarded as given to meet the injury suffered through not getting payment of the lump sum promptly, but that does not alter the fact that what is added is interest. This is the view taken by Evershed J., and by the Court of Appeal (du Parcq, and Morton L.JJ. and Cohen J.). Notwithstanding Mr. Grant's excellent argument, this view, in my opinion, is correct"

and Lord Wright added:

"The contention of the appellant may be summarily stated to be that the award under the act cannot be held to be interest in the true sense of that word because it is not interest but damages, that is, damages for the detention of a sum of money due by the respondents to the appellant and hence the deduction made as being required under r. 21 is not justified because the money was not interest. In other words the contention is that money awarded as damages for the detention of money is not interest and has not the quality of interest. Evershed J. in his admirable judgment rejected that distinction. The appellant's contention is in any case artificial and is in my opinion erroneous because the essence of interest is that it is a payment which becomes due because the creditor has not had his money at the due date. It may be regarded either as representing the profit he might have made if he had had the use of the money, or conversely the loss he suffered because he had not that use. The general idea is that he is entitled to compensation for the deprivation. From that point of view it would seem immaterial whether the money was due to him under a contract express or implied or a statute or whether the money was due for any other reason in law. In either case the money was due to him and was not paid, or in other words was withheld from him by the debtor after the time when payment should have been made, in breach of his legal rights, and interest was a compensation, whether the compensation was liquidated under an agreement or statute, as for instance under s. 57 of the Bills of Exchange Act, 1882, or was unliquidated and claimable under the Act as in the present case. The essential quality of the claim for compensation is the same and the compensation is properly described as interest."

58. In *Euro Hotels*, an agreement for lease between a landlord and its tenant in relation to a site that was being developed provided that, once the aggregate payments made by the landlord for the purpose of carrying out the development exceeded a certain figure, then, until the lease was granted, the landlord would pay interest on that aggregate amount. Sir Robert Megarry J held that that interest amount was not "interest" properly so called because, in order for a payment to be interest, two requirements had to be satisfied. The first was that there needed to be a sum of money by reference to which the payment was to be ascertained and the second was that that sum of money needed to be due to the person entitled to the interest. In *Euro Hotels*, the second of those requirements was not met because the sum of money by reference to which the payment was calculated was just a unit of calculation - it could not be said that that sum was in any way due from the tenant to the landlord. The Judge said as follows:

"The word 'interest' has a wide and flexible meaning; …It has, quite rightly, not been suggested that the language used by the parties to an instrument in describing payments to be made under it can bind the Inland Revenue, or affect the operation of a statute. The question must always be one of the true nature of the payment. The language, of course, is important, for the words used may mould or affect the nature of the obligation; but one must always return to a consideration of what, given that language, the payments made under the obligation truly are: are they 'interest of money' within the meaning of the statute?

The relevant sense of the word 'interest' as given in the Shorter Oxford English Dictionary is 'Money paid for the use of money lent (the principal), or for forbearance of a debt, according to a fixed ratio (rate per cent)'. A similar idea is conveyed by the language used in certain authorities….

It seems to me that running through the cases there is the concept that as a general rule two requirements must be satisfied for a payment to amount to interest, and a fortiori to amount to 'interest of money'. First, there must be a sum of money by reference to which the payment which is said to be interest is to be ascertained. A payment cannot be 'interest of money' unless there is the requisite 'money' for the payment to be said to be 'interest of'. Plainly, there are sums of 'money' in the present case. Second, those sums of money must be sums that are due to the person entitled to the alleged interest; and it is this latter requirement that is mainly in issue before me."

59. In *Chevron*, two groups of companies each held a production licence over adjacent areas of the North Sea. The two groups agreed that the two adjacent areas should be developed and operated as a single unit. As part of that overall agreement, it was agreed that all expenditure in relation to that single unit was to be shared in proportion to the total estimated oil attributable to each area but that, as and when the actual oil attributable to each area was known, an adjusting payment would be made between the parties to reflect that re-determination. The adjusting payment was expressed to include an amount of interest on the payment that was being made to reflect the re-determination. Sir Robert Megarry J held that the interest component was "interest" properly so called because, although the sum of money which was due from one group to the other was not known at the outset, there was an obligation at the outset to make the adjustment payment once the oil attributable to each area was known. The interest component was therefore properly to be characterised as payment by time for the use of money.

60. It may be seen from the cases described above that:

(1) if a payment constitutes "interest" properly so called, it will not cease to be such merely because it is included in a greater aggregate sum of money – see *Westminster*;

(2) in order for a payment to be "interest" properly so-called, it merely needs to be compensation for the time value of money. In other words, it must be compensation to the recipient for the profit that the recipient might have made if he or she had had the relevant money on time or compensation to the recipient for the loss the recipient has suffered because he or she did not have the relevant money on time – see *Westminster*;

(3) in order for a payment to be "interest" properly so called, there needs to be a sum of money by reference to which the payment was ascertained and that sum of money needs to be due to the person entitled to the payment– see *Euro Hotels*; and

(4) however, it is not necessary for the sum of money in respect of which the payment has been calculated to be known to be due on the date on which the payment starts to accrue. It is possible to determine with the benefit of hindsight that the relevant sum should have been due on a particular date and then to calculate the payment on the relevant sum from that date – see *Westminster* and *Chevron*.

61. I now turn to the facts in this particular case.

62. As was the case in relation to determining the character of the Basic Redress Element, it is first necessary to determine the reason for the payment of the Interest Element and that reason is to be deduced from the background to, and the terms of, the redress offer letter.

63. In the extract from the FCA website set out in paragraph 9 above, the FCA described the interest element of the compensation payments which the banks would make as follows:

"Interest: The opportunity cost (loss of profits or interest) of being deprived of the money awarded as basic redress.

The banks will either pay 8% a year of simple interest, or an interest level in line with:

1. an identifiable cost that the customer incurred as a result of having to borrow money; or

2. an identifiable interest rate that a customer has not earned as a result of having less money in the bank.

Taking into account the economic environment over the last five years, interest will avoid many customers from having to put together consequential loss claims."

64. This description of the interest element was as close as it could possibly be to the classic definition of "interest" set out in the above cases. In other words, the interest element was intended to compensate the relevant recipient for the fact that he or she was out of his or her money for a period of time as a result of the mis-sold IRHP. In that respect, the recipient could either accept the 8% simple which was being offered as a straightforward and simple estimate of the cost to the recipient of being out of his or her money for a period of time or make a specific claim to show that his or her circumstances were such that the actual costs to him or her of being out of his or her money was greater than that estimate.

65. The redress offer letter was phrased in exactly the same way. Paragraph ii on the first page of the letter described the Interest Element as amounting to "interest at 8% simple per year on the refunded IRHP amounts under this redress offer, for a period up to and including 90 days following the date of this letter". In addition, the letter went on to say that the same interest calculation would be made in relation to IRHP payments made after 26 November 2013 as the Basic Redress Element did not take such payments into account (although, in this case, there appear to have been no such payments). Then, under the heading "Consequential losses", the letter said as follows:

"This redress offer includes interest at a rate of 8% simple per year on all refunded IRHP amounts. This is intended to compensate you for (i) any interest on money you have had to borrow to make payments under a missold IRHP; and/or (ii) lost profits or opportunities incurred because you were required to make payments under a missold IRHP…

You will see that the FCA guidance explains that, in respect of the opportunity cost of customers being deprived of money, customers can choose between either: (i) accepting the offer of interest at a rate of 8% simple per year on the amounts refunded in respect of the missold IRHP; or (ii) submitting a specific claim for consequential loss in respect of identifiable costs incurred or interest rate not earned as a result of the missale of the IRHP."

66. Again, it is clear from the above terms that the Interest Element was intended to be compensation for the fact that the Appellant had been deprived of his money for a period of time as a result of having to make payments under the Swap which were in excess of the payments which the Appellant would have made under the Cap and that, in lieu of accepting compensation for that at the rate of 8% simple, it was open to the Appellant to show that the actual costs to him of being out of his money for that period of time were greater than the compensation reflected in that interest rate.

67. Both the FCA website and the redress offer letter made it clear that:

(1) in the event that a claimant such as the Appellant were to make a claim for consequential loss based on actual loss of profits/opportunity and/or interest on borrowings, that might lead to compensation for those matters which was lower than the Interest Element; and

(2) the 8% simple interest calculation was an alternative only to the heading of consequential losses which related to loss of profits/opportunity and/or interest on borrowings. Consequential loss claims based on other items of expenditure such as out-of-pocket expenses, bank charges, professional advisers' fees and tax were not alternatives to the 8% simple interest calculation.

68. The inescapable conclusion from the matters described above is that the Interest Element was intended to compensate the Appellant for being out of his money because of the additional expenses which he incurred as a result of entering into the Swap instead of the Cap. Those additional expenses meant that the Appellant might either have had to borrow money to replace the money that he had expended or have missed out on a valuable opportunity to earn revenue from the money he had expended. In either case, the Appellant needed to be compensated for that. The Interest Element was that compensation. As such, the Interest Element was properly characterised as "interest" when it was included in the Compensation.

69. It does not matter that, at the time when each excessive payment under the Swap was made, it was not known to be excessive. The same could be said of the damages for fraud in *Westminster* and the contractual payments in *Chevron*. The key issue is that, by the time that the redress offer was made by Barclays, it had been determined that those payments were excessive at the time when they were made and that the Appellant needed to be compensated for being out of his money from the time when they were made. That is why the Interest Element was added to the amount which had to be refunded. It was added in order fully to compensate the Appellant for the impact of the mis-sale because simply refunding the excess payments on its own wouldn't be sufficient to do that.

70. For the same reason, the fact that the interest rate of 8% simple bore no relationship to the rate at which Barclays was generally able to borrow because of its own creditworthiness is irrelevant. The payment was being calculated to compensate the Appellant for being out of pocket in respect of the excess payments over the period in question. The Appellant might well have had to borrow an amount equal to the shortfall arising as a result of the excess payments and, in that event, the rate at which the Appellant might have had to borrow could easily have been 8% simple. Alternatively, the Appellant might well have been unable to pursue another revenue-making opportunity because of the shortfall arising as a result of the excess payments and, in that event, the rate of return which the Appellant might have derived from the foregone revenue-making opportunity could easily have been 8% simple. It was presumably for that reason that the rate of 8% simple was chosen. In any event, it matters not whether the rate of 8% simple was an accurate measure of the cost to the Appellant of being out of his money as a result of the excess payments. All that matters is that the Interest Amount was calculated by applying the rate in question to the excess payments from the date when they were made in order to compensate the Appellant for being out of his money. That means that the two conditions set out by Sir Robert Megarry J in *Euro Hotels* was satisfied.

71. It follows from the above that, in my view, it is clear beyond any reasonable doubt that the Interest Element was "interest" properly so called and therefore that it was subject to income tax as such in the hands of the Appellant.

CONCLUSION

72. The result of the conclusions set out above is that this appeal fails. It is my view that each of the Basic Redress Element and the Interest Element is properly chargeable to income tax and therefore the closure notice was correct.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

73. 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.

TONY BEARE
TRIBUNAL JUDGE

RELEASE DATE: 11 SEPTEMBER 2020