[2022] UKFTT 00026 (TC)

TC 08378/V

Appeal number: TC/2016/05931
TC/2017/02448

INCOME TAX, NATIONAL INSURANCE CONTRIBUTIONS – award of bonuses under contracts for differences - whether under the Income Tax (Pensions and Earnings) Act 2003 the arrangements in place were contracts for differences for the purposes of Part 7 of ITEPA – no – whether the payments made to employees should be treated as cash – yes – appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

(1) JONES BROS RUTHIN (CIVIL ENGINEERING) CO LTD **Appellants**

-and-

(2) BRITANNIA HOTELS LTD

- and -

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

TRIBUNAL: JUDGE JENNIFER DEAN
MEMBER: MISS SUSAN STOTT

The hearing took place on 12, 15, 16, 17 and 18 March 2021 using the Tribunal's video platform. It was not in the interests of justice to hold a face-to-face hearing because of the pandemic. It was attended remotely by counsel and witnesses of the Appellants and Respondents. Prior notice of the hearing had been published on the gov.uk website, together with information about how representatives of the

media or members of the public could apply to join the hearing remotely in order to observe the proceedings. The hearing was therefore held in public.

Mr K. Prosser QC, Counsel for the Appellant

Mr T. Brennan QC and Mr C. Stone, Counsel instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. These are the appeals of Jones Bros Ruthin (Civil Engineering) Co Ltd and Britannia Hotels Ltd. The two appeals were heard together because they give rise to similar questions of fact and law. There are also a number of additional appeals which raise similar issues and which have been stayed as "related cases" under Rule 18 of the Tribunal Rules.

2. Both cases concern the interpretation and application of the provisions under the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"), Part 7. It is common ground that the Tribunal is only concerned in this decision with the the issues of principle that arise.

3. The two appellant companies, who we will refer to as "Jones Bros" and "Britannia", or together as "the Appellants", participated in arrangements called a Growth Securities Ownership Plan ("GSOP") which, HMRC argue, gave rise to an obligation to account for national insurance contributions ("NIC") and to pay income tax under the pay as you earn system ("PAYE"). The arrangements concerned the use of marketed schemes utilising purported contracts for differences ("CFDs").

4. In summary, under their respective GSOP arrangements each of the Appellants entered into written contracts with certain employees under which:

(i) It agreed to make a payment to the employee if the employer's future profits exceeded a stated figure;

(ii) That payment would only be made if the employee continued to be employed and satisfied certain conditions;

(iii) The employee agreed to make a payment to his or her employer if the profits were less than a lower specified figure;

(iv) On entering the contract the employee made an upfront payment to the employer of an amount calculated to be equal to the then market value (without regard to the conditions referred to in (ii) above) of the employee's rights under the Contract.

5. The Jones Bros appeal is representative of a number of "bonus replacement" appeals in which, HMRC argue, the participants would have received some form of money bonus (taxable as earnings) which was, in the years in which GSOP was operated, replaced by the GSOP arrangements to escape income tax and NICs.

6. The Britannia appeal represents those where, HMRC argue, typically a director/shareholder used the GSOP arrangements to extract profits from the employer company that would otherwise be taxable.

7. HMRC argue that the GSOP arrangements were a tax avoidance scheme marketed by Grant Thornton, the aim of which was to remunerate participants with money that escaped both income tax and NICs. It is HMRC's case that the scheme used what purported to be CFDs in order to give it the veneer of commerciality and contingency, however in reality it was no more than a disguised and artificially contrived method of paying money.

8. HMRC made determinations under Regulation 80 of the Income Tax (Pay as You Earn) Regulations 2003 (the "PAYE Regulations") and under s8 of the Social Security (Transfer of Functions etc) Act 1999, and it is against those determinations that the Appellants appeal. As stated earlier this decision is only concerned with the issues of principle at this stage and we have not therefore considered issues of valuation or quantum.

Evidence

9. For Jones Bros and Britannia, we took evidence from the following witnesses of fact respectively:

(a) Mr Dewi Osian Ab Ifan, the former finance director of Jones Bros; and

(b) Mr Ferrari, the finance director of Britannia.

Both were beneficiaries of the GSOP arrangements and were involved in their implementation.

10. We also took expert evidence on behalf of the Appellants from:

(a) Mr David Bowes, a Fellow of the Chartered Institute of Taxation and a Fellow of the Society of Share and Business Valuers;

(b) Mr Altan Alpay, B.A, M.Sc., founder of and portfolio manager at Sarus Select Capital.

11. On behalf of HMRC we took expert evidence from Ms Esther Mayr, Managing Director of FTI Consulting LLP.

Preliminary matters

12. On the first day of the hearing the Appellants sought to adduce additional evidence of City Index Terms and Conditions. HMRC opposed the application.

13. On behalf of the Appellants, Mr Prosser submitted that the document should be admitted into evidence for the following reasons. The document contains standard terms and conditions of a company which is in the business of providing CFDs with retail customers, and demonstrates that discretion provisions are included in such terms. Ms Mayr states that such provisions are not typical in CFDs and the Appellants would seek her comment on the document.

14. Mr Prosser accepted that the application was made late in proceedings. However, he highlighted the difficulty in finding terms and conditions dating back to 2010, and he noted that Ms Mayr had referred to a number of recent or current publications produced by the FCA. In the circumstances Mr Prosser submitted that given the limited material available to him it was legitimate for him to be allowed to refer to up to date terms and conditions; the weight to be applied to the document was a different question to its admissibility.

15. Mr Prosser accepted that there was no witness to speak to the document. However, he noted that there was no opportunity for the experts to meet or respond to the other's report and this document enabled each Appellant to do so in stronger terms than simply asking its own expert.

16. Mr Prosser urged the Tribunal not to adopt HMRC's inflexible and narrow approach to these proceedings and highlighted a wish to expand on the experts' evidence by way of supplemental questions in the absence of a joint report.

17. Mr Brennan predicated his objection on the following grounds. Directions for disclosure in these appeals were made approximately four years ago. Furthermore, the City Index document was dated February 2021 which was 11 years after the events with which these appeals were concerned. There was no witness to give evidence relating to the document nor any evidence to demonstrate that it was typical of the industry or City Index contracts generally. Mr Brennan objected to the lateness of the application and the fact that the document was not made available for comment by any of the experts, nor was it disclosed to the Respondents with an explanation as to its relevance. The Tribunal should therefore refuse to admit the document.

18. In relation to the supplementary examination in chief proposed by Mr Prosser, HMRC submitted that it was inappropriate four years after Directions were issued for the Appellants to attempt to supplement their case with additional expert evidence. The correct approach would be for the Appellants to apply to adduce supplementary experts' reports.

Decision on preliminary matters

19. Having considered the parties' submissions, we decided not to admit the evidence for the following reasons. We considered that the evidence was produced too late in the day, without notice and without any sufficient explanation as to why it was not, and could not have been, produced earlier. The main factor we considered was the relevance of the document. There was no evidence offered in support of the document and no witness to speak to its contents; in those circumstances we were left without any

knowledge as to what the document was, the circumstances in which it came about or whether it had any relevance to what is typical in the industry. In our view, the relevance is limited to potentially illustrating a point which could be put to a witness in any event without the document.

20. In relation to the second issue, namely whether supplementary questions of the experts should be permitted, we took the view that the parties and the Tribunal would be assisted by further clarification which should avoid leading new evidence. We therefore indicated to the parties that the Tribunal would take a flexible approach as and when the experts gave evidence, with our focus being the relevance of any supplementary evidence and the assistance it would provide.

Agreed Facts

21. The following is taken from the Joint Statement of Facts and Issues.

Jones Bros

22. The facts mentioned below apply to arrangements entered into on 7 February 2011 pursuant to which Jones Bros made payments to employees on 30 March 2012. It is common ground that the decision of the Tribunal in respect of those arrangements and payments applies equally to the similar arrangements entered into, and payments made, in later years.

23. At all material times Jones Bros carried on a civil engineering trade, for the purposes of which it employed inter alia 34 relevant employees, some of whom were also directors and one of whom was also a shareholder.

24. Jones Bros entered into arrangements, described as an "employee incentive plan" and called "Growth Securities Ownership Plan" or "GSOP", with each of those 34 employees.

25. On (or around) 7 February 2011, Jones Bros and each employee executed documents, one called a "Master Agreement for Contract for Differences" and the other called a "Confirmation in relation to Contract for Differences". The documents contained the following provisions, in summary –

(a) the employee was to pay Jones Bros a "premium" of £10 in return for Jones Bros entering into the arrangements.

(b) Subject to (c) below, if the Adjusted Operating Profit (as defined) ("AOP") on ordinary trading activities of the civil engineering business of the Jones Bros group for the 12 month period to 31/1/2012 was £875,000 or more, Jones Bros would on the "settlement date", defined as 31/1/2012 pay the employee an amount determined by reference to a formula (see (d) below); whereas if the AOP was less than £150,000, the employee would pay Jones Bros a stated amount (varying between £500 and £6,000); and if the AOP was between £150,000 and £875,000 no payment would be made either way.

(c) However, Jones Bros would have no obligation to make any payment if the employee disposed of or purported to dispose of his rights, otherwise than to his spouse, was adjudicated bankrupt, ceased to be employed by Jones Bros otherwise than as a Good Leaver as defined, was subject to a Disciplinary Event as defined, or if the Health and Safety Inspection Condition as defined was not met.

(d) The formula (called "the Contract Reference Asset Value") varied as between the employees, who were allocated to different categories:

(i) Category A (23 employees):

Sum of (FC x PR%) x 3% - IA, where

"FC" = Net contribution to date for each listed contract for the employee (that is, an engineering contract for which the employee was responsible) as stated in his "Portfolio" (that is, the portfolio of such contracts, against which the performance of the employee was assessed, quite apart from GSOP) as at 31st January 2012,

"PR%" = "Participation" expressed as a percentage for each listed Contract,

"IA" = "Initial Adjustment" being an amount determined by the Jones Bros board and notified in writing to the employee no later than 14th March 2011, such amount reflecting the cumulative financial summary for the Portfolio as at 1st February 2011,

"Portfolio" was the "Portfolio of Contracts Cumulative Financial Summary" for the employee as prepared and approved by the Jones Bros board on a consistent basis.

(ii) Category B (3 employees):

(10% x RP) less £2,163.66 or £5,600, whichever is the greater (for 1 employee) or nil (for 2 employees), where

"RP" = residual profit from gross site margin after deduction of 4% head office overhead, actual regional overhead and a margin threshold of 1% of turnover, as stated as "Regional Profit" in the "Southern Region Cumulative Financial Summary" as at 31st January 2012, as prepared and approved by the Jones Bros board on a consistent basis.

(iii) Category C (2 employees):
Sum of (FC x PR%) x 0.33%, where
"FC" and "PR" had the same meanings as for category A.

(iv) Category C1 (1 employee):
Sum of (FC x PR%) x 1%, where
"FC" and "PR" had the same meanings as for category A.

(v) Category E (1 employee):
TPH x 1%, where
"TPH" = net contribution from the plant hire business after adjustment for level
depreciation and yard standing costs being "Total Plant Hire (level depreciation)"
for the employee as stated in his Portfolio

"Portfolio" was the "Plant Hire Departmental Financial Summary" for the employee for the period from 1st February 2011 to 31st January 2012, as prepared and approved by the Jones Bros board on a consistent basis.

(vi) Category F (2 directors, including Mr ab Ifan):

3% x (OP - £1m) provided that if such amount would otherwise be less than zero, it shall be equal to zero, where
"OP" = operating profit before interest of the Jones Bros group for the 12 month period to 31st January 2012 being "Group Total" in the management accounts after adjusting for (and excluding the effect of): performance bonuses paid by the group (being amounts described as bonus in any relevant payroll, other than "Site Bonus"); distributions or other payments or salaries or benefits to shareholders and members of the shareholders' family; and any accrual or expense in respect of the entry into or settlement of this CFD or any other CFDs entered into by the company or other Group Member with specified employees or directors.

(vii) Category G (2 employees):

10% x OP, where
"OP" had the same meaning as for category F.

26. The formula varied as between the employees, who were allocated to different categories.

27. Jones Bros and each employee signed a written joint election under s.431(1) ITEPA in respect of the "securities" acquired by the employee under the arrangements. The documents were dated 7 February 2011.

28. In the event, Adjusted Operating Profit ("AOP") exceeded £875,000, and Jones Bros, on (or around) 30 March 2012, paid £1,610,697 in total to 29 of the 34 employees.

29. By notices given on 22 December 2015, HMRC determined and decided that Jones Bros was liable to pay PAYE and NIC in respect of (i) the rights granted on 7 February 2011 and/or (ii) the payments made on or around 30 March 2012.

30. Jones Bros appealed against the notices on 4 and 13 January 2016 and notified the appeals to the Tribunal on 1 November 2016.

Britannia

31. The facts mentioned below apply to arrangements entered into on 22 March 2010 pursuant to which Britannia made payments to employees on 29 October 2010. It is common ground that the decision of the Tribunal in respect of those arrangements and payments applies equally to the similar arrangements entered into, and payments made, in later years.

32. At all material times Britannia carried on a hotels trade. Britannia employed inter alia 3 relevant employees, namely Eileen Downey, who was a director of Britannia, Robert Ferrari, who was both director and company secretary, and Alex Langsam, who was both director and a major shareholder of Britannia.

33. Britannia entered into arrangements, described as an "employee incentive plan" and called "Growth Securities Ownership Plan" or "GSOP", with those 3 employees.

34. On or around 22 March 2010, Britannia and each employee executed documents, one called a "Master Agreement for Contract for Differences", and the other called a "Confirmation in relation to Contract for Differences". The documents contained the following provisions, in summary –

(a) the employee agreed to pay Britannia a "premium" of £10 in return for Britannia entering into the Contract.

(b) Subject to (c) below, if the "Contract Reference Asset", that is the Group Operating Profit for the 52 week period to 25/9/2010 ("GOP") was more than £9.67m, Britannia would on the Payment Date (within 30 business days after the board approved the management accounts, or if earlier on 31/12/2010) pay the employee a stated amount (RF £250,000, AL £5m, and ED £50,000); if the GOP was less than £9.67m but equal to or more than £9.46m, Britannia would pay the employee a lesser amount determined by reference to a formula (see (d) below); if the GOP was under £9.46m but equal to or more than £8.25m, no payment would be made either way; whereas if the GOP was under £8m, the employee would pay Britannia a stated amount (RF £12,500, AL £250,000, ED £2,500); and if the GOP was equal to or more than £8m but under £8.25m, the employee would pay Britannia a lesser amount determined by reference to a formula (see (e) below). These amounts reflected a proportion of any increase in the value of the hotels as a result of any increase in Group Operating Profit.

(c) However, Britannia would have no obligation to make any payment if the employee disposed of or purported to dispose of his rights, otherwise than to his spouse, or was adjudicated bankrupt, or ceased to be employed for any reason.

(d) If the GOP was less than £9.67m but equal to or more than £9.46m, the formula for payments by Britannia to the employees was:

To Mr Ferrari: £200,000 + (50,000 x ((GOP - 9.46m) /210,000))

To Mr Langsam: £4m + (1m x ((GOP- 9.46m/210,000))

To Ms Downey: £40,000 + (10,000 x ((GOP – 9.46m)/210,000))

(e) If the GOP was equal to or more than £8m but less than £8.25m, the formula for payments by the employees to Britannia was:

By Mr Ferrari: £10,000 – ((2,500 x 8.25m – GOP)/250,000)

By Mr Langsam: £200,000 – ((50,000 x (8.25m – GOP)/250,000)

By Ms Downey: £2,000 – ((500 x (8.25m – GOP)/250,000).

35. Britannia and each employee signed a written joint election under s.431(1) ITEPA in respect of the "securities" acquired by the employee under the arrangements. The documents were dated 22 March 2010.

36. Britannia, on or around 29 October 2010, paid £5.3m in total to the three employees.

37. By notices given on 29 November 2013, 17 December 2014 and 18 October 2016, HMRC determined and decided that Britannia was liable to pay PAYE and NIC in respect of (i) the rights granted on 22 March 2010 and/or (ii) the payments made on or around 29 October 2010.

38. Britannia appealed against the notices on 3 December 2013, 6 January 2014 and 7 November 2016, and notified the appeals to the Tribunal on 17 March 2017.

Issues

39. The parties agreed that the following issues fell to be determined:

(i) Whether the payments of money made by each relevant company to each relevant employee were taxable as earnings irrespective of the resolution of issues (ii) to (v).

(ii) Whether the arrangements gave rise to a "contract for differences or a contract similar to a contract for differences" within s 420(1)(g) and (4) ITEPA and therefore a "security" and an "employment related security" for the purposes of Part 7 ITEPA;

(iii) Whether the arrangements gave rise to a "restricted security" or "a restricted interest in securities" for the purposes of Part 7 Chapter 2 ITEPA;

(iv) Whether s 447 ITEPA (charge on other chargeable benefits from securities) applied to the payment received by the employee;

(v) Whether (a) the employee's rights under the arrangements were, and/or (b) the payment received was, earnings of the employee, chargeable under s 62 ITEPA or Part 3 Chapter 10 ITEPA (taxable benefits: residual liability to charge);

40. A separate issue was also raised in relation to Britannia Hotels only, namely:

(vi) Whether any payments to Alex Langsam (and if so, which payments) were not taxable as earnings because they were distributions out of assets of the Appellant in respect of shares in the Appellant taxable as such under Chapter 3 part 4 of ITTOIA 2005. (This issue arises only in respect of Britannia Hotels Ltd and does not form one of the issues in respect of which the appeal is a lead case under rule 18 of the tribunal rules).

41. Some of these issues were not pursued or challenged in any meaningful sense by the end of the hearing and we shall address the issues that remained live (principally the earnings issue and whether the arrangements were contracts for differences) at the end of this decision.

42. It was common ground that Class 1 primary and secondary NIC charges arose if income tax charges arose. As there was no material difference between the provisions imposing income tax liability and those in relation to National Insurance Contributions the parties' submissions focussed on the legislation imposing charges to income tax. We propose to do the same in this decision.

The contentions of the parties

43. We set out below a brief summary of the parties' main arguments. We consider the arguments in more detail later in this decision.

44. In outline, for the Appellants it is contended that:

(a) The rights received by the employees at the outset could not be ignored unless there was certainty about the amount of money to be received at the end. In this case there was genuine non-artificial uncertainty and (applying *UBS AG v HMRC, DB Group Services (UK) Ltd v HMRC* [2016] UKCS 13 ("*UBS*") and *Abbott v Philbin* [1961] AC 352) this is fatal to HMRC's case in respect of issue 1;

(b) The rights were rights under contracts for differences or similar; in looking at what the contracts did and what the outcomes were, the contracts had the fundamental features of a CFD however exotic they may be;

(c) The restrictions could not be ignored as they served a proper commercial purpose; therefore, no income tax liability arose because they were "restricted securities" exempted from liability by section 425 of ITEPA.

45. HMRC contends that:

(a) On a realistic view of the facts the structures were simply a device used to deliver money and give the appearance of being within Part 7

ITEPA in order to drive out a money payment. The sums were earnings received by employees for the purposes of section 62 of ITEPA. The contractual pyramid should be ignored as a preordained arrangement with no real effect and the transactions fell to be taxed as cash payments made directly to the employees.

(b) The arrangements were not CFDs nor similar to CFDs as they lacked the characteristics of CFDs. They inserted commercially irrelevant aspects such as the floor/downside to attempt to qualify as CFDs and lacked the essential character of exposure to movement in the underlying metric;

(c) If they were securities, HMRC accepted that the conditions such as continued employment would likely have restricted market value and so they would be restricted securities, save in relation to Mr Langsam where such a restriction was meaningless and further demonstrated that the arrangement was a conditional bonus.

Statutory provisions

46. The main statutory provisions of ITEPA that are relevant to the income tax aspects of this appeal are set out below. All references are to ITEPA unless otherwise stated.

47. Section 6(1) of ITEPA is the basic charging provision which provides as follows:

> (1) The charge to tax on employment income under this Part is a charge to tax on –
>
> a) general earnings, and
>
> b) specific employment income.

48. "General earnings" is defined in s7 (3):

> 7 Meaning of "employment income", "general earnings" and "specific employment income"
>
> …
>
> (3) "General earnings" means –
>
> (a) earnings with Chapter I of Part 3, or
>
> (b) any amount treated as earnings (see subsection (5))
>
> excluding in each case any exempt income.

49. The concept of "earnings" is defined in s62 which provides as follows:

> (2) … "earnings", in relation to an employment means –
>
> (a) any salary, wages or fee
>
> (b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or
>
> (c) anything else that constitutes an emolument of the employment.

(3) For the purposes of subsection (2) “money's worth” means something that is—

(a) of direct monetary value to the employee, or

(b) capable of being converted into money or something of direct monetary value to the employee.

50. Part 7 of ITEPA contains Chapters that deal with different categories of employment related securities which is relevant to the issues that fall to be determined in this appeal.

51. S 420(1) sets out the meaning of “securities”: (emphasis added)

(1) Subject to subsections (5) and (6), for the purposes of this Chapter and Chapters 2 to 5 the following are “securities”—

(a) shares in any body corporate (wherever incorporated) or in any unincorporated body constituted under the law of a country or territory outside the United Kingdom,

(aa) rights under contracts of insurance other than excluded contracts of insurance,

(b) debentures, debenture stock, loan stock, bonds, certificates of deposit and other instruments creating or acknowledging indebtedness (other than contracts of insurance),

(c) warrants and other instruments entitling their holders to subscribe for securities (whether or not in existence or identifiable),

(d) certificates and other instruments conferring rights in respect of securities held by persons other than the persons on whom the rights are conferred and the transfer of which may be effected without the consent of those persons,

(e) units in a collective investment scheme,

(f) options and futures, . . .

(g) rights under contracts for differences or contracts similar to contracts for differences (other than contracts of insurance),

(h) arrangements to which section 564G of ITA 2007 (alternative finance arrangements: investment bond arrangements) applies.

. . .

(4) For the purposes of subsection (1)(g) a contract similar to a contract for differences is a contract—

(a) which is not a contract for differences, but

(b) the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in the value or price of property or an index or other factor designated in the contract.

(5) The following are not “securities” for the purposes of this Chapter or Chapters 2 to 5—

(a) cheques and other bills of exchange, bankers' drafts and letters of credit (other than bills of exchange accepted by a banker),

(b) money and statements showing balances on a current, deposit or savings account,

(c) leases and other dispositions of property and heritable securities, [and]

(d) . . .

(e) securities options.

52. S 421B(1) provides that Chapters 2 to 4A apply to securities acquired by a person where the right or opportunity to acquire them is available by reason of employment of that person or any other person.

53. The definition of "restricted securities" is set out in s 423:

> 423 "Restricted securities" and "restricted interest in securities"
>
> (1) For the purposes of this Chapter employment-related securities are restricted securities or a restricted interest in securities if—
>
> (a) there is any contract, agreement, arrangement or condition which makes provision to which any of subsections (2) to (4) applies, and
>
> (b) the market value of the employment-related securities is less than it would be but for that provision.
>
> (2) This subsection applies to provision under which—
>
> (a) there will be a transfer, reversion or forfeiture of the employment-related securities, or (if the employment-related securities are an interest in securities) of the interest or the securities, if certain circumstances arise or do not arise,
>
> (b) as a result of the transfer, reversion or forfeiture the person by whom the employment-related securities are held will cease to be beneficially entitled to the employment-related securities, and
>
> (c) that person will not be entitled on the transfer, reversion or forfeiture to receive in respect of the employment-related securities an amount of at least their market value (determined as if there were no provision for transfer, reversion or forfeiture) at the time of the transfer, reversion or forfeiture.
>
> …

54. Section 425 of ITEPA provides that, subject to certain exceptions, there is no income tax charge on the acquisition of restricted securities as follows:

> [425 No charge in respect of acquisition in certain cases]
>
> [(1) Subsection (2) applies if the employment-related securities—
>
> (a) are restricted securities, or a restricted interest in securities, by virtue of subsection (2) of section 423 (provision for transfer, reversion or forfeiture) at the time of the acquisition, and
>
> (b) will cease to be restricted securities, or a restricted interest in securities, by virtue of that subsection within 5 years after the acquisition (whether or not they may remain restricted securities or a restricted interest in securities by virtue of the application of subsection (3) or (4) of that section).
>
> (2) No liability to income tax arises in respect of the acquisition, except as provided by—
>
> (a) Chapter 3 of this Part (acquisition by conversion),
>
> (b) Chapter 3C of this Part (acquisition for less than market value), or

(c) Chapter 5 of this Part (acquisition pursuant to securities option).

"

55. S 426 provides that if a "chargeable event" within the meaning of s 427 occurs in relation to the employment-related securities then the taxable amount (as determined under s 428) counts as employment income of the employee for the relevant tax year.

56. S 431 of ITEPA permits an employer and employee jointly to make elections as follows:

> 431 Election for full or partial disapplication of this Chapter
>
> (1) The employer and the employee may elect in relation to employment-related securities which are restricted securities or a restricted interest in securities that—
> (a) for the relevant tax purposes their market value at the time of the acquisition is to be calculated as if they were not, and
> (b) sections 425 to 430 are not to apply to the employment-related securities.

57. The Social Security Contributions and Benefits Act 1992 ("SSCBA") contains the main NIC charging provision relevant in this appeal. It is common ground between the parties that insofar as any money and/or securities are chargeable to income tax under ITEPA, those payments are also subject to primary and secondary class 1 NICs either because they are earnings under s 3 SSCBA or are treated as earnings under s 4 or Regulation 22 of the Social Security (Contributions) Regulations 2001 (the "SSC Regulations") and s 6 imposes liability. In short, the NICs follow the income tax treatment and for that reason we do not make separate reference to those provisions.

Authorities

58. The parties referred to and relied heavily on a number of authorities. The principles set out therein inform our decision and we consider it helpful to include the references highlighted by the parties at some length. We set out later in this decision our approach to the issues and application of the principles set out below.

59. It is settled law (see *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51) that a tax statute is to be interpreted by reference to the ordinary principles of purposive construction. As per Lord Nicholls at [28]:

> "…the modern approach to statutory construction is to have regard to the purpose of a particular provision and interpret its language, so far as possible, in a way which gives effect to that purpose."

He went on to say at [32]:

> "The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. Of course this does not mean that the courts have to put their reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute. But however one approaches the

> matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found."

60. In *Abbott v Philbin* [1961] AC 352 HMRC argued that an employee who was granted an option to subscribe for shares in an employer company should be subject to income tax when the option was exercised (on the substantial difference between the market price of the shares at that time and the amount he paid for the shares).

61. Viscount Simonds stated (at pages [365] to [366]) that the option was a valuable right that could be turned to pecuniary account and the words "perquisites or profits whatsoever are as wide and general as they well could be". He explained that it could not be said that an option to take up shares at a certain price was not a valuable (or potentially valuable) right:

> "How, then, can it be said that an option to take up shares at a certain price is not a valuable or at least a potentially valuable right? Its genesis is in the desire of the company to give a benefit to its employees, and at the same time, no doubt, to enhance their interest in its prosperity. It is something which the employee thinks it worth his while to pay for: not a large sum, truly, but £20 deserves a second thought. And it is something which can assuredly be turned to pecuniary account…
> It is mere guesswork what use of the option was intended or desired. I would not myself assume that the company intended that the grantee of an option should for ever, or for a day longer than he wished, hold the shares that he took up, or that he should not at once, if he wished, reap the benefit of a rise in price. But, guess right or wrong, there is nothing to prevent him doing so: that is his legal right, and, if he could so deal with the shares when acquired, nothing could prevent him so using his option by arrangement with a third party as to secure for himself a similar advantage. Two other adjectives are used by the Lord Justice, "unrealised " and " unvalued." But the fact that there was no realisation in the sense of actual turning into money is irrelevant. The test is whether it is something which is by its nature capable of being turned into money. Nor is it relevant that it is " unvalued."…"

62. In rejecting arguments that the option could not be turned to pecuniary account Viscount Simonds stated that the option was: "a right which is of its nature valuable and can be turned to pecuniary account". He added that there could not be one perquisite at the date of the grant and a second one when the shares were taken up and therefore HMRC's case failed "at the initial step" and that there were "other grave difficulties in the way of its success" in that the increase in value of the shares in future years could not be said to relate to a reward for employment services:

> "The taxable perquisite must be something arising "therefrom", i.e., from the office, in the year of assessment. I do not want to embark on the notoriously difficult problem as to the year to which, for the purpose of tax, a payment should be ascribed if it is not expressly ascribed to any particular year. But I do not find it easy to say that the increased difference between the option price and the market price in 1956 or, it might be, in 1964, in any sense arises from the office. It will be due to numerous factors which have no relation to the office of the employee, or to his employment in it. The contrast is plain between the realised value, as it has been called, of the option when the shares are taken up (though the realisation falls short of money in hand) and the value of the option when it is granted. For the latter is nothing else than the reward for services rendered or, it may be, an incentive to future services. Unlike the realised value it owes nothing to the

adventitious prosperity of the company in later years. On this ground also I should reject the claim of the Crown."

63. Lord Reid and Lord Radcliffe agreed that the option was a taxable "perquisite" in the year of assessment in which it was granted. Lord Reid noted (at [372]-[373]):

> "…there appears to me to be another difficulty in the way of the respondent. Rule 1 taxes a person exercising an office or employment of profit " in respect of all salaries, fees, wages, " perquisites or profits whatsoever therefrom *for* the year of "assessment." It does not say salaries or perquisites received during the year of assessment. It may be difficult to relate a perquisite strictly to a particular year. But if a reward is given in the form of an option and the option is itself the perquisite, it would generally be sufficiently related to the year in which it is given to be properly regarded as a perquisite for that year. If, on the other hand, the option is not the perquisite—if there is no perquisite until the option is exercised and shares are issued, it may be many years later - in what sense would the shares be a perquisite for the year when they were issued? There would be no relation whatever between the service during that year and the giving of the option many years earlier, or the exercise of the option during the later year. I do not wish to express any concluded opinion on this point, but it does seem to lend support to the conclusion which I have reached on other grounds."

64. Lord Radcliffe stated (at [379]):

> "The advantage which arose by the exercise of the option, say £166, was not a perquisite or profit from the office during the year of assessment: it was an advantage which accrued to the appellant as the holder of a legal right which he had obtained in an earlier year, and which he exercised as option holder against the company. The quantum of the benefit, which is the alleged taxable receipt, is not in such circumstances the profit of the service: it is the profit of his exploitation of a valuable right. Of course, in this case the year of acquiring the option was only the year immediately preceding the year in which, *pro tanto*, it was exercised. But supposing that he holds the option for, say, nine years before exercise? The current market value of the company's shares may have changed out of all recognition in that time, through retention of profits, expansion of business, changes in the nature of the business, even changes in the market conditions or the current rate of interest or yield. I think that it would be quite wrong to tax whatever advantages the option holder may obtain through the judicious exercise of his option rights in this way as if they were profits or perquisites from his office arising in the year when he calls the shares…"

65. In *Gray's Timber Products Ltd v Revenue and Customs (Scotland)* [2010] UKSC 4 Lord Walker identified the purpose of Part 7 (at [4] – [7]) with reference to *Abbott v Philbin*:

> 4. Part 7 of ITEPA 2003 is headed "Employment income: income and exemptions relating to securities." Its provisions reflect three different, and to some extent conflicting, legislative purposes. First there is Parliament's recognition that it is good for the economy, and for social cohesion, for employees to own shares in the company for which they work. Various forms of incentive schemes are therefore encouraged by favourable tax treatment (those in force in 2003 are covered in Chapters 6 to 9 inclusive of Part 7).

5. Second, if arrangements of this sort are to act as effective long-term incentives, the benefits which they confer have to be made contingent, in one way or another, on satisfactory performance. This creates a problem because it runs counter to the general principle that employee benefits are taxable as emoluments only if they can be converted into money, but that if convertible they should be taxed when first acquired. That principle was stated by Lord Radcliffe in *Abbott v Philbin* [1961] AC 352, 379:

"I think that the conferring of a right of this kind as an incident of service is a profit or perquisite which is taxable as such in the year of receipt, so long as the right itself can fairly be given a monetary value, and it is no more relevant for this purpose whether the option is exercised or not in that year, than it would be if the advantage received were in the form of some tangible form of commercial property."

That was a case about share options, which are now dealt with separately in Chapter 5, but it illustrates the general approach that applied in the days when the taxation of employee benefits was very much simpler than it is now.

6. The principle of taxing an employee as soon as he received a right or opportunity which might or might not prove valuable to him, depending on future events, was an uncertain exercise which might turn out to be unfair either to the individual employee or to the public purse. At first the uncertainty was eased by extra-statutory concessions. But Parliament soon recognised that in many cases the only satisfactory solution was to wait and see, and to charge tax on some "chargeable event" (an expression which recurs throughout Part 7) either instead of, or in addition to, a charge on the employee's original acquisition of rights.

7. That inevitably led to opportunities for tax avoidance. The ingenuity of lawyers and accountants made full use of the "wait and see" principle embodied in these changes in order to find ways of avoiding or reducing the tax charge on a chargeable event, which might be the occasion on which an employee's shares became freely disposable (Chapter 2) or the occasion of the exercise of conversion rights (Chapter 3). The third legislative purpose is to eliminate opportunities for unacceptable tax avoidance. Much of the complication of the provisions in Part 7 (and especially Chapters 3A, 3B, 3C and 3D) is directed to counteracting artificial tax avoidance. There is a further layer of complication in provisions which regulate the inevitable overlaps between different chapters. It is regrettable that ITEPA 2003, which came into force on 6 April 2003 and was intended to rewrite income tax law (as affecting employment and pensions) in plain English, was almost at once overtaken by massive amendments which are in anything but plain English."

66. *Scottish Provident Institution v IRC* [2004] 1 WLR 3172 ("*Scottish Provident*) concerned a scheme designed to take advantage of a change in the law governing the taxation of gains and losses made by mutual life offices on the grant or disposal of options to buy or sell gilts. At [18] – [24] Lord Nicholls explained:

"…So the short question is whether the Citibank option gave it an entitlement to gilts.

That depends upon what the statute means by "entitlement". If one confines one's attention to the Citibank option, it certainly gave Citibank an entitlement, by exercise of the option, to the delivery of gilts. On the other hand, if the option formed part of a larger scheme by which Citibank's right to the gilts was bound to be cancelled by SPI's right to the same gilts, then it could be said that in a practical sense Citibank had no entitlement to gilts. Since the decision of this House in W T Ramsay Ltd. v. Inland Revenue Commissioners [1982] AC it has been accepted that the language of a taxing statute will often have to be given a wide practical meaning of this sort which allows (and indeed requires) the Court to have regard to the whole of a series of transactions which were intended to have a commercial unity. Indeed, it is conceded by SPI that the Court is not confined to looking at the Citibank option in isolation. If the scheme amounted in practice to a single transaction, the Court should look at the scheme as a whole. Mr. Aaronson Q.C., who appeared for SPI, accepted before the Special Commissioners that if there was "no genuine commercial possibility" of the two options not being exercised together, then the scheme must fail.

The Commissioners adopted (at para 24) the analogy of horserace betting:

"If the chance of the price movement occurring was similar to an outsider winning a horse race we consider that this, while it is small, is not so small that there is no reasonable or practical likelihood of its occurring; outsiders do sometimes win horse races."

Mr. Aaronson said that a test of "no practical likelihood" derived from the speech of Lord Oliver of Aylmerton in Craven v. White [1989] AC 398, at p514 and assented to by Lords Keith of Kinkel and Jauncy of Tullichettle. In that case, however, important parts of what was claimed by the Revenue to be a single composite scheme did not exist at the relevant date.

…

Thus there was an uncertainty about whether the alleged composite transaction would proceed to completion which arose, not from the terms of the alleged composite transaction itself, but from the fact that, at the relevant date, no composite transaction had yet been put together. Here, the uncertainty arises from the fact that the parties have carefully chosen to fix the strike price for the SPI option at a level which gives rise to an outside chance that the option will not be exercised. There was no commercial reason for choosing a strike price of From the point of view of the money passing (or rather, not passing), the scheme could just as well have fixed it at 80 and achieved the same tax saving by reducing the Citibank strike price to 60. It would all have come out in the wash. Thus the contingency upon which SPI rely for saying that there was no composite transaction was a part of that composite transaction; chosen not for any commercial reason but solely to enable SPI to claim that there was no composite transaction. It is true that it created a real commercial risk, but the odds were favourable enough to make it a risk which the parties were willing to accept in the interests of the scheme.

We think that it would destroy the value of the Ramsay principle of construing provisions such as s 150A(1) of the 1994 Act as referring to the effect of composite transactions if their composite effect had to be disregarded simply because the parties had deliberately included a commercially irrelevant contingency, creating an acceptable risk that the scheme might not work as planned. We would be back in the world of artificial tax schemes, now equipped with anti-Ramsay devices. The composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned.

It follows that in our opinion the Special Commissioners erred in law in concluding that their finding that there was a realistic possibility of the options not being exercised simultaneously meant, without more, that the scheme could not be regarded as a single composite transaction. We think that it was and that, so viewed, it created no entitlement to gilts and that there was therefore no qualifying contract."

67. *UBS AG v HMRC, DB Group Services (UK) Ltd v HMRC* [2016] UKSC 13, [2016] 1 WLR 1005 ("*UBS*") involved an employee bonus scheme implemented for tax avoidance. Instead of cash bonuses, shares in an equivalent amount were awarded, via a special purpose vehicle company, to the employees who redeemed them for cash a short time later. The shares were subject to a short-term contingency (relating to the performance of the stock market over a short period) which was unlikely to, but might

possibly, occur. The contingency was included to enable the shares to achieve the intended tax result as "restricted securities".

68. UBS argued that the shares, which were forfeitable in certain situations, were "restricted securities" when acquired. HMRC argued (the "broad Ramsay" argument) that the redeemable shares should be disregarded and the employees treated as if paid cash bonuses. Furthermore, HMRC argued, the shares were not "securities" but money (within s 420(5)(b)) on the grounds that the commercial reality of the arrangements was payment of cash and that the securities were not "restricted securities" because the restrictions were only imposed for tax purposes and so should be ignored for s 423 purposes (which meant the exemption in s425 did not apply). HMRC submitted that the employees should be taxed on the unrestricted value of the shares.

69. The Supreme Court rejected the broad Ramsay argument, and held that on a realistic view of the facts the employees received shares and not money. As the amount for which the shares might be redeemed was neither fixed nor ascertainable when the shares were acquired, the shares could not be disregarded even though they were brought into the arrangements for the purpose of tax avoidance.

70. However, the Supreme Court accepted HMRC's argument that the shares were not restricted securities on the basis that s423 only applied to restrictions imposed for commercial reasons. Therefore the exemption did not apply and employees were chargeable to income tax in respect of the acquisition (per *Abbott v Philbin*.)

71. Lord Reed explained (see [61] – [68]) how facts must be analysed in the light of the statutory provision being applied and the effect of *Ramsay*, stating at [64]:

> "This approach has proved to be particularly important in relation to tax avoidance schemes as a result of two factors identified in *Barclays Mercantile* at para 34. First, "tax is generally imposed by reference to economic activities or transactions which exist, as Lord Wilberforce said, 'in the real world'". Secondly, tax avoidance schemes commonly include "elements which have been inserted without any business or commercial purpose but are intended to have the effect of removing the transaction from the scope of the charge". In other words, as Carnwath LJ said in the Court of Appeal in *Barclays Mercantile*, [2002] EWCA Civ 1853; [2003] STC 66, para 66, taxing statutes generally "draw their life-blood from real world transactions with real world economic effects". Where an enactment is of that character, and a transaction, or an element of a composite transaction, has no purpose other than tax avoidance, it can usually be said, as Carnwath LJ stated, that "to allow tax treatment to be governed by transactions which have no real world purpose of any kind is inconsistent with that fundamental characteristic." Accordingly, as Ribeiro PJ said in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 52; (2003) 6 ITLR 454, para 35, where schemes involve intermediate transactions inserted for the sole purpose of tax avoidance, it is quite likely that a purposive interpretation will result in such steps being disregarded for fiscal purposes. But not always."

72. Lord Reed went on to quote Lord Nicholls in *Scottish Provident Institution* (see paragraph 66 above) and, having considered the legislation, Lord Reed, with whom the members of the Supreme Court agreed, set out the approach to construction (at [72]) and concluded that a purposive construction was possible (at [76] – [78]):

"72. It is necessary now to return to the statutory provisions in issue in the present appeals. Rather than dealing with the arguments in the way in which they were presented, in terms of broader and narrower versions of a "*Ramsay*" approach, it seems to me to be preferable to begin with the interpretation of the legislation, and the fundamental question whether it can be given a purposive interpretation going beyond its literal terms: that is to say, whether a "*Ramsay*" approach is possible at all, and if so, the purposive construction on which it is to be based. If those issues are determined in the Revenue's favour, the question next arises how, on its proper interpretation, the legislation is to be applied to the facts. It is at that stage that what have been described as the broad and the narrow approaches require to be considered.

…

[76] It is in the context explained in para [74], and against the background described in para [75], that it is necessary to consider the scope of the exemption on acquisition conferred by s 425(2), and more specifically the question whether, in s 423(1), the words 'any contract, agreement, arrangement or condition which makes provision to which any of subsections (2) to (4) applies' should be construed as referring to 'provision' with a genuine business or commercial purpose.

[77] Approaching the matter initially at a general level, the fact that Ch 2 was introduced partly for the purpose of forestalling tax avoidance schemes self-evidently makes it difficult to attribute to Parliament an intention that it should apply to schemes which were carefully crafted to fall within its scope, purely for the purpose of tax avoidance. Furthermore, it is difficult to accept that Parliament can have intended to encourage by exemption from taxation the award of shares to employees, where the award of the shares has no purpose whatsoever other than the obtaining of the exemption itself: a matter which is reflected in the fact that the shares are in a company which was brought into existence merely for the purposes of the tax avoidance scheme, undertakes no activity beyond its participation in the scheme, and is liquidated upon the termination of the scheme. The encouragement of such schemes, unlike the encouragement of employee share ownership generally, or share incentive schemes in particular, would have no rational purpose, and would indeed be positively contrary to rationality, bearing in mind the general aims of income tax statutes.

[78] More specifically, it appears from the background to the legislation that the exemption conferred by s 425(2), in respect of the acquisition of securities which are 'restricted securities' by virtue of s 423(2), was designed to address the practical problem which had arisen of valuing a benefit which was, for business or commercial reasons, subject to a restrictive condition involving a contingency. The context was one of real-world transactions having a business or commercial purpose. There is nothing in the background to suggest that Parliament intended that s 423(2) should also apply to transactions having no connection to the real world of business, where a restrictive condition was deliberately contrived with no business or commercial purpose but solely in order to take advantage of the exemption. On the contrary, the general considerations discussed in para [77], above, and the approach to construction explained in paras [64] and [68], above, point towards the opposite conclusion.."

73. He summarised as follows at [85] – [88]:

"[85] In summary, therefore, the reference in s 423(1) to 'any contract, agreement, arrangement or condition which makes provision to which any of subsections (2) to (4) applies' is to be construed as being limited to provision having a business or commercial purpose, and not to commercially irrelevant conditions whose only purpose is the obtaining of the exemption.

[86] In the UBS case, the condition—whether the FTSE 100 rose by a specified amount during a three-week period—was completely arbitrary. It had no business or commercial

rationale beyond tax avoidance. Such a condition is simply not relevant to the application of s 423, if, for the reasons already explained, that section is concerned with 'provision' having a genuine business or commercial purpose. Applying s 423 to the facts, viewed from a commercially realistic perspective, it follows that the condition to which the UBS shares were subject should be disregarded, with the consequence that the shares are not 'restricted securities' within the meaning of that section.

[87] That conclusion is fortified by another aspect of the facts of the UBS case. The economic effect of the restrictive condition was in any event nullified by the hedging arrangements, except to an insignificant and pre-determined extent (namely 0.8% at most - see para 32 above). The fact that what the First-tier Tribunal described as "a deliberate near miss" was designed into the scheme, rather than a complete offsetting of the risk, is immaterial. Paras 22 and 23 of the opinion in *Scottish Provident,* cited at para 70 above, are in point. As the Committee stated, the effect of the scheme should be considered as it was intended to operate. So considered, the benefit to the employee was not truly dependent on the contingency set out in the condition.

[88] The restrictive condition in the DB case was simpler but equally artificial. "Leaver" provisions in employee benefit arrangements often serve a genuine business or commercial purpose. But that cannot be said of the condition attached to the Dark Blue shares. The forfeiture provision operated for only a very short period, during which the possibility that it might be triggered lay largely within the control of the employee who would be adversely affected. It had no business or commercial purpose, and existed solely to bring the securities within the scope of section 423(2). Paras 22 and 23 of the opinion in *Scottish Provident* are again in point. DB deliberately included a contingency which created a minor risk, but one which the parties were willing to accept in the interests of the scheme. The scheme should therefore be considered as it was intended to operate, without regard to the possibility that it might not work as planned."

74. In *Cyclops Electronics Ltd & Anor v Revenue and Customs* [2016] SFTD 842, [2016] UKFTT 487 (TC), Judge Richards applied the approach of Lord Reed in considering whether securities were restricted as follows (at [74] – [75]):

"74…Lord Reed's judgment is, in my view, setting out the approach that must be followed when construing s423 of ITEPA. That approach involves focusing on the provisions for forfeiture and asking whether they have a "business or commercial purpose" or whether they are "commercially irrelevant conditions whose only purpose is the obtaining of the exemption". It is clear from paragraph [85] of Lord Reed's judgment that the focus is on the provisions for forfeiture (and not on a wider consideration of the commercial purpose of the securities). When Lord Reed applies his own test in paragraphs [86] to [88] he applies it by reference to the forfeiture provisions alone. While he was "fortified" in his conclusions in the *UBS* case by the fact that the hedging arrangements in that case prevented the employees from suffering any real consequence, that was not central to his conclusion.

75. I do not consider that paragraphs [77] or [78] of Lord Reed's judgment are suggesting anything different. While those passages do appear to refer to matters other than the relevant forfeiture provision, it is clear that they are part of the reasoning that he applies in determining what kind of forfeiture provisions Parliament had in mind when enacting s423 of ITEPA. That is made clear by his introductory comments at paragraph [76] of his judgment. I agree with Mr Sherry that the Supreme Court in *UBS* and *Deutsche Bank* were not intending to reverse the previous lines of authority set out in *Craven v White* or *Barclays Mercantile*. However, those authorities do nothing more than echo the conclusion that the Ramsay doctrine is concerned with the approach to statutory construction and the ascertainment of the facts. Of course in construing taxing provisions, or deciding the facts to which statutory provisions apply, it will often be relevant to ask

whether particular steps were pre-ordained or not (as in *Craven v White*). However, in *UBS* and *Deutsche Bank* the Supreme Court have formulated the correct approach to the construction of s423 of ITEPA in terms of the "business purpose" of the relevant forfeiture provision and not in terms of whether particular transaction steps were pre-ordained or not."

75. The *UBS* approach was reiterated more recently in *Uber BV v Aslam* [2021] UKSC 5 at [70] & [85]:

> "The modern approach to statutory interpretation is to have regard to the purpose of a particular provision and to interpret its language, so far as possible, in the way which best gives effect to that purpose. In *UBS AG v Revenue and Customs Comrs* [2016] UKSC 13; [2016] 1 WLR 1005, paras 61-68, Lord Reed (with whom the other Justices of the Supreme Court agreed) explained how this approach requires the facts to be analysed in the light of the statutory provision being applied so that if, for example, a fact is of no relevance to the application of the statute construed in the light of its purpose, it can be disregarded. Lord Reed cited the pithy statement of Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets Ltd* (2003) 6 ITLR 454, para 35:
>
> "The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."
>
> The conduct of the parties and other evidence may show that the written terms were in fact understood and agreed to be a record, possibly an exclusive record, of the parties' rights and obligations towards each other. But there is no legal presumption that a contractual document contains the whole of the parties' agreement and no absolute rule that terms set out in a contractual document represent the parties' true agreement just because an individual has signed it."

76. The Appellants highlighted *London Capital Group, R (On the Application Of) v The Financial Ombudsman Service Ltd* [2013] EWHC 2425 in support of the argument that the purpose to which the statute refers is that of the <u>customer</u> entering into the contract. HMRC contended that the reference to the <u>parties</u>' intention did not support the Appellants' argument, per Leggatt J at [20] and [24]:

> "In accordance with general principle, the purpose of the contract and the intention of the parties must be ascertained objectively by construing the terms of the contract in its factual setting. It is not relevant to ask what Mr Shrubb or London Capital subjectively intended. The task for the court is to ascertain what purpose and intention reasonable people in the situation of the parties to the contract may fairly be taken to have had.
>
> …
>
> …the purpose and intention of the parties to the relevant contract must be determined from what they agreed. If what was done did not accord with what was agreed, that cannot affect the question of whether or not rights under the contract are a regulated investment."

77. The scope of the earnings charge in s 62 ITEPA was set out in the Court of Session in *Advocate General for Scotland v Murray Group Holdings Ltd and Others* [2015] CSIH 77, and by the Supreme Court in *RFC 2012 Plc (in liquidation) v Advocate General for Scotland* [2017] UKSC 45 (the "Rangers" case). The Court of Sessions stated:

"[56] The fundamental principle that emerges from these cases appears to us to be clear: if income is derived from an employee's services *qua* employee, it is an emolument or earnings, and is thus assessable to income tax, even if the employee requests or agrees that it be redirected to a third party. That accords with common sense. If the law were otherwise, an employee could readily avoid tax by redirecting income to members of his family to meet outgoings that he would normally pay: for example to a trust for his wife, as in *Hadlee*, or to trustees to pay for his children's education or the outgoings on the family home. It follows that, if the principle applies, it is irrelevant that the redirection is through the medium of trust arrangements. It is equally irrelevant that the trustees who receive the payment, at whatever remove, exercise a genuine discretion as to what happens to the funds. The funds are ultimately derived as consideration for the employee's services, and on that basis they are properly to be considered emoluments or earnings. Indeed, in *Brumby* v *Milner*, the existence of a discretion in the trustees as to the benefits taken by employees was taken as a factor pointing towards the conclusion that the payments were derived from employment.

[57] This principle is ultimately simple and straightforward – indeed, so straightforward that in cases where elaborate trust or analogous relationships are set up it can easily be overlooked. That, it seems to us, is what happened before the First-tier and Upper Tribunals in this case."

78. In the Supreme Court Lord Hodge stated, with reference to *Barclays* (at [13], [16], [35], [39], [58] and [64]):

"Lord Nicholls (para 34) recognised two features which were characteristic of tax law. First, tax is generally imposed by reference to economic activities or transactions which exist, as Lord Wilberforce said (in *W T Ramsay*, 326) "in the real world". In the Court of Appeal in *Barclays Mercantile* [2003] STC 66, para 66, Carnwath LJ made the same point: taxing statutes generally "draw their life-blood from real world transactions with real world economic effects". Secondly, the prodigious intellectual effort in support of tax avoidance results in transactions being structured "in a form which will have the same or nearly the same economic effect as a taxable transaction but which it is hoped will fall outside the terms of the taxing statute". He continued:

"It is characteristic of these composite transactions that they will include elements which have been inserted without any business or commercial purpose but are intended to have the effect of removing the transaction from the scope of the charge."

The correct response of the courts was not to disregard elements of transactions which had no commercial value. That, he said, was going too far. Instead the court had, first, to decide, on a purposive construction, exactly what transaction would answer to the statutory description and secondly, to decide whether the transaction in question did so (para 36).

…

…In answering the question whether the relevant statutory provisions were intended to apply to the transaction, the proper approach is, first, to interpret the relevant statutory provisions purposively and, secondly, to analyse the facts in the light of those statutory provisions so construed.

Income tax on emoluments or earnings is, principally but not exclusively, a tax on the payment of money by an employer to an employee as a reward for his or her work as an employee. As we have seen from the use of the word "therefrom" in section 19 of ICTA

> (para 5 above), income tax under Schedule E was charged on emoluments from employment. In other words, it was a tax on the remuneration which an employer pays to its employee in return for his or her services as an employee. This concept also underpins the concept of "earnings" in ITEPA (para 6 above) which in section 9(2) refers to "taxable earnings from an employment" and in section 62 defines earnings in relation to an employment. Included in that definition in section 62(2)(c) is the catch-all phrase: "anything else that constitutes an emolument of the employment". That which was an emolument under prior legislation remains an emolument under ITEPA. What is taxable is the remuneration or reward for services…
>
> The breadth of the wording of the tax charge and the absence of any restrictive wording in the primary legislation, do not give any support for inferring an intention to exclude from the tax charge such a payment to a third party which the employer and employee have agreed as part of the employee's entitlement. Both sums involve the payment of remuneration for the employee's work as an employee…
>
> In summary, (i) income tax on emoluments or earnings is due on money paid as a reward or remuneration for the exertions of the employee; …
>
> The relevant provisions for the taxation of emoluments or earnings were and are drafted in deliberately wide terms to bring within the tax charge money paid as a reward for an employee's work."

Evidence and Findings of fact

79. We set out below a summary of the witness evidence and our findings thereon. We supplement our findings in further detail later in this decision.

General points

80. We agreed with and adopted the approach per Leggatt J in *Gestmin SGPS SA v Credit Suisse (UK) Ltd & Anor* [2013] EWHC 3560 (Comm) who stated:

> "…the best approach for a judge to adopt in the trial of a commercial case is, in my view, to place little if any reliance at all on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts. This does not mean that oral testimony serves no useful purpose – though its utility is often disproportionate to its length. But its value lies largely, as I see it, in the opportunity which cross-examination affords to subject the documentary record to critical scrutiny and to gauge the personality, motivations and working practices of a witness, rather than in testimony of what the witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth."

81. We will set out our findings as to the reliability of the witnesses in due course. However, in summary we formed the view that, unsurprisingly, the recollections of the witnesses of fact were affected by the passage of time and had (as Mr Ferrari and Mr ab Ifan both stated) been informed by the documents. In the case of Mr ab Ifan he stated he had assisted his recollection by reference to his daybook. However, we noted that the daybook was not in evidence. We therefore took the view that where his oral evidence was unsupported by documentary evidence and was at odds with other documents, we should attach greater weight to the documents before us.

82. It also seemed to us that at various points in their evidence both Mr Ferrari and Mr Ab Ifan were more concerned with anticipating where the line of questioning was leading than in answering the questions directly. It was clear to us that both Mr Ab Ifan and Mr Ferrari had a good understanding both of the arrangements and their potential tax consequences and we formed the impression that in attempting to present their respective cases on behalf of the Appellants – and their own involvement – in the best possible light, they sought to highlight features they considered helpful from a legal perspective at times at the expense of providing direct answers. We also found, as we shall set out further in due course, that some evidence lacked credibility when viewed against the remainder of it.

Jones Bros documentary evidence

83. On 23 April 2010 Grant Thornton emailed Mr ab Ifan setting out the matters discussed between Grant Thornton and Jones Bros in an earlier meeting which included:

> "GSOP
>
> We discussed this plan whereby bonuses can be treated differently so that they are taxed as capital gains rate rather than income tax. From our initial discussion it did not seem appropriate because of the flexibility you require however it is perhaps something to consider in the future."

84. Grant Thornton emailed Mr ab Ifan on 23 June 2010 confirming its engagement and stating, regarding GSOP:

> "As regards the GSOP idea, to pay bonuses at CGT rates, this is still attractive but would need to be implemented very soon as it would be based on targets set early in the accounting year, and paid out pre 6 April 2011…I include the rest of the note below for completeness as we were unsure if this would work for you and it needs likely figures split by type of bonus which I don't really have a handle on…
>
> Based on an individual being subject to income tax at 50%, the saving under GSOP compared with employment income are 23% for the individual…and a saving of 12.8% in NIC for the employer…In addition the individual will be entitled to the CGT annual exemption of £10,000 should they have no other capital gains in the tax year."

85. From the documents set out above it was clear that the GSOP arrangements were marketed as a way in which money due as a bonus could be paid to employees in a different way for the purpose of reducing the charge to tax. We considered that the documents clearly demonstrated that the purpose of the arrangements was to pay bonuses to employees with tax savings.

86. A Grant Thornton document entitled "Growth Securities Ownership Plan: Introduction of a new equity-based incentive arrangement" sent by Grant Thornton to Mr ab Ifan on 25 August 2010 outlined the GSOP arrangements. Included as benefits in the Executive Summary were:

> - Any growth in value realised by the employer should be subject to capital gains tax, currently at maximum rate of 28 %, rather than income tax at a rate currently up to 50%

- the growth in value will not be subject to employer National Insurance Contributions (NIC)
- a corporation tax deduction should be available.
- when compared to employment income of £100,000 the GSOP would give additional net income to the participant of £24,000, resulting in a pre-tax saving to the company of £13,800 and an overall saving of £37,800
- payment under the GSOP can be made in cash or equity, as the Company requires
- a flexible structure which can be designed to fit around the unique and specific commercial needs and goals of the Company (for example, the award can be based on performance at the overall company or business division level)
- an employee incentive plan where awards are aligned to the overall performance of a business and the participant.

87. The structure of the GSOP was such that the security:

> "will have little or not value at the date it is awarded to the participant. This is achieved by linking any payout under the security to future growth only in the underlying asset of index.
>
> …
>
> If the value of the underlying asset increases, the employee receives an amount linked to the increase in value of the asset. The nature of the underlying asset and relationship between the change in its value and the level of payout are set out in the security."

88. The document explained that the downside risk "can be limited to a predetermined amount…and can be set at a relatively low amount. Furthermore, the "downside risk" can be managed such that the participant is effectively protected against suffering any financial loss".

89. The tax treatment of such an arrangement was explained as follows:

> - if the security is deemed to have value at the date of award and this is not paid for by the participant, income tax and National Insurance Contributions (NIC) will be due at the date of award on the difference between the value of the security at that date and the amount paid for it by the participant. However, as long as the value of the security is based on future growth only and a sufficient hurdle level is incorporated, no income tax or NIC should arise at the date of award.
>
> - at the end of the security period when cash out occurs, receipt of the cash payment should subject to capital gains tax only (at 28% for an individual - as reduced by available annual exemptions, and by transfer (in whole or part) to a spouse to utilise their exemption as appropriate
>
> - the company should be entitled to a corporation tax deduction in respect of the cash paid out to the employees.

90. The document explained:

> "…in order to secure the beneficial tax treatment afforded by the GSOP, it is necessary for the participants to have some exposure to "downside" in the event that the value of the underlying investment goes down."

91. Although some reference was made to the GSOP as "an innovative employee incentive plan, providing tax efficient arrangements which align employee reward to the commercial objectives of the business", we noted that the document mainly focused on the tax benefits to be

achieved through such arrangements and that the generic structure referred to above, namely "If the value of the underlying asset increases, the employee receives an amount linked to the increase in value of the asset", was not in fact implemented by Jones Bros as the amount received by the employees was not determined by the value of the underlying asset but by a wholly separate, unrelated formula, more about which we will say when we consider the evidence of Mr Alpay.

92. The documentary evidence satisfied us that the intention from the outset was that there would be a zero valuation of the GSOP at its commencement, and that the downside was included solely for the purpose of qualifying for the tax benefits and to fall within the scope of the legislation as opposed to any genuine commercial reason and that consideration was given to ensuring that the participants would be protected from making any payments arising from the downside.

93. Handwritten notes, confirmed by Mr ab Ifan as his own, recorded the downside as being 1/20th or 1/30th of the upside and envisage "GSOP + existing" and "parallel running". The notes referred to it as "incentive scheme [not an extraction scheme]…No CGT this parliament…2 years or more life in this arrangement" There is reference to "Floor - individual pays must hurt £500 - £50k possible loans" and "employee loans for transition period".

94. We were satisfied from the notes, taken together with the correspondence with Grant Thornton, that Mr ab Ifan envisaged the GSOP arrangements and bonus scheme would work together. He was aware, even if not in precise figures, of the level of downside payments as against the upside from an early stage. We considered the reference to employee loans to cover the transition period which appeared to us to indicate that the intention of Jones Bros was to ensure that the employees were protected during any period from the quarterly bonus arrangements in place to the annual GSOP arrangements. Similarly, the reference to possible loans demonstrated the company's intention to protect employees against any potential economic impact of the downside, which reinforced our view that there was no commercial reason for the inclusion of the downside but rather it was there to meet the statutory requirements.

95. An email from Grant Thornton dated 19 November 2010 to Mr ab Ifan records that the company "as far as possible…would like to maintain the current bonus plan but also introduce GSOP arrangements as a further incentive arrangement to encourage the individuals to add value to the business". We shall address the issue of incentivisation later in this decision, however it is clear that the GSOP arrangements were intended to replace the bonus payments for participants – who acknowledged in signed documents that they would not be entitled to both – and act as a more tax efficient substitute. Our conclusion is reinforced by Minutes of a Jones Bros Board Meeting of the same date which recorded the only benefit as that "bonus payments can be received as a capital gain so the first £10k would be tax free… and the remainder would be at a reduced rate… The GSOP would be a trigger to use the existing bonus calculation formulae."

96. An email from Grant Thornton to Ruth James at Jones Bros explained that:

> "In the event that a participant leaves employment, unless specific provisions are made, the security would still carry value. We would therefore suggest that in all cases the

> securities created are non-transferable and are forfeitable in the event of leaving the employment of the company.
>
> Under the terms of the GSOP, participants who are not in the employment of the company (for whatever reason), or are under notice, at the date of settlement will not receive any payment due to them. Similarly, where an employee has ceased to work for the company (for whatever reason) or is under notice at the date of settlement, they will not be liable for any downside arising."

97. This email reinforced our conclusion that the GSOP arrangements were a direct substitute for the bonus scheme; had the participants obtained an asset or security there seems no reason why it would not have been retained upon cessation of employment, unlike a bonus scheme which would only reward employees.

98. On 22 December 2010 Grant Thornton gave a presentation to potential participants in which the current bonus was described as:

> "costly to company and to individuals…considering new arrangements …similar to share scheme…without using shares…potential for significant savings for company and all participants…value of security when awarded is nil…payment level is calculated in same way as current bonus arrangements…current bonus will run alongside – Neutral EBIT = cash bonus – EBIT at Hurdle or above = GSOP payment…no worse than current position."

99. The presentation failed to outline any benefit of GSOP arrangements as compared to the bonus scheme in place, other than by reference to tax savings. We again noted that the amount of payment was to be calculated in the same way as the current bonus scheme, the only difference being that whether the payment was paid through GSOP was by reference to the hurdle (otherwise the cash bonus scheme applied); in our view this indicated that the reason for the payment, namely remuneration for services, remained the same.

100. The Grant Thornton Feasibility Report dated 24 December 2010 identified no additional purpose of the GSOP arrangements beyond those of current bonus arrangements other than tax saving:

> "Jones Bros…in common with a number of other successful companies, uses discretionary cash bonus arrangements as part of its incentive structure for the Company's key employees. Whilst such awards are essential in order to retain and motivate senior staff, they are a significant cost to the business and, therefore, the Company is looking at alternative, cost-effective means by which it could incentivise its senior staff."

101. The benefits identified related to the tax savings and included a statement that the downside risk "need not be proportionate to the potential payments receivable". The document identified the cost effectiveness of the arrangements by aligning the reward to the commercial objectives of the company which was said to already be the purpose of the bonus scheme. It noted:

> "2.1 The Company operates incentive plans to retain and incentivise its directors and employees through participation in the success of the business. There is currently a bonus scheme for Contract Managers, which is linked to the status of contracts for which they

> are responsible. The bonus plan is intended to reflect the contributions that each manager makes to the overall value of the business.
>
> However, the Company is also keen to ensure that any arrangements used are tax efficient where possible. The arrangements should be cost effective to implement and operate. The Company is therefore considering whether GSOP would be a suitable framework for incentivising staff, whilst, at the same time, reinforcing the message that employees should consider their actions in relations to the growth of the overall business, rather than solely their particular department."

102. The document recorded the saving to the company through the use of GSOP and the benefit to the employees by a "higher net income after tax without any increase in the gross payment from the Company":

> "There is currently a bonus arrangement in place for Contract and Site Managers. Commercially, the optimum solution for the Company would be an exact replication of the current bonus strategy, this would minimise the overall changes for the employees between the existing plan and a GSOP…
>
> It is possible to continue to operate the current cash bonus arrangements alongside the GSOP, which would give the Company added flexibility. This could mean that if the hurdle is not achieved, the participants may still be entitled to a cash bonus depending on their own individual performance…
>
> The proposed level of rewards to employees that are currently used could be replicated in the GSOP framework. However, by using a GSOP the employees will receive more net proceeds from the same gross payment"

103. From the documentary evidence it was unclear to us how the GSOP could be said to further incentivise employees or align their interests with the overall business when the current bonus scheme ran in parallel with it and employees were still able to receive a bonus on individual performance. We also note that there was no explanation as to how the downside, which was set very low, could, in reality, affect the employees' behaviour. In our view the documents demonstrated that the GSOP arrangements were no more than a mechanism by which Jones Bros could pay the same cash bonuses, using the same formula for calculation, without a charge to tax.

104. On 19 January 2011 Mr ab Ifan emailed Grant Thornton to suggest a hurdle of £1million "or maybe a little less" which was said to be a "reasonable forecast revised by the Board at their meeting last Thursday." A further email on 28 January 2011 from Mr ab Ifan suggested downside payment levels in respect of certain employees.

105. An email from Ms Kidston, senior tax manager at Grant Thornton, dated 17 March 2015 to HMRC confirmed that the calculations under GSOP arrangements were on the same basis as those under the cash bonus scheme and, furthermore, there was no formula for setting the downside payments. That again indicated to us that the inclusion of the downside was not based upon any commercial rationale:

> "From the information provided it seems clear that potential payments under the 2011/12 (GSOP 1) were calculated on exactly the same basis as entitlements under performance bonus scheme for the previous year. Please confirm that this is correct. As above.

> From the information provided it seems clear that payments made under 2011/12 (GSOP 1) were (subject to the GSOP hurdle) calculated on exactly the same basis as payments made for the same year under the performance bonus scheme to employees who did not take part in the GSOP. Please confirm this is correct. As above. Performance bonus is calculated and paid on a quarterly basis and was not subject to meeting the performance hurdle whereas the GSOP is paid on an annual basis.
>
> In relation to the setting of the downside payments from participants the individuals' remuneration was considered and the downside payments set at a level that was considered 'non negligible' in the context of their personal circumstances. i.e. a not insignificant sum. No prescribed formula was used in calculating the downside."

106. The Grant Thornton valuation report dated 31 January 2011 noted that the operating profit was determined internally and confirmed that, if met, the amount of payment would be determined by the participant's job portfolio and performance as opposed to by reference to the operating profit. There was no need for a cap (i.e. limit on operating profit above which the payment level would not increase) as the participants' level of payment was not affected by movement in the operating profit:

> "as the level of operating profit does not impact the amount of payment made. The payment is merely triggered if the hurdle is achieved, and the amount depends on other factors."

107. The Grant Thornton GSOP Participant Guide dated 31 January 2011 explained:

> "The GSOP is structured so that you know the results the business needs to achieve in order for you to receive a GSOP payment. The payment you receive will depend on your job performance, and will be determined by your portfolio (more detail below).
>
> The GSOP award is taxed in the same way as a share in a company. In the same way as many employee share schemes, the GSOP allows you to share in the value of the business…
>
> The final advantage of the GSOP is that it is a very tax efficient way of rewarding you for your contribution to the value of the business. Currently, a cash bonus payment would, when paid out to you, be taxed to income tax and National Insurance ("NIC"). Depending on the level of your income, any monies received will be subject to income tax at either 20% (plus NICs of 12%) or 40% (plus NICs at 2%) during the tax year ended 5 April 2012.
>
> However, payments under a GSOP should be taxed at the capital gains tax ("CGT") rate. This is currently set at 18% for basic rate taxpayers and 28% for higher rate taxpayers, with gains under £10,100 (the CGT allowance for 2010/11) being free of tax, if you have not used your CGT allowance already. Additionally, no NIC should be due on the monies received from a GSOP for either you or the Company. If the GSOP is considered by HM Revenue & Customs to have any value on the day you receive it, that value will be subject to income tax and NIC and you agree to allow the Company to deduct any related liabilities through the payroll (or as otherwise agreed). The company believes that the GSOP has no current value but HMRC will not confirm this in advance.
>
> …
>
> As noted above in Section 1, by using a GSOP, you should be able to receive any monies at the currently lower CGT rates. <u>However, in order that the GSOP security qualifies for this treatment, there is an express requirement that the holder of the GSOP security is exposed to a "downside" position, should the Company's future performance be below a certain acceptable level.</u>

> …
> As part of the terms of the GSOP, you will be required to purchase the GSOP security for its full and unrestricted market value. <u>However, given that the proposed Hurdle is seen as being a "stretching target" in order to encourage generating value for the Company, the GSOP security at acquisition is considered, by the Company, to have no current value. However, in order to finalise the CFD Agreement, at least a nominal sum must be paid over to the Company. Therefore, the acquisition price of the GSOP security has been set at £10.</u>
> …
> The GSOP is a new incentive structure, however we are confident that under the current legislation it should work tax efficiently as set out above. Of course, it is always possible that the government will change the tax legislation. Therefore, it is possible that the rules which determine how your GSOP is taxed will be changed before you receive your payment. If this does occur then the most likely worst case for you as a participant is that you may be taxed on the amounts you receive in the same way as if you had received a cash bonus."
>
> (emphasis added)

108. The Participant Guides for each category of employee were materially identical save for the calculation payment received. The documents confirmed that payments depended on the participant's job performance and not by reference to movement in the underlying asset. This was also confirmed in the Grant Thornton "GSOP – summary of tax administration" dated 21 June 2011:

> "Although the same Hurdle will apply for each participant, their level of payment will depend on their own performance in their job. On achieving the Hurdle, each participant will receive a payment which is calculated in accordance with predetermined methodology.
>
> The calculation will depend on the employee group and generates a higher payment for good performance."

109. In our view the documents show that the purpose was to achieve the tax benefits attainable through GSOP arrangements while providing the employees with the same payments as would be received by them through the bonus scheme as reflecting "your contribution to the value of the business." The downside had no other purpose than to make the arrangements qualify as CFD. The arrangements were such as to benefit the company in relation to corporation tax whilst also safeguarding its position if that was not achieved and ensuring that there was no prejudice to the company or the participants. That the hurdle was designed to be "seen" as stretching indicated to us that the focus was on bringing the arrangements within Part 7. Similarly the nominal payment had no business purpose other than as a by-product of ensuring the scheme met the legislative requirements.

110. Although the Master Agreements and Confirmation Agreements indicated provision for Initial Margin and Additional Margin to be paid, there was no evidence before us that any Margin was ever required or paid.

111. An extract from one participant's SA return gave the following explanation:

> "The payout received was based on the movement in value of a commercial index determined by my employer at acquisition."

112. This was clearly inaccurate as demonstrated by the documents referred to above. Payment was determined by the level of EBIT, but the payout was based on the calculation set out for each specific group of participants.

113. An internal letter from Ms James, Commercial Manager at Jones Bros, to Mr Roberts dated 9 March 2012 stated:

> "I am very pleased to inform you that the "hurdle" operating profit of £875,000 for the 12 months ending 31 January 2012 has been exceeded. Therefore you become eligible for a payment under the GSOP. The payment due in accordance with your Contract for Difference is dependent upon the cumulative financial performance of the portfolio of civil engineering jobs which you have been involved [sic] up until the end of January…
>
> Performance Bonus Calculation – March 2012"

114. The calculation method was materially identical to that for the bonus the previous year. The impact of payments in previous years was shown on the level of GSOP payments.

115. In relation to the employees who were not eligible for a GSOP payment despite the hurdle having been reached, one employee was written to on 9 March 2012 as follows:

> "…such payments can only be made if further conditions are met. One of these is that the recipient is not subject to a disciplinary event during the GSOP period. You were given a written warning on 07/10/11. For this reason no GSOP payment can be made on this occasion…
>
> As you have not met the conditions for a GSOP payment I have assessed you for the normal performance related bonus and I am pleased to inform you that the amount due to you is £16,023.25."

116. The £16,023.25 awarded to the employee under the "normal performance related bonus" was subsequently taken into account in determining payments received in later GSOPs. That indicated to us that the GSOP operated alongside the bonus scheme and that where the bonus could not be paid tax free under the GSOP, the employee could still qualify for the discretionary taxed bonus calculated in the same way.

117. The payments were expressed to employees as their bonus entitlement. For instance in a letter from Mr ab Ifan to an employee dated 4 March 2011:

> "As you have elected to participate in the GSOP scheme you will not be eligible for further bonus payment until this time next year. However I propose to issue a quarterly statement to you which will indicate how your portfolio of jobs are progressing – from which you will see how your entitlement to bonus is progressing."

Witness evidence and findings of fact: Jones Bros

118. Mr Dewi Osian Ab Ifan is the former finance director of Jones Bros, a family run and family owned civil engineering business based in Denbighshire. Mr Ifan started working at Jones Bros in 2006. He was appointed finance director in 2007 and retired in 2014. His role had a wide remit covering responsibility for various business areas

including accounting, finance, legal, HR, IT, organisational and management development. The company structure in 2011 consisted of Jones Bros Ruthin Co Ltd and one wholly owned subsidiary company, Jones Bros Ruthin (Civil engineering) Co Ltd. The parent company conducted the plant hire business and the subsidiary undertook civil engineering projects.

119. He explained that following the financial crisis of 2007-08 there was a lack of construction projects available which resulted in market leaders competing for medium sized projects such as those Jones Bros had traditionally relied upon. As a consequence of the financial crisis of 2008 the company's tender win rate deteriorated and at the time the information for the scheme was being prepared it had dropped from 1 in 4 to 1 in over 14.

120. According to Mr ab Ifan, employees were traditionally rewarded on an ad hoc discretionary basis in a variety of ways depending on their role. There was no formal reward or recognition system in place. In 2008 a new system for reporting contract performance to the directors and managers was introduced. Until 2010 financial reports were reviewed on a quarterly basis and discretionary rewards given in recognition of good performance. Mr Ab Ifan stated that the bonus scheme was not contractual but discretionary. He added that, although it was theoretically correct that the cash bonus arrangements would continue to operate alongside the GSOP, that was not the intention. The discretionary bonus would only be continued for those not invited to join the GSOP. Mr Ab Ifan was adamant that the previous bonus system worked in isolation, rewarding employees individually. However, the GSOP arrangement encouraged employees to support each other.

121. We found Mr ab Ifan's evidence that the GSOP arrangements further incentivised employees to be vague; other than stating that it gave them "skin in the game" there was no explanation as to how employees' behaviour was affected by participation in the GSOP. Furthermore, we did not accept the evidence that the GSOP and cash bonus scheme did not work in parallel; this was contrary to the documentary evidence which demonstrated that not only did Mr ab Ifan indicate in his notes that the two schemes would work alongside each other but there were also examples of instances in which employees who qualified for, but did not receive a payment under GSOP arrangements, were rewarded using the cash bonus scheme.

122. There were three individuals who did not qualify to receive a GSOP payment despite the company hitting the hurdle. Mr ab Ifan explained that one employee made a personal appeal to the managing director who after consideration decided to award the employee a discretionary bonus similar to that which would have been received in the past because the employee was valued. The same consideration was given to the other two employees; one received a discretionary bonus and one did not. The evidence was as follows:

> "Q. But can we agree on this, that, as we have seen from that PowerPoint slide, and we have now seen from the example of Mr Wheldon, the discretionary bonus scheme was simply running alongside GSOP and, at any rate for the right employee, if he did not qualify under GSOP, he could still qualify for a discretionary cash bonus?

A. Well, the potential was there to actually be given a discretionary bonus. I think in one instance – in another year – one individual not only was awarded GSOP, because all the conditions – the strict conditions – were met, but because of his own particular, over and above performance in that particular year, he was even awarded a separate discretionary bonus on top of that related to one individual. In the year that we're focusing on, which is GSOP1, out of the 34 people that accepted the invitation, five did not get any payment under the GSOP arrangements. Two of those five were awarded a discretionary non-GSOP payment.

Q. And what about Mr Boniface, whom you have just mentioned?

A. Yes, he failed – he failed the conditions on more than one count. There was a disciplinary event – I don't recall the date of it. There was a complex disciplinary event. So, that trigger was off, as far as GSOP was concerned. But even had that trigger not been in place, the portfolio of jobs in which he was associated with did not return a positive margin. So, had there not been a disciplinary event, he would not have been awarded anything and because of his circumstances and his personal performance in lots of different measures, he would have failed very quickly for consideration under any discretionary payments.

Q. But he was assessed for the normal performance-related bonus calculation?

A. Well, I'm sure that the calculation would have been done, yes.
…

Q. But the critical thing I want to establish about Mr Boniface --- is that he did not qualify under GSOP --- because he had a disciplinary record…but he was, nonetheless, assessed for the normal performance-related bonus calculation, but with an outcome of nil?

A. Yes, yes.

Q. And we can see that ---

A. But had he – may I add just a point? Because of what had happened during the year, had his portfolio of jobs made a positive margin, because of the nature of the disciplinary events surrounding his performance that year, I don't think any discretionary payments would have been made to him, in fact.

Q. So, he did not qualify anyway and he was told that, was he?

A. Yes.
…

Q. Right. Let us just look at whether he was told that.
…
Q. And so what Mr Boniface gets told on 9th March 2012 – Ruth James is pleased to inform him that the hurdle has been exceeded. However, there is a bit of a kicker, because he has got a disciplinary event. So, he cannot have the GSOP payment…But then it goes on, and he is assessed for the normal performance related bonus. "No further payment is due at this time". That is a calculation point, is it not?

A. It is, yes.

Q. It does not say anything about him being deprived as a matter of discretion anyway?

A. No, but – I'm sorry, I didn't have the advantage of having read this particular page in the last few weeks, let alone few years, I suspect – but I do recall the significance of some disciplinary events relating to him, and my response to you – to an earlier question there – having those in mind, that had this calculation become positive – this non-GSOP calculation – then it is very unlikely that that would have been paid. I think Mr Huw Jones, from my memory of events, would have overruled it. Now then, had he been entitled to one under GSOP and that none of the off-triggers had been triggered, then he would have got the payment, whether Mr Huw Jones liked it or not, because that was contractual.

Q. Then just to go back, if we may, to Mr Wheldon, to see how his bonus fed into his GSOP…Now, we know that Mr Wheldon got £16,000 in March 2012, through the cash bonus arrangement, because he was disqualified from GSOP that year…So, let us just identify that. This document is a performance bonus calculation for March 2015, and we can see the cumulative calculation; and then in the bottom box we can see "Less Previous Payments", and we can see a whole list of payments of cash bonus from March 2004 up to March 2014…And we can see that it is variously described as "Wages" or "Salary" – all the way up to March 2012; and in March 2012, we can see that he is recorded as receiving £16,023 odd as salary. That is the figure that we were just looking at when he did not get GSOP, but did get a cash bonus.
…
A. It looks like that very much, sir, yes.

Q. And then the following year, and the year after that, he got GSOP in sums of 13,000-odd and 1,000-odd. The whole calculation was done on the same basis – a cash bonus and GSOP, all took account of the historic position driving out the figure which was to be paid to Mr Wheldon, and GSOP was just treated as one more step in the historic pattern of how bonuses were paid?

A. Well, yes – it was a different type of mechanism for paying bonus, but, yes, it was a performance bonus payment.

Q. Thank you. There is one critical thing – I am going to come on to the downside. But let us just park that for a moment. There is just one critical thing that differentiates GSOP from the cash bonuses of previous years, which is the condition of the "hurdle".

A. Well, and the formality with which the off-triggers were regarded, in that a disciplinary event meant GSO was off; and the same went for what we loosely called the "health inspection report" – this was an examination by an independent team within our organisation which looked at health and safety, environmental and quality standards. Those are the three main things, yes.

Q. With that qualification, we can see, can we not, that payment of GSOP – and I am still leaving out of account the downside – payment of GSOP is simply a conditional bonus. You have got to satisfy the condition that the hurdle is exceeded and defeat, as it were, the negative conditions about disciplinary warning --- health and safety and so on, but, subject to fulfilment of those conditions, positive or negative, the GSOP payment is just a conditional bonus?

A. Except, though – yes, is the answer, in addition – except that there was another dimension to it, and this is the bit that – and I've used the phrase now twice, I think, but forgive me for re-using it – that there was a skin in the game. There was a downside potential, if the results of the operating profit was – hit the floor as Grant Thornton, or below the floor as Grant Thornton – there would be a payment the other way, and had that occurred, clearly, these statements would have to have been re-engineered to reflect that happening and, you know, and taking the potential positive individual person's portfolio performance during that – any year, you know, had that happened.

> Q. But the downside --- was simply there, was it not, to make sure that this arrangement worked from a tax point of view?
>
> A. Well, it was a requirement, as I understood, of the arrangement from a tax point of view, but it was the only way where, as an alternative to having some share options – and, you know, we weren't a quoted company. Although we toyed with the idea, we quickly dismissed it because of the cost. It was a mechanism by which – if we don't pull together on this one and work really hard, it was an environment where we could have easily gone into a loss for reasons in my statement and that I've discussed previously ---
>
> Q. All I simply put to you --- was that the downside was there because it was seen as essential for this scheme to work, if it was going to.
>
> A. Yes, it was the downside that gave it that dimension."

123. We concluded that where a GSOP participant did not receive a GSOP payment due to not meeting the conditions such as disciplinary events, they could still qualify for the discretionary cash bonus which was calculated in the same way as the cash bonus scheme payments. We noted Mr ab Ifan's evidence that there was no "entitlement to a cash bonus". However we were satisfied that there was an entitlement to consideration for a cash bonus and, although Mr Ab Ifan stated that he did not believe entitlement to an annual discretionary bonus was a key term of an employee's contract, he accepted it would have been a key aspect when trying to recruit an individual as an enticement and would be a term of offer.

124. We noted that a letter of employment showed the key terms for position of senior contracts manager as base salary and an annual discretionary bonus related to personal performance. The letter detailed how the bonus would be calculated from the net financial contribution from the construction projects for which the employee is responsible after taking account of full overhead recovery (normally 3%, subject to an overall limit of 9% and to a maximum payment of £40,000 per annum) and also subject to achievement of satisfactory standards relating to health and safety and other matters. Mr Ab Ifan confirmed that a similar bonus arrangement applied to junior and senior site contract management staff.

125. Mr ab Ifan believed, and we accept, that Jones Bros was contractually bound to give such employees fair consideration of the discretionary bonus. Furthermore, we accept HMRC's submission that for the purposes of calculating cumulative performance bonuses, GSOP was no more than an additional step in the historic pattern of how cash bonuses were paid. We noted Mr ab Ifan's evidence that this was not true of all participants, but we were satisfied from the evidence that this only related to a small number of participants who had not previously been engaged in the cash bonus scheme.

126. We are satisfied that the Appellant used the GSOP in parallel with the cash bonus scheme for those who did not participate in the GSOP arrangements, and are also satisfied that where the hurdle was met, payments would be made under GSOP. However if the hurdle had not been met the Appellant may have paid out cash bonuses, as Mr ab Ifan accepted:

> "Q…if the GSOP was met, then GSOP paid out?
>
> A. Yes.
>
> Q. But if it was not met, then you retained the situation where you may be paying cash bonuses anyway?
>
> A. Yes, I think you're right there. That is correct."

127.Mr Ab Ifan explained that he was familiar with the concept of CFDs from his earlier career in the early 1990s in the electricity industry. He was aware from the outset that the structure would need to be such that there was a risk of no payment and a risk of payment in the other direction by the individual to make the particular arrangement work.

128.Mr an Ifan explained that it was important to reach a situation whereby key employees had "skin in the game"; something at risk to help them align their performance with the company's objectives. He considered the hurdle to be very stretching and although the actual result achieved was very different, he believed at the time the forecast was made that it was very realistic.

129.For reasons set out later in this decision, we do not accept that the hurdle was very stretching and preferring the evidence of Ms Mayr in this regard. She concluded that it was highly likely that the hurdle would be reached. We also considered that the figures used to arrive at the forecast were unreliable for the reasons set out later in this decision.

130.Although Mr ab Ifan asserted that reducing the frequency of the bonus type payment and delaying the receipt of the GSOP reward assisted the company with staff retention, we found that the documentary evidence which showed that consideration was given to ensuring that any risk to employees would be mitigated, for example by way of loans, did not support the contention. Furthermore, we considered that the company's switch back to the cash bonus scheme when GSOPs were no longer used did not support this.

131.Mr ab Ifan confirmed that it was not the intention of Jones Bros to make a profit from contracting with the employees. It was also not the purpose to avoid a loss by contracting with the employees. Jones Bros wanted to profit as a business from the arrangement, growing for the future and increasing profits:

> "Q…Jones Bros paying out, that wouldn't be an intention. The over-riding objective was not the CFD but what it enabled us – the manner in which it enabled us to incentivise those key people to perform at a higher level and to perform together so that the business performed better financially, it would meet the hurdle, everybody would see it and not only that to build the business for the future…
>
> Q. Is it fair to describe GSOP as a bonus scheme?
>
> A. As it stands yes, I would say it was a bonus scheme.
>
> …
>
> Q. But the true structure of what was set up was simply a slightly more complicated, conditional bonus.

A. Well, you could phrase it that way"

132.Mr Ab Ifan stated that the savings to the company cited by Grant Thornton were not the main driver; they primarily benefitted the employees and would help the company attract and retain key employees as well as increasing performance and productivity. The employees had "skin in the game" and the GSOP arrangements promoted behaviour that required achievement of mandatory minimum standards such as health and safety. The arrangements gave greater focus on teamwork and measured performance over a longer period than the quarterly bonus. They also ensured that key decision makers were more aligned with the business by exposure to personal financial risk (by the premium and downside payments) and the opportunity of gain (by reaching the hurdle).

133.We found this evidence unconvincing for the following reasons. As set out earlier, the numerous references made by Mr ab Ifan to "skin in the game" were vague and there was no clear evidence that the GSOP arrangements had any impact on the behaviour of employees. The employees were (see [117] above) were "kept updated" as to the measurement of their performance on a quarterly basis and therefore we could see no distinction in real terms between the cash bonus scheme already in place other than the frequency at which they were paid. We considered that there was, in reality, no exposure to personal financial risk; not only had the Appellant considered how to guard against this for example by use of loans, but the downside was set at an amount which had no real likelihood of ever becoming a reality. We address this topic further when we consider the evidence of Ms Mayr, but it was clear from the documentary evidence and that of Mr ab Ifan that the downside had no genuine commercial reason for inclusion: its sole purpose was to meet the legislative requirements.

134.We did not accept the evidence of Mr ab Ifan that the GSOP was not implemented in order to save money for the company by saving tax; the documentary evidence clearly showed that the marketing and design of the arrangements focused heavily on this aspect (see [85] - [91] above).

135.Mr ab Ifan agreed that his own contract had an upside payment of in excess of £60,000 and his maximum exposure if the floor was breached was £2,000. He explained:

"Q. Can you agree with me the downside risk and the upside advantage are disproportionate one to another?

A. Looking at what the outcome was, it would appear that way. At the time -- I did not determine any of these figures -- we were entering on preparing for GSOP 1. Our forecast operating profit for the civ eng business was much lower than what it turned out to be…that was an honest forecast built up based on what we understood and what we felt the market was, and what we were going to win. Had we applied the formulae, particularly the ones relating to Huw Jones and Bethan, we would not have imagined it to be up to anything like the level that was eventually paid out because we had just not anticipated at all making the margin that we did in that first year."

136.However, we were satisfied that in looking at the figures it was clear that the downside risk and the upside advantage were significantly disproportionate and that Mr ab Ifan was aware of this, even if not in precise terms, particularly bearing in mind his involvement in the planning and implementing of the arrangements. We found his evidence that this was not something he had anticipated during the planning stages lacked credibility when viewed against the evidence as a whole and, in particular, the fact that Mr ab Ifan recorded in his notes the general level of the downside as 1/20th or 1/30th of the upside. Moreover, he was a member of the board which took and approved the decision and formula, and the calculations in respect of payments followed the same pattern as the cash bonus scheme. We found the Jones Bros evidence that the margin was not anticipated implausible; the margin achieved was, in fact, in line with the previous year.

137.In relation to the presentation to participants on 22 December 2010 we found Mr ab Ifan's evidence that the presentation was probably used by Grant Thornton to many clients and the information that "Current bonus plan will run alongside – Neutral EBIT = Cash bonus; EBIT at Hurdle or above = GSOP payment" was not a matter which Jones Bros was particularly conscious of to be unconvincing. It was clear from the documentary evidence that the presentation demonstrated the design of the arrangements, as sought by Jones Bros, and we did not accept that the tax advantage which was a focus of the presentation was not a dominant driver in undertaking the arrangements.

138. Mr Ab Ifan agreed that he had initially suggested a figure of £1 million as the hurdle to Grant Thornton in January 2011, but stated that this was suggested without a forecast and he believed the risk of not hitting the hurdle or of making a significant loss to be very real. His written evidence provided three examples of large contracts which made substantial losses. Despite Mr ab Ifan's evidence, we considered that the figures were not reliable as a basis upon which to say that the hurdle was stretching given the disproportionate nature of the losses which Mr Ab Ifan agreed were the biggest:

> "Q. I do not want to sound unduly critical when I say this, Mr ab Ifan, but it is really rather misleading, is it not, just to select the three worst contracts in order to suggest that there was a substantial risk of you not making the hurdle.
> …
>
> A. That was included there to indicate the riskiness, the lumpiness of some of the civil engineering jobs that we had, and it helped to explain why five of the invitees, the senior people, thought: Well, hang on, the risk is too big to them; they didn't want to participate despite the potential very beneficial tax treatment.
>
> Q. But it is a completely useless illustration of lumpiness if you do not give the upside that smooths out the downside, is it not? That is why it is misleading.
>
> A. Well, not in the context that it was presented. It was presented in the context of illustrating the types of losses. It wasn't intended and I don't believe the context that it is misleading."

139. We considered that if, as Mr ab Ifan stated, the figures were used for illustrative purposes only, they were of little relevance in supporting the position that the hurdle was stretching. If, as we found they were, the figures were intended to provide support for the proposition, we considered them to provide an inaccurate picture.

140. In relation to Mr Bowes' summary of trading performance based on historical performance, Mr Ab Ifan explained:

"A. This table does not relate to the civil engineering business. It appears to me, but I have attempted to try to reconcile it to the published accounts, but it is at a group level. It includes both civil engineering and plant hire. There are two corporate entities in the group, or there were at that time, Jones Brothers Ruthin and Jones Brothers Civil Engineering. The figures there appear to relate to the group as a whole and therefore will include plant hire operating profit.

…

Q. When you noticed that further error on Mr Bowes's part, did you make any calculation as to what the operating profit should be recorded as?

…

A. No, I've not been in a position to do that. This has been noticed by myself in the last four or five days. I'm retired a few years and I don't have ready access to… – but I've been trying to trace through where those numbers may have come from from some of the other exhibits, and it appears at best that they may have come from the published reports for the group entity, the Jones Brothers Ruthin --

Q. All right. Maybe we will have a little more back-pedalling from Mr Bowes in a day or two. But just looking at that figure which he put as the forecast at 775 --

A. My figure, yes.

Q. …That is your best case forecast, is it?... But, in fact, the figure you suggested… was £1 million, and the one that was fixed on was still higher than that at 875.

A. Forgive me for saying this: I think we're confusing a couple of things there. One is what I submitted to Grant Thornton on something like 19th January, something that we referred to a little later. The forecast was 775. I had been asked to comment or suggest a hurdle based on my understanding of what a hurdle was and it's in that context that the £1 million is referred to…

…

Q. What was the hurdle? How was it expressed?

A. As a stretching target above the forecast, and I believe the figure was 875,000.

…

Q. You had originally suggested for the "hurdle" £1 million.

A. Yes, but in the context of ... I was not the party to determine what the "hurdle" was. I didn't have a knowledge, sufficient knowledge of GSOP or valuation techniques to actually set the "hurdle", that was something ... It was more "what did I expect the 'hurdle' to be" question, it was something that was determined by the expert valuers within Grant Thornton and I understood that they took into consideration not only my forecast but also lots of other information relating to the market conditions. There was a very high level of uncertainty at that point in time, and very much deteriorating tender win rate and the fact that when we provided to them past figures – and they're in one of the documents here – of the actual for a comparable figure for GSOP 1 for the preceding three years, it showed a gradual deterioration in the operating profit as defined for GSOP purposes."

141. We found Mr ab Ifan's evidence that he lacked sufficient knowledge to propose a hurdle unconvincing. He was the finance director with, as he told us, an understanding and previous experience of contracts for differences. Mr ab Ifan claimed that the operating profit figures used by Mr Bowes in his comparison of the GSOP1 forecast against earlier years' performance were not the same operating profit metric used as the CRA. The evidence of Mr Bowes was:

> "Q. The forecast is given as 775,000, but I think when Mr Osian ab Ifan gave evidence he was telling us that there was some sort of error in that and that figure couldn't be relied on either, that you got that wrong. Do you agree with that? Did you hear him give that evidence?
>
> A. I heard him give his evidence, I don't recall him saying that and I have to say that I have revisited the forecast that we were provided with and that figure of 775 is included in there. So, I'm at a loss really to understand, you know he may have a valid point but I'm not aware of what it is because the 775 was in the forecast with which we were provided.
>
> Q. Right. So, as far as you are concerned, having looked at the figures and subject to that spreadsheet point, which you have helpfully corrected, you stand by your table in appendix 2?
>
> A. I think I do, yes."

142. We did not accept Mr Prosser's submission that as a witness of fact and person who knew the business, Mr ab Ifan's evidence should be accepted over that of Mr Bowes who gave an opinion on valuation on matters he assumed were factually correct. The point had never been raised before, no alternative figures were provided in support and no additional evidence was served addressing the issue. We preferred the evidence of Mr Bowes who confirmed the accuracy of his figures and which we accepted as reliable. Furthermore, the issue raised by Mr ab Ifan formed only a small part of the consideration and analysis carried out by Mr Bowes in reaching his opinion. We did not find Mr ab Ifan's new and unsupported evidence undermined Mr Bowes' conclusion to any material degree.

143. In response to Ms Mayr's supplemental report which noted that a Balfour Beatty contract was much more profitable than forecast which raised the likelihood of reaching the hurdle from 30 – 47% to 70 – 100%, Mr Ab Ifan explained that at the relevant time one key job was underway, namely the construction of the Porthmadog by-pass which was a joint venture with Balfour Beatty. He stated that the figure used by Ms Mayr (£1.5 million of margin having accrued during the GSOP 1 year) was incorrect and the error may have impacted on Mr Bowes' evidence. A request for information by Grant Thornton for a later GSOP valuation report was misconstrued as an additional £750,000 on top of the forecast which gave the £1.5 million. Mr ab Ifan also disputed that the company did not always account for revenues in a full and timely basis as outlined by Mr Bowes. He stated Mr Bowes had misunderstood the position regarding higher than expected invoices in March 2012 which Jones Bros had been invoicing for several months before this was noticed and which were corrected by the issue of overdue invoices shortly after the valuation date.

144. As we explain later in this decision, we accepted the evidence of Ms Mayr which we found robust and reliable. We did not accept that Mr ab Ifan's assertions undermined the evidence of either Mr Bowes or Ms Mayr in relation to the probability of the hurdle being reached to any material extent; Mr Bowes and Ms Mayr both stood by the accuracy of their figures and their conclusions, in particular those of Ms Mayr, were supported by a range of analyses which led us to prefer their evidence.

Documentary evidence: Britannia

145. In September 2009 Britannia began discussions with Grant Thornton. The GSOP period commenced on 26 September 2009 and Mr Langsam was appointed as director on 29 September 2009.

146. On 5 November 2009 Grant Thornton were formally engaged. A forecast to September 2010 and stretched target were sent by Ms Parry, a member of the finance department at Britannia, to Grant Thornton on 6 January 2010. The GOP was forecast at £8.933 million and the stretched target was £9.828 million. Grant Thornton responded on 21 January 2010 requesting "information required to firm up the valuation report" and which we noted indicated a concern to justify the figure as stretching:

> "a written explanation of potential barriers/opportunities for the company to achieve the hurdle, which will help to demonstrate that the hurdle is stretching and therefore difficult to achieve."

147. In the event, the GOP was forecast at £8.6 million and the hurdle at £9.6 million.

148. PWC published its UK hotels forecast on 3 March 2010. This report, which forecast positive growth for London and the provinces on 2010 and 2011, was not relied upon by Grant Thornton in its valuation. Instead Grant Thornton relied on the 2009 PWC "UK Hotels Forecast" which showed Rev PAR falling in London and the provinces.

149.The GSOP valuation report from Grant Thornton dated 10 March 2010 considered the suitability of the hurdle and was based on GOP for the 52 week period to 25 September 2010. The forecast relied upon was prepared solely for the purpose of the GSOP and the valuation relied upon the earlier 2009 PWC report which it described as "the most recent of the major surveys". Grant Thornton did not verify the accuracy of the information provided by Britannia and the report stated:

> "This paper sets out our opinion as to the suitability of a target threshold or "hurdle" in respect of a planned GSOP in Britannia Hotels Ltd (Britannia). We have considered the "hurdle" in the context of whether the GSOP could have a nil or negligible value at its inception and the extent to which HMRC's Shares and Assets Valuation (SAV) would likely accept a nil or negligible value.
>
> …
>
> For legal reasons a GSOP requires a downside threshold which triggers payments by the GSOP recipient if the downside threshold is breached. The potential payment is required to be "non-negligible" and the prospect of hitting the downside target should also be "nonnegligible".
>
> …

> In particular we have reviewed a substantial report prepared by PriceWaterhouseCoopers dated September 2009 (Issue 20) entitled "UK hotels forecast". Having regard to this being the most recent of the major surveys, we have attached greater weight to this than to the Datamonitor reports.
>
> …
>
> we have accepted, for the purposes of this opinion, the accuracy of the information supplied by management in respect of the prospects for the group and its individual hotels. We have not sought to verify the accuracy of the information supplied and, were we to do so, it is possible that our conclusion could differ.
>
> …
>
> In the circumstances, we consider that a "hurdle" OP of £9.46 million as against an anticipated ie some 10% in excess of what is considered "realistic", is a stretching target. It relies either on increasing sales via increasing occupancy or cost saving measures which would appear difficult to achieve in the light of the comments of management and the figures provided.
>
> Our view is therefore that an effective defence of a nil or negligible value can be made if the view is challenged by HMRC's Shares and Assets Valuation (SAV). Again this assumes the accuracy of information supplied by management
>
> …
>
> As mentioned previously, it is quite likely that SAV will adduce that a prospective purchaser of the GSOP security would reasonably require details of performance in respect of the three months period from January 2010 to mid March 2010 even if, as a matter of fact, the figures are not known with certainty. In our view it will be difficult to argue with such logic. In the circumstances SAV may conclude that it is legitimate to base the valuation on the known outcome for the period even though that would involve the use of hindsight (technically inadmissible). However, it is legitimate to look at the future events in order to determine what might have been ascertained at the valuation date and, again, it would be difficult to argue forcibly against such an approach in this particular instance."

150.Taken together with the correspondence dated 21 January 2010, we considered that the documents indicated the concern to justify the figures relied on for the GSOP in order to demonstrate to HMRC that the legislative requirements were met. We noted that almost half of the GSOP period had expired by the date of the report yet the Appellant did not use nor did they provide Grant Thornton with the actual figures for the period January to February 2010 which we consider would have provided a more accurate view of the situation. Although Mr Ferrari stated he was not aware of the actual figures, the fact remains that figures were available to him – even if not in precise terms – but which were ignored.

151.Furthermore, the PWC report relied upon related to the previous year and the updated forecast was not used. We also took the view that the Appellant's argument that the GSOP arrangements incentivised participants lacked credibility when viewed against the fact that half of the relevant period had expired before implementation. Viewed in totality we concluded that the focus was not to calculate an accurate valuation but to provide figures which could be defended in the event of challenge by HMRC.

152.The GSOP Design Report dated 19 March 2010 noted that Britannia wished to "implement an incentive plan linked to performance of the business to incentivise and reward key management." The methodology is stated to result in "the following predetermined potential payments to participants":

	Hurdle (£9.46m)	Cap (£9.67m)
Alex Langsam	4,000,000	5,000,000
Robert Ferrari	200,000	250,000
Eileen Downey	40,000	50,000

153.The downside is set out as follows:

> "The downside payment will be collared to a maximum fixed payment which is different for each individual. The collar has been set at £8 million. The minimum and maximum downside payments are as follows:
>
> | | Floor (£8.25m) | Collar (£8m) |
> |---|---|---|
> | Alex Langsam | 200,000 | 250,000 |
> | Robert Ferrari | 10,000 | 12,500 |
> | Eileen Downey | 2,000 | 2,500 |

154.Considerations under "managing the downside" included:

> "The simplest way in which to deal with the downside is to leave it unpaid and then for the Company to call for it, should it be required. However, in our experience, some employees consider an unpaid outstanding debt as de-motivational.
>
> Accordingly, one option is for the company to make a loan of the monies upfront. Where the loan is for less than £5,000 (and there are no other loans already in place to take the employee over this threshold) this should not constitute a benefit in kind to the employee. Where loans are over this threshold, the employee would pay tax at their marginal rate on the official rate of interest of 4.75%.
>
> The monies from the loan axe then paid over to the company into a margin account. This has the net effect of keeping the company in a neutral position commercially. The loan can then be left outstanding, or can be paid off incrementally during the year. Although the loan is still a debt, the fact that money passes through the employees hands gives the situation a different feel for employees. Alternatively, the employee could make payment during the period directly via the payroll into a margin account. However, given the sums involved and the fact that the payment will be due in one year, this may not be seen as attractive either."

155.In our view the documents indicate that the sole purpose for inclusion of the downside was for the arrangements to meet the necessary requirements; it is clear that the arrangements were formed with a view to protecting participants from any exposure or prejudice potentially caused by the downside. In those circumstances we considered that the downside could not have added any incentivisation to the GSOP participants.

156.The Grant Thornton GSOP Feasibility Report noted that Britannia was looking for a "tax-efficient means by which it could incentivise its senior staff…it is very important to motivate management…" The report sets out the benefits which all relate to tax and NICs and the savings illustrations show a saving for the company in paying £5 million using GSOP instead of cash bonuses as £461,000 and a tax saving to employees of £1.65 million. It is noted that the downside was required but "need not be proportionate to the potential payouts receivable but must be a sum that is non-negligible in respect of each employee." The report records that "the level of the hurdle must be considered to be 'stretching'". In relation to Mr Langsam the report states:

> "…to ensure the Group's continuing good performance relative to others in the hotels industry, it has been decided that [Langsam] should now become a director and be incentivised relative to his individual contribution going forward…With regards to Mr Langsam, it is costly for a Company to remunerate shareholders by way of dividend due to the lack of corporation tax deduction for the payments. Given that total amount of remuneration hoped for, the Company is considering other methods of remuneration for Mr Langsam…The use of a GSOP could allow Mr Langsam to be remunerated if the Hurdle is met, whilst minimising costs to the Company. Both achievement of the Hurdle and the cost efficiency of a payment through GSOP would be in the best interests of the Company….[GSOP is]more favourable than a dividend, which has savings for the individual when compared with a cash bonus but is costly to the Company which would not be entitled to a corporate tax deduction…In order to reduce the acquisition value of the GSOP security to a nil or nominal amount, the Hurdle set must be considered 'stretching', such that HMRC would not consider achieving that hurdle a 'certainty'…Importantly, the downside does not need to be an inverse of the 'upside' position. However the amount at stake must be 'non-negligible' for the employee in question."

157. The report states:

> "The value of the GSOP security at the date of award is therefore what a third party might be willing to pay for it in an arm's length transaction. This method of valuation is therefore very similar to that used to value other assets, such as shares. However, in order to reduce the value of the security at acquisition, a Company can require that a certain 'Hurdle' is met before a payment is made by one party to the other. This Hurdle is a level of minimum performance which must be reached in order for any payment to be made. In order to reduce the acquisition value of the GSOP security to a nil or nominal amount, the Hurdle set must be considered 'stretching', such that HM Revenue & Customs ("HMRC") would not consider achieving that hurdle as a 'certainty'. What constitutes a suitable stretch will be based partly on historic performance, partly on the current economic outlook and partly on the Company's current forecasts and budgets trading going forwards."

158. We queried how Mr Langsam was incentivised by the arrangements; as sole shareholder we considered that his interests were already aligned with those of the business. In our view the GSOP arrangements added no further benefit to employees which could not have been achieved through payment of performance related cash bonuses, other than the tax savings. The document demonstrated the continued focus on the tax benefits to be achieved through GSOP and the ability to justify the arrangements to HMRC. It was clear that the downside had no commercial purpose and was included to meet the requirements. Our view on this point was reinforced by the "GSOP Participant Guide: Robert Ferrari" dated 22 March 2010 (and which was materially identical to the guides for the remining participants) in which it was noted that:

> "…you should be able to receive any monies at the currently lower CGT rates. However, in order that the GSOP security qualifies for this treatment, there is an express requirement that the holder of the GSOP security is exposed to a "downside" position…As part of the terms of the GSOP, you will be required to purchase the GSOP security for its full and unrestricted market value. However, given that the proposed Hurdle is seen as being a "stretching target" in order to encourage the growth of the Company, the GSOP security at acquisition is considered to have no current value."

159. The Master Agreement between Britannia and Mr Langsam made provision for initial margin and additional margin to be paid, although there was no evidence that these obligations were enforced, and the Confirmation document recorded that no initial margin or additional margin was payable. The Board had discretion to vary or waive any term it considered “no longer represents a fair and objective measure”.

160. We noted that the calculation of amounts payable in the Master Agreement were said to be the difference between the contract value at settlement date and the contract value at the date of commencement. However, in the Confirmation Agreement the calculation was set out as follows:

The Contract Reference Asset Value at the Settlement Date for the CFD shall be determined as set out in the table below.

Contract Reference Asset (£)	Contract Reference Asset Value (£)
9,670,000 or more	**5,000,000**
Equal to or more than 9,460,000 but less than 9,670,000	**4,000,000 + (1,000,000 x (Group Operating Profit - 9,460,000))** **210,000**
Equal to or more than 8,250,000 but less than 9,460,000	**0**
Equal to or more than 8,000,000 but less than 8,250,000	**-200,000 – (50,000 x (8, 250,000 - Group Operating Profit))** **250,000**
Less than 8,000,000	**-250,000**

161. The Confirmation Agreement relating to Mr Langsam contained a leaver provision which we consider was unnecessary given his shareholding. Furthermore, the minutes of the board meeting of Britannia Hotels dated 22 March 2010 were materially identical to those for the Jones Bros board meeting and in those circumstances we did not accept Mr Ferrari’s evidence that the arrangements were a bespoke product. As Mr Ferrari accepted, and we inferred, retention was not an issue in relation to Mr Langsam, the leaver provisions were unrealistic and the template for the minutes were provided as part of the package.

162. The Grant Thornton “GSOP – summary of tax administration” dated 11 May 2010 summarised the tax treatment of the arrangements for the company and participants. It explained to participants the steps to be taken in accounting for GSOP as follows:

> “Generally, from a UK GAAP perspective, awards under a GSOP designed in these ways will be considered as short-term employee benefits (and accounted for as such). While there is no definitive reporting standard that deals with such accounting, the accruals principle and the requirements of FRS12 (provisions, contingent liabilities and assets) are taken into account. On the grounds that the awards under GSOP constitute employee remuneration the standards governing the accounting treatment of financial instruments

should not be applicable. In the event that a beneficiary is not deemed to be an employee a different (and more complex) accounting treatment may be necessitated.

…

As you will appreciate, the GSOP is a new idea. However, Grant Thornton is confident that the GSOP can be an effective incentivisation tool and the tax treatment, as described above, is in accordance with the current legislation. As a firm Grant Thornton has spent a considerable amount of time developing the idea and we have received leading tax counsel's opinion that the planning does work and does afford the cost efficiencies set out above. This is largely because the planning uses the existing tax legislation in the manner in which it was intended to be used, and does not depend on any loopholes or potentially controversial "interpretation" of the law or on any complex structures.

As such, in our opinion, and that of Leading Tax Counsel, it would be necessary for the existing tax legislation to be amended in order to defeat this planning idea. HMRC does have the power to amend legislation retrospectively in cases of tax avoidance and although extremely unlikely in this case an action of this kind cannot be ruled out. In the event of such an amendment, the "worst-case" scenario in terms of the tax treatment of the employees should be that the GSOP settlement payments would be charged to income tax and NIC as bonuses. As an alternative, it is possible that the legislation might be altered to deny a corporation tax deduction for the payment made out of the GSOP. As mentioned above, in order to secure the beneficial tax treatment currently afforded by the GSOP, it is necessary for the employees to have some exposure to "downside" in the event that the value of the underlying investment goes down."

163. The contract for services between Britannia and Grant Thornton dated 26 October 2012 contained the following advice, including mention of inclusion of the downside as a requirement as part of the "Risk Warnings – Important":

"As with any tax planning, however, HMRC could seek to challenge both the technical efficacy and the implementation of this tax planning, in consequence there are risks that the arrangements will not achieve the desired outcome in part or at all.

…the 'worst-case' scenario could be that the GSOP would lose its beneficial tax treatment, such that any payouts to participants under the GSOP would be subject to income tax and NICs as bonuses, rather than being subject to capital gains tax.

…in order to secure the beneficial tax treatment afforded by the GSOP, it is necessary for the employees to have some exposure to 'downside' in the event that the value of the underlying investment goes down. This 'downside' can be limited and, where relevant, there are ways for the Company to assist its employees funding such exposure…"

164. The GSOP feasibility report for GSOP 2 dated 31 January 2013 recorded:

"The Company implemented a Growth Securities Ownership Plan ("GSOP") in March 2010 and this incentivised senior management to drive up profit and add value to the group. Profits have remained steady since 2010, therefore it is proposed that the Company should consider the introduction of a second GSOP to stimulate growth and value increase in the business."

165. However, the document did not provide an assessment of the actual value GSOP1 was said to have added. The GSOP valuation report dated 11 February 2013 noted that the GOP above target was reached as a result of external events such as the volcanic eruption. There was no reference to the results being achieved by, for instance, cost cutting measures as described by Mr Ferrari. As with GSOP1 no actual figures were

used despite the fact that 4 months of the relevant period had passed and management accounts for Q1 were produced in the same month and therefore could have been used.

Witness evidence and findings of fact: Britannia

166. Mr Robert Christopher Ferrari is the Finance Director and Company Secretary of Britannia which operates in the hotel industry across the UK. Mr Langsam holds 49.9% of the shares in Britannia and 50% are held by the trustees of a trust called the Moravcik Trust of which Mr Langsam is a beneficiary. Mr Ferrari explained that on Mr Langsam's death the value of the trust will be distributed to a number of charities and therefore Mr Langsam will not benefit personally from the trust.

167. Mr Langsam relinquished his directorship of Britannia in 2006 due to ill health. He was reappointed in 2009 in order to participate in the GSOP. At the time the GSOP arrangement was introduced the directors were Mr Langsam as managing director, Mr Ferrari as finance director and Ms Eileen Downey as operations director.

168. Mr Ferrari explained that Britannia used commissions and bonuses to incentivise staff throughout the business; the incentives were a range of weekly and quarterly ones, and to qualify it was a condition that the employee must still be employed by Britannia at the time that the bonus results were declared. This condition was also incorporated into the GSOP arrangements. Prior to the introduction of the GSOP none of the directors received a bonus nor were they involved in any incentive scheme. However, following the financial crisis in 2008 it was decided to incentivise the directors in order to protect/increase the asset value.

169. Grant Thornton introduced the principle of a CFD to Britannia. This was further developed by Mr Ferrari who explained that it operated by aligning the value of the CFD to a movement in the value of specific hotel assets aimed at achieving an uplift in that value. Mr Ferrari did not accept that the only metric that was used in the Britannia GSOP to determine whether or not there was a payment was a measure of profitability. However, although he queried the meaning of "trigger" in the proposition that the only trigger was the profit figure, Mr Ferrari ultimately agreed that the only metric that the GSOP actually directly targeted was the group operating profit figure, and the product was not bespoke to Britannia:

> "Q. In your witness statement you suggest that the format of the GSOP was bespoke to Britannia, but it is correct that Grant Thornton already had the idea of using contract for differences with hurdles, caps, floors and collars linked to an underlying measure of profitability didn't they?
>
> A. Yes.
>
> Q. So there was nothing bespoke in the structure that was put in place for Britannia.
>
> A. Well you see, it depends if we are going to have a debate on what the word "bespoke" means. The difference between our GSOP and other people's GSOPs, to my knowledge anyway, is the fact that our GSOP was an attempt, as well as increasing the profits, was an attempt to increase the asset value of the properties, and as I explained to Mr Prosser earlier, the yardstick was that the profit increased the value of the hotels, so that was something which was individual to us. To my knowledge none of the other GSOP – you

would know better than I would, I don't know if you have had a look at the other GSOPs, I would say now that none of the others had that factor in them. Now, if you can contradict me then fine.

Q. You have explained at length this morning and in your witness statement that there is a connection between the profitability of hotels and their asset value, and I don't think that is going to be controversial, but as regards the GSOP and its structure, the measure of underlying value in the GSOP for Britannia was a measure of profitability. For Jones Brothers the measure of underlying assets was a measure of profitability. There were different measures of profitability but they were simple profitabilities for the company.

A. One, I don't know about Jones Brothers because I haven't looked at anything to do with Jones Brothers, but if you looked at their feasibility studies and you looked at the valuation it says that there were two aims, one was to increase the profitability and the other was to increase the asset value. It says that in black and white.

Q. I am just focusing on this point, Mr Ferrari, see if you can just accept it as a simple proposition, the only metric against which the value of the GSOP was measured was a measure of profitability in the business?

A. It says in the feasibility study, in the valuation, that there were two objectives, which was to increase the profitability and to increase the asset value: two metrics.

Q. …Can you just accept the simple proposition that the only metric that was used in the Britannia GSOP to determine whether or not you got a payment was a measure of profitability?

A. And I disagree with you.

Q. Where in the structure of the GSOP is the payment triggered by reference to the asset value of the hotels?

A. The asset value is inevitably triggered by an increase in the profit(?)

Q. The only trigger is the profit figure isn't it?

A. It depends what you mean by the word "trigger".

Q. You understand how the GSOP was meant to work, don't you?

A. Yes.

Q. It had within it a forecast, and it had within it a hurdle, and above that you got a payment, and the payment increased up to the cap, and it had a floor, and below that you had to make a smaller payment down as far as the collar, and whether or not you had to make a payment was determined solely by the level of group operating profit as defined in the GSOP.

A. On the word "trigger" I agree with you.

Q. So you might say that it would have an effect necessarily on increasing the asset value, but the only metric that you were actually directly targeted on was the group operating profit figure?

A. I agree with you."

170. Mr Ferrari said that he and Mr Langsam understood the commercial objective of the GSOP and would have explained it to Ms Downey. The long-term aim was to increase the company's asset value by increasing its profits. In his view, Mr Langsam was incentivised by his wish to leave something behind for posterity; the charities named as beneficiaries would benefit from any increase in the value of Britannia. Mr Ferrari confirmed that Mr Langsam received no remuneration in his role as director other than through the GSOP and that he was appointed as director specifically to enable him to participate in the GSOP. That meant he could receive substantial remuneration while minimising the cost to both himself and the company. Mr Ferrari agreed that:

> "whatever was good for the company was good for Mr Langsam… if it was good for the company to increase the asset value of the hotels, it was also good for Mr Langsam"

Mr Langsam was the biggest beneficiary and stood to gain £5 million compared with the £300,000 that could be paid out to Mr Ferrari and Ms Downey. In our view Mr Ferrari's claim that with or without the GSOP, Mr Langsam's interests were aligned with the company's cannot be accepted; retention of Mr Langsam's services was not the purpose of the GSOP.

171. Mr Ferrari confirmed that Britannia was not looking to profit from entering into the contracts with the employees, but rather sought to make payments. As he stated: "…if Britannia made a payment to us then it was a good result for Britannia."

172. Although Mr Ferrari felt that Mr Langsam may have been motivated by the GSOP and as a result spent more time involving himself in the business, Mr Ferrari accepted that a cash bonus conditional on hitting an aoperating profit would have achieved the same focus and saved £45,000 of fees to Grant Thornton. It was clear from his evidence that the advantage to Britannia and the participants of the GSOP over a cash bonus was a tax saving in delivering remuneration to the directors. Although Mr Ferrari queried the words "conditional" and "bonus" he agreed that that the characterisation of the GSOP scheme was effectively a form of conditional bonus scheme.

173. Mr Ferarri's evidence that the GSOP increased the asset value of Britannia's hotels was based on a comparison of the results achieved by the hotels in the 52 weeks to September 2010 with Britannia's own forecasts. The comparison, which we noted had been produced solely for the purpose of the GSOP, was not independently verified by Grant Thornton and which was described by Mr Bowes as "very pessimistic". Mr Ferarri accepted that if the forecast was wrong then his analysis was also wrong.

174. Mr Ferrari explained that he had not made a comparison with figures for the previous year as he claimed this was not an objective measure, highlighting uncertainty in the industry caused by the financial crisis of 2008 which he believed was relevant to the forecast and made it impossible to predict how the business would perform in the future.

175. In the year to September 2009 there had been a severe contraction in the economy, and Britannia had made an operating profit of £9.4 million. Notwithstanding, Mr Ferrari said he did not believe at the time that the forecast operating profit for the

same hotels in 2010 of £8.6 million was pessimistic. He queried the premise that there was any expectation in the market for a growth in the hotel sector in the provinces and for an increase in profitability in 2010. However, on the basis there was no more than an expectation as opposed to a reality, he accepted that reducing the profit from an actual of £9.44 million to a forecast of £8.6 million would be pessimistic.

176. The PWC Report "UK Hotels Forecast" dated September 2009 showed that outside London between January and June 2009 occupancy, average room rates and revenue per available room were down 7.7%, 7.2% and 14.5% respectively. However, the PwC Report published on 3 March 2010 stated:

> "Overall, our latest forecast for UK hotels for 2010 reflects London's strength and the Provinces' weak fight-back. The UK saw RevPAR decline by almost *(unclear*) % in 2009 but we predict overall UK growth of 3.1 % this year, driven by a 1.8% ARR gain and 1.3% occupancy growth. Further growth of 4.7% is in 2011 as ARR nudges up to 2.9% growth and occupancies show a 1.7% increase."

177. The Appellant highlighted the report's reference to:

> "our research among key participants found that most expect trading in the regions to remain pretty flat in 2010 but to start to improve in 2011."

However, whilst the report referred to these concerns it nevertheless remained the case, and we accept, that the PwC forecast was one of improvement in the provinces whereas that of Britannia was pessimistic. With the benefit of hindsight, Mr Ferrari accepted that to have been the case.

178. We are unable to accept Mr Prosser's submission that in saying that the PwC report "seems a good report", Mr Ferrari was referring to the 2009 report. Mr Ferrari explained that there had been great difficulty in forecasting at the time and the evidence continued to discuss the positive growth forecast in the provinces by PwC. Even if Mr Ferrari had been referring to the previous year's report there seems no reason why he would have accepted it as authoritative in one year but not the next.

179. Grant Thornton provided a Feasibility Report, a Valuation Report and a Design Report on 19 March 2010 and Participation Guides on 22 March 2010 to the three participants, namely Mr Langsam, Mr Ferrari and Ms Downey.

180. The hurdle for the 2010 CFD arrangement was £9.46 million with a cap of £9.67 million. The arrangement was to be measured over a 52 week period and determined on the management accounts for the period to 25 September 2010. The values were calculated by Grant Thornton who considered a 10% stretch from the forecast of £8.601 million to £9.46 million as a stretched target or "hurdle".

181. In relation to this valuation Mr Ferrari stated that Grant Thornton started their valuation process on 8 January 2010 against a poor outlook for the hotel industry. Britannia produced quarterly management accounts and those for the December quarter were produced on 8 February 2010. Grant Thornton completed their valuation on 19 March 2010 and the participants signed their agreements on 22 March 2010.

182. The documentary evidence dated 6 January 2010 showed that Ms Parry, in Britannia's Finance Department, provided a forecast of £8.933 million and a stretched target of £9.828 million to Grant Thornton. Mr Ferrari stated that these figures would have been confirmed with him but claimed it was a "back of a cigarette packet" forecast which Grant Thornton said was not good enough. However, in terms of testing the accuracy of the figures provided, we observe that Grant Thornton stated:

> "In this respect we have accepted for this opinion the accuracy of the information supplied by management in respect of the prospects for the group and its individual hotels. We have not sought to verify the accuracy of the information supplied and were we to do so it is possible that our conclusion could differ."

183. The GSOPs were entered into on 22 March 2010. By the end of March 2010, the actual performance figures were £664,000 ahead of the forecast. Mr Ferrari accepted that:

> "So at the time, this time, I would have a good idea of what the sales numbers were but I would have no visibility as towards the costs. I wouldn't know what the costs were, I wouldn't know what the wage costs were."

184. Although Mr Ferrari highlighted that he would not have known the costs, he agreed that it "looked as if the results would be better" than forecast. The Grant Thornton Valuation Report stated:

> "It is proper to assume that the prospective purchaser would require further information subsequent to March 2009…
>
> He or she would, in our view, be provided with details of performance to December 26 2009 and might reasonably request information relating to actual performance through January and February and into early March."

However, Mr Ferrari agreed that no figures showing actual performance against target for January or February were provided to Grant Thornton as per the valuation report. As set out above, we consider that reliance on the older PwC report combined with the failure to consider the actual performance figures (in the absence of the precise figures) indicated that the focus was on setting a hurdle which could be justified rather than testing or ensuring the accuracy of it.

185. That conclusion was reinforced by the evidence of Mr Bowes, who gave the following evidence (see [9.12] – [9.13] of the report):

> "The company's forecast was for a pessimistic figure, notwithstanding that many of the indications at the time were for growth in the sector during 2010. The reality appears to have been that BHL had achieved far superior performances in the then recent years notwithstanding the downturn that the sector had suffered. I have been provided with copies of the Management Figures prepared on a quarterly basis and which have been re-stated to enable a comparison with the CFD period ...
>
> On the footing that the expectation was that the sector would be more likely than not to experience growth from 2010 onwards, as a result of which the £9,460,000 would be exceeded in that year, it seems that the forecast [£8.6 million] was very pessimistic. In my opinion, therefore, the weight of evidence suggests that the forecast would be

exceeded, as would the £9,460,000, and that a payment…at some level was more likely than not."

186. On the issue of incentivisation Mr Ferrari explained:

Q. In order to deliver the operating profit forecast target, you and your fellow directors, it is fair to say, had three main levers to focus upon, being turnover, gross profit and operating costs?

A. Yes, if the operating costs includes wages, then, yes.

Q. The actions you took to try and hit the hurdle would have been to pull those levers one way or the other?

A. Yes, you would pull any lever you could.

Q. Those three metrics I referred to, they are the three metrics by which you were already managing the business prior to introducing the GSOP, were they not?

A. Yes.

Q. Doing your role as directors in the best interests of the company, you were already trying to improve the profit by using the same levers as you subsequently did when the GSOP was in place?

A. Yes. I think the essence is that the GSOP was an extra additional factor, it made us more---

Q. It did not require you to focus on anything different from what you were already focusing upon, because you were already focused upon improving operating profit?

A. I think it depends on the term "focused". I think it increased the focus…It was a lot harder, it was a lot "we have to get a result here, we have to do something". It just made me do more -- I cannot explain. One must understand that you get more intense about things. That is what it did, it made me more intense about it. I probably seem quite intense at the moment, but that is just the way I am, it makes me more "got to get this sorted".

Q. Is it fair to summarise it this way, for you personally the opportunity to get £200,000 of GSOP was an incentive to do a better job, but it did not fundamentally change the job you had to do?

A. It did not change the job, you are right, it just made me do it better, if you understand.

Q. Obviously this GSOP was in place for one year, and you did not have a GSOP for two years and then you went back into the GSOP. In the following year your job remained the same as it was in the year with the GSOP?

A. Yes, that is true.

Q. You remained focused on improving operating profits to the extent you could?

A. Yes, that is true as well."

187. We consider that the predominant purpose of the arrangements was not to incentivise; as Mr Ferrari agreed, Britannia could have achieved the same focus on GOP by using a conditional cash bonus with a target which would have saved £45,000 in fees to Grant Thornton. We are satisfied that the advantage of the GSOP for Britannia and the participants, and the purpose in implementing the arrangements was the tax saving in providing a form of conditional bonus, as is shown by the following evidence:

> "Q. Do you accept this: if it was important for you to have this laser focus on operating profit, you could have put in place a cash bonus that was conditional on you hitting operating profit?
>
> A. Yes.
>
> Q. If you had done that, you would have saved £45,000 of Grant Thornton's fees?
>
> A. Yes, that would be true.
>
> Q. The advantage for you and for Britannia of the GSOP over a cash bonus was a tax saving, was it not?
>
> A. Yes.
>
> Q. You wanted a tax efficient way of delivering the remuneration to the directors?
>
> A. Yes, correct.
>
> Q. The savings to the company were substantial because of the amounts that were put through the GSOP in the hundreds of thousands of pounds?
>
> A. In the sense you mean NIC and stuff like that, yes, that is correct.
>
> Q. …the feasibility report from March 2010.. "In order for the employees to be eligible for capital gains tax achievement, they must have an exposure to a downside risk if Group operating profit falls below the minimum required level (the floor)." The purpose of having the downside risk in your Britannia GSOP was in order to qualify for the...tax achievement, was it not?
>
> A. I am not an expert on COPs [*sic*], but I think what you say roughly is right, yes.
>
> Q. You were involved with Grant Thornton in the discussions, in the design of your GSOP, and the reason you had that downside risk was in order to get into the capital gains tax stream?
>
> A. Yes, I am agreeing that. I am just saying I am not an expert in COP [*sic*], that is all."

188. It was clear from Mr Ferrari's evidence, and we find, that the purpose of the arrangements was the tax saving and that elements such as the downside were included in order that the GSOP would qualify for the beneficial tax treatment.

Expert evidence

189. Although we set out our findings on the expert evidence within our conclusions, it may assist to set out the different issues upon which the experts provided evidence, their varying approaches to those issues and an overview of their opinions.

Evidence of Mr Bowes

190. Mr David Bowes is a Fellow of the Chartered Institute of Taxation, a Fellow of the Society of Share and Business Valuers and a member of the Expert Witness Institute who has for many years been engaged in valuation of shares and businesses.

191. Mr Bowes prepared reports for both appellants dated 18 October 2019 to answer the question:

> "In relation to each Relevant Contract, was the market value of the Rights, as at the date when that Contract was entered into, less than it would have been but for the provisions?
>
> For this purpose, "rights" means the rights excluding the obligations, of the employee under the relevant contract."

192. The relevant clauses considered by Mr Bowes were numbered 3 and 4 in the Confirmation Agreements. They were materially identical for each Appellant.

> "The relevant provisions of the CA that I have been requested to take account of in my valuation are paragraphs 3 and 4 thereof. Paragraphs 3 and 4 dealt solely with the position of the Buyer – the employee. Clause 3 provided that, except as a consequence of the death of the Buyer, in the event of the Buyer transferring, assigning, charging or otherwise disposing of any of that person's rights under the CFD, or purporting to do any of these things, to any person, the Seller would have no obligation to pay any amounts or further amounts under the terms of the Master Agreement. The position would have been the same in the event that the Buyer became bankrupt or was otherwise deprived of the legal and beneficial ownership of the CFD by operation of law or otherwise.
>
> 4.1.1 dealt with the position in the event of cessation of the Buyer's employment with the Seller or any other Group member. If he/she ceased being an employee for any reason whatsoever, no amounts would be payable under the CFD, which would automatically terminate, although the Premium would have to be repaid by the Seller to the Buyer. Cessation of employment did not apply where the employee ceased to be employed by one Group member but was immediately re-employed by another.
>
> 4.1.3 imposed conditions as to when employment was deemed to cease.
>
> These restrictions seem to me to comprise entirely normal such provisions to guard against the possibility of departing employees sharing in the CFD payments. They are nonetheless restrictions that could be expected to be issues in the minds of any person contemplating purchasing a CFD at the relevant time. It appears to me that these provisions would have had the effect of reducing the value such purchaser might be prepared to pay when compared to a CFD not subject to the same conditions.
> …
>
> My opinion would be that…the effect of the provisions referred being ignored would be to increase the value of those rights by 10%."

In terms of the restrictions generally, Mr Bowes regarded restrictions such as cessation of employment as material because they would have an effect on value. He explained:

> "A …for tax valuation purposes, for example, a restriction such as the inability to assign would be disregarded. The assumption has to be that the asset is to be sold on the open market and, therefore, you have to assume that that sale takes place or a restriction preventing you from assigning it would in effect have to be ignored, but if that as a question of fact does exist you have to have regard to it… the supposition is you have to assume that it can be sold because we are supposing the sale in the open market, so the assignment is assumed to take place. However, whoever buys the asset is subject to those restrictions and can't assign it, for example. So you take it into account in the value, but you have, as it were, for the purposes of the transfer, assume it to be set aside.
>
> Q. You have got to assume that somebody is buying something which cannot in fact validly be sold to him and then take into account the restriction on the validity of sale in deciding the value of that which he has bought?
>
> A. Perverse though that is, that is my understanding of the case law.
>
> Q. You have come to a conclusion that the restrictions might reduce the unrestricted market value of the shares by 10 per cent. …
>
> A. Yes, I have.
>
> Q. …You have taken that figure without actually addressing the detail of what the restrictions are, so you just said there are restrictions and by reference to restricted shares, well, 10% sounds about right. It's as rough and ready as that, is it?
>
> A. Well, that's, you know as I have explained, I can't remember now whether I explained in the report, but I have compared them to restricted shares under the employment income legislation. HMRC, mindful of the fact that it is very difficult to quantify the effect on value of specific restriction has taken the pragmatic approach and said okay, when we value, when we try to arrive at unrestricted market value we will get to that figure by adding a 10% premium to the actual market value of the shares, so we value on the basis of the restrictions, if we lift the restrictions off, we enhance the value by 10%. Now, nobody is saying that is the perfect solution but that is the pragmatic solution that HMRC have arrived at and it is generally accepted, it won't be so in every case, but as a general proposition that's how it is applied. To my mind these restrictions were very similar to those that apply in the case of lots of unlisted company shares, on which premise I follow the HMRC guidance and went to 10%. There is no more empirical reasoning than that."

193. HMRC accepted that if the GSOPs were securities, then the restrictions such as the leaver provisions were real, even if their inclusion in the scheme was tax motivated. In the absence of any evidence or argument to the contrary we accept Mr Bowes' evidence in this regard.

Jones Bros

194. In relation to Jones Bros, Mr Bowes concluded that the effect of ignoring the provisions would be to increase the value of those rights by 10%.

195. Mr Bowes did not determine what the respective market values of the rights (either subject or not subject to the relevant provisions) were. He first considered whether those rights (ignoring the relevant provisions) would have had a positive market value of more than a trifling amount. He then considered whether the effect of the relevant provisions was that the actual market value of the rights was less.

196. In relation to Jones Bros, Mr Bowes' report dated 18 October 2019 explained that he had not visited the company, but he had discussed the company's historical results and financial projections with one of the former directors and the current finance director.

197. In summary, Mr Bowes concluded:

> "…that a prudent purchaser of the CFDs would have been likely to take the view that there was a genuine possibility, rather than a theoretical one, of the £875,000 "hurdle" in the CFDs being exceeded such that, ignoring the relevant provisions, the rights would have had a Market Value of more than a trifling amount."

198. Mr Bowes went on to explain that on 7 February 2011 the rights would have had a market value that was 10% (in line with established practice as set out at [9.45] of the Report) greater than the market value of the rights under a CFD where those provisions applied.

199. By way of explanation Mr Bowes informed us that it appeared to him to be an almost inescapable conclusion that if two assets, in this case securities, had identical rights but one had a restriction that might adversely affect the rights of the owner and the investment returns, it was self-evident that there must be a difference in value between the two securities. Mr Bowes took the view that the provisions guarding against departing employees and disciplinary issues were entirely normal but were nonetheless restrictions which would have the effect of reducing the value a purchaser might be prepared to pay.

200. The forecasts prepared by the company and relied on were dated 20/12/2010 and19/01/2011. Both dealt with the twelve-month period from 1 February 2011 to 31 January 2012 and contained two scenarios; "Worst Case T/O and Low Margin", and "Reasonable Forecast". Both assumed identical forecast turnover of £30,000,000 on the worst-case basis and £45,500,000 as the reasonable forecast.

201. In Mr Bowes' opinion, the 20/12/2010 forecast was relatively pessimistic and the 19/01/2011 forecast was more optimistic. He noted that the appellant did not usually make forecasts, stating that the forecasts in question appeared to have been prepared for reasons that included the creation of the GSOPs and the setting of the targets.

202. Mr Bowes was provided with an undated document headed "Forecasted Results" for the year ended 31 March 2010 which showed total turnover of £46,340,204, Administrative Expenses of £1,906,916, and Operating Profit of £2,128,816. He also considered the historical performance of the appellant, noting that turnover had been increasing, particularly since 2008, peaking in 2010 at £46.064 million. It fell in 2011

to £43.54 million, but the 2012 Reasonable Forecast referred to above was close to the actual turnover achieved in 2011.

203. He considered the principal issue in determining the values of the rights under the CFDs in February 2011 would have been the probability at that time of the Operating Profit target being exceeded.

204. In assessing that probability, Mr Bowes considered a variety of factors including the economic situation at the relevant time, expectations of new future work, expected profitability on contracts won and the basis of the company's forecasts. Mr Bowes noted that there was a mixed view of the industry; public spending was under pressure which could adversely affect the appellant's projects but there were also some areas in which the position was improving. Mr Bowes also noted that the Appellant was involved in a major joint venture with Balfour Beatty where all the substantial costs had been accounted for but the income on the contract had not. He noted:

> "I am advised that the Company had not at the valuation date ascribed value in full to all work done on this contract as a result of which costs were in excess of revenues. I further understand that the position was corrected by the issue of overdue invoices shortly after the valuation date, but it appears that this oversight may have adversely affected the forecast, which would explain the much weaker forecast performance as compared to actual, whether historical or future."

205. In Mr Bowes' initial opinion, a prudent purchaser would have been likely to take the view that in light of previous performance the forecast prepared in relation to Operating Profit was Pessimistic and highly likely to be exceeded.

Britannia

206. In relation to Britannia Mr Bowes carried out the same exercise and set out the results in his report dated 18 October 2019. He did not visit the company, but did have the opportunity to discuss the company's historical results and financial projections with Mr Ferrari. In summary, Mr Bowes concluded:

> "…that a prudent purchaser of the CFDs would have been likely to take the view that there was a genuine possibility, rather than a theoretical one, of the £9.46m "hurdle" in the CFDs being exceeded, such that, ignoring the relevant provisions, the rights would have had a Market Value of more than a trifling amount."

207. Mr Bowes went on to explain that on 22 March 2010 the rights would have had a Market Value that was 10% greater than the Market Value of the rights under a CFD where those provisions applied. He did not consider what the actual values were.

208. As with Jones Bros, Mr Bowes stated that it appeared to him an almost inescapable conclusion that if two assets, in this case securities, had identical rights but one had a restriction that might adversely affect the rights of the owner and the investment returns, it was self-evident that there must be a difference in value between the two securities. He added that the provisions guarding against departing employees sharing in the CFD payments were entirely normal but were nonetheless restrictions

which would have the effect of reducing the value a purchaser might be prepared to pay.

209. PwC set out two projections of possible worst case scenarios for 2010 at the valuation date. In a "No Recovery" scenario it was estimated, in the provinces, that Revenue Per Available Room ('RevPAR') would fall by 15% throughout 2009 and a further 3.2% in 2010. In its "Early Recovery" scenario, on the assumption that financial markets would stabilise more quickly than expected and credit conditions would ease significantly in the second half of 2009, PwC projected a progressive revival of the UK and global economies in that period. Growth in the GDP for 2010 would lead to a sharp recovery in travel and hotel demand. Overall, there appeared to have been some optimism that growth was expected to return to the economy generally which would have a positive effect on the hotel sector.

210. Mr Bowes identified the crucial issue in the Agreement as far as obtaining a payment for the Buyer was concerned as the probability of achieving the £9,460,000 or £9,670,000 Contract Reference Asset.

211. Mr Bowes noted that no meaningful comparison between the forecast and earlier trading periods could really be made as the company's accounting year end was 31 March and the forecast period for which the GSOP profitability was relevant was the year ended 25 September 2010. However, Mr Bowes expected that a purchaser would have considered the actual trading performance of the company. The figures for the financial year ended 31 March 2009 would have given a purchaser a pessimistic view as to the likelihood of the company achieving the required profitability in the relevant year.

212. However, Mr Bowes was advised that the Management Figures that set the benchmarks for the CFD targets were prepared on a very different basis from that used in the statutory year end accounts, did not include Head Office and a number of other costs, and accordingly produced significantly different figures. He thus concluded that any purchaser would have required the Management Figures to determine whether the forecasts were reliable.

213. The forecasts prepared by the company, and available at the valuation date, showed that it was quite accurate. Assuming a similar performance in 2010 Mr Bowes opined that the 2010 target would seem to have been attainable. The Report stated:

> "The purchaser would also have considered the forecast for the year then current at the valuation date. This dealt on a quarterly basis with the twelve month period from 1 October 2009 to 30 September 2010, indicating a forecast OP of 8,601,000, although referring also to a "Stretched target" of £9.46 million. At the valuation date, part of the year to which the required OP related had already passed. At that date, it is understood that part of the information available to a purchaser would have been Management Figures for 39 weeks ended 26 December 2009, which included the 13 weeks to that date, which would have been included in the first quarter of the relevant year for CFD purposes. The Group OP for that period amounted to £2,346,795, as compared to £2,763,713 for the same 13 week period in 2008. This appears subsequently to have been revised to a figure of £2,402,000.

> The forecast for the 3 months to 27 March 2010 showed OP of £927,000, again revised subsequently, this time to £953,000, resulting in a total of £3,355,000 for the first six months of the relevant period. The remaining six months to September are traditionally the better trading periods for hotels, including as they do the summer months when business improves significantly by reason of holidays, corporate summer parties and events, and weddings in particular, on which basis the performance for the remainder of the relevant year could have been expected to be much improved.
>
> It appears to me to be appropriate to take account of the company's previous performance in order to determine whether or not it was likely that the £9,460,000 would be achieved. The company's forecast was for a pessimistic figure notwithstanding that many of the indications at the time were for growth in the sector during 2010. The reality appears to have been that BHL had achieved far superior performances in the then recent years notwithstanding the downturn that the sector had suffered. I have been provided with copies of the Management Figures prepared on a quarterly basis and which have been re-stated to enable a comparison with the CFD period – to the end of September – to be made. For the three years ended 30 September 2009, the relevant annual Operating Profits for the hotels in question were as follows.
>
> Year ended 30 September 2007 - £11,893,728
> Year ended 30 September 2008 - £11,288,276
> Year ended 30 September 2009 - £9,439,019.
>
> As is obvious from the above, the performance in two of the years in question substantially exceeded the CRA, and in 2009 when that was not the case, the difference between the actual performance and the £9,460,000 required to trigger a payment in 2010 was negligible at £20,981 or 0.22%. On the footing that the expectation was that the sector would be more likely than not to experience growth from 2010 onwards, as a result of which the £9,460,000 would be exceeded in that year, it seems that the forecast was very pessimistic.
>
> In my opinion, therefore, the weight of evidence suggests that the forecast would be exceeded, as would the £9,460,000, and that a payment to the Seller at some level was more likely than not. This would therefore in my view have had the effect of attributing value to the CFDs."

214. Mr Bowes concluded that a prudent purchaser of the rights of the CFDs in 2010 would have been likely to take the view that in light of previous performance the target operating profit was highly likely to be exceeded such as to place a value in those rights.

Amendments to evidence

215. Mr Bowes wrote to the tribunal on 11 March 2021 to amend his view in relation to both reports from "highly likely" that the threshold would be reached to "likely". He explained that his original opinion was "a bit more bullish" and, although he had changed the wording in his report (at [1.4]) to "there was a genuine possibility", he had omitted to change the wording in his conclusion before the report was issued. Mr Bowes had no reason to revisit the report until shortly before the hearing at which point he recognised the conflict between the amended wording and his final conclusion.

216. Mr Bowes went on to explain that, in relation to Britannia, there were particular conditions which suggested that a payment would be highly likely. He had arrived at that view on the basis of the PWC report and other indications of improvement in the

sector. However, there were no certainties in valuation and following a conversation in or around October 2019 with Mr Ferrari who had strong views, Mr Bowes considered he had been too positive and that a payment was probable but not highly likely:

> "I listened to what he had to say. He had a much better take on the business in that he was hands on with it and I was quite remote and this was some years after the event and I thought that that maybe I was being a bit to positive. There are always, as I say, no certainties or few certainties, there's always the possibility that things will not work out as planned. Overall I still had a positive feel, but I just decided that maybe it's appropriate to rein it in a little."

217. Mr Bowes explained that the conversation had taken place prior to completing his report, and that the report was signed off in error in both cases.

218. In relation to Jones Bros, Mr Bowes could not recall all the circumstances but again, having arrived at his initial view he changed his opinion because the facts as he understood them had changed. He believed he had spoken to the current finance director and may have had a conversation with Mr ab Ifan although he could not recall it.

219. Mr Bowes considered his choice of words, in both cases, based upon a previous understanding, no longer appropriate. However, he remained of the view that it was likely that that target was going to be exceeded both for Jones Bros and for Britannia; correspondingly the floor was unlikely to be breached.

220. Save for a small amendment to an appendix showing operating profit calculated without the deduction of administrative and operating expenses, Mr Bowes confirmed his figures as reliable. He did not recall being told by Mr Ab Ifan that there was an error in the forecast figure of £775,000 but confirmed that he had revisited the figures provided and that £775,000 was included in them, so he had no knowledge of any error referred to by Mr Ab Ifan.

221. For Britannia, Mr Bowes' report relied on the September 2009 figures. He agreed that the PwC report was suggesting improvement and positive growth for the sector in the provinces where Britannia is based. Mr Bowes confirmed that he did not use the PwC figures for average room rate growth in 2010. Had he done so his conclusion that the target was pessimistic would have been even stronger.

Mr Alton Alpay

222. Mr Altan Alpay, B.A, M.Sc., was the founder of and portfolio manager at Sarus Select Capital, a London based financial advisory firm which provides investment management and investment advisory services. In a report dated 26 September 2019 he provided an opinion on the commercial nature of a CFD.

223. Mr Alpay was asked to consider what, if any, was the generally understood commercial/business meaning of CFDs. He explained in his report that:

> "A CFD is a contract under which one party agrees to make a payment to the other depending on fluctuations or differences in the value or price of an asset (a "reference asset") or in an index or other factor of some kind linked by a formula…The terms of the contract can be very innovative, but the contract will always refer to the difference between some value at maturity/termination and the value set or observed at the start of the contract."

224. Mr Alpay included "spread bets" under the term contract for differences as they pay an amount determined by a formula in relation to fluctuations between the termination value and the initial value of a reference asset.

225. The business meaning and FCA definition of CFDs are consistent. The FCA Handbook states that a CFD:

> "is a contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in:
> (i) the value or price of property of any description; or
> (ii) an index or other factor designated for that purpose in the contract;"

226. In relation to execution Mr Alpay explained:

> "CFDs are usually executed with a main agreement followed by individual confirmations. Although each and every transaction between the provider and the CFD buyer is a separate agreement it is impractical to send back and forth the full terms and conditions for each transaction. As a result, binding terms and conditions are entered into between the CFD provider and its customers at the start of the relationship even if there are no transactions taking place at that moment. Then, each individual trade gets a confirmation with the most relevant details of the transaction pointed out….A CFD, as its name implies, makes a payment in relation to the difference between the termination value and the initial value of the reference asset. If the difference is positive, then the buyer of the CFD receives some amount. If the difference is negative, then the buyer of the CFD pays some amount."

227. Mr Alpay set out in his report various features of CFDs. By way of example he explained that reference asset or subject matter (such as an index) must generally be objectively verifiable and not in the subjective discretion of one of the parties. There was also no maximum or minimum initial reference value and the formula for payment could be a simple multiplier linked to the difference or, in more complex CFDs, the formula between the payment and the difference of reference asset may be linked with an option. There were also CFDs that were linked with a multiplier.

228. A CFD might have a maturity which would derive from the nature of the reference asset. Mr Alpay explained:

> "If the reference value does not have a maturity e.g. a CFD on FTSE 100, then there would be no maturity. In contrast, a CFD on the presidential election or a spread bet on corners in a football match, does have a maturity by definition.
>
> As already explained, under a CFD one party makes a payment to the other at maturity or upon termination, depending on the price of the reference asset or the state of the reference index or other factor at that time. The contract might also provide for one party to make an upfront payment to the other, as a fee for entering into the contract… It is also usual for a professional CFD "provider" to require its "client" counterparty to provide security

for his potential payment on maturity, in the form of a "margin" payment or payments... This is a matter of counterparty risk management and is not an essential feature of CFDs especially before August 2018..."

229. In the opinion of Mr Alpay, the value of the reference asset must be able to fluctuate, but the fluctuation did not need to be symmetrical. Similarly, the payoff did not need to be symmetrical or proportionate to risk.

230. Having considered whether certain features of a contract would be inconsistent with the contract being a CFD, in particular:

> "(i) The fact that the parties to the contract are an employer and employee, and the contract is entered into as an employee incentive arrangement so that: (a) the obligations of the parties are not equal and opposite, giving rise to non-proportionate outcomes, in that the employer's payment is greater than the employee's payment and the risk of the employer's payment becoming due is greater than the risk of the employee's payment becoming due; and (b) the contract contains a provision to the effect that no payments are to be made, and the contract will terminate, in the event that the employee ceases to be employed by the employer otherwise than as a Good Leaver, or that the employee is subject to a Disciplinary Event;
>
> (ii) The fact that the contract contains a provision to the effect that no payment is to be made by the employer in the event that the employee transfers or otherwise disposes of his rights under the contract or purports to do so, or that the employee is adjudged bankrupt."

Mr Alpay concluded as follows:

(a) An employer/employee relationship does not have an effect on the nature of a CFD although other consequences could arise for instance from a compliance perspective or potential conflicts of interest;

(b) The obligations of the parties need not be equal but must be opposite;

(c) The risk of who will pay whom and whether it is greater or smaller has no direct bearing on whether the contract is a CFD;

(d) Cessation of employment, "good leaver" and "disciplinary event" are not ordinary parts of a CFD and Mr Alpay had never seen such terms relating to a CFD contract. However, CFD providers do ordinarily communicate the conditions under which a contract could be terminated and there could be reasons to use such terms. Mr Alpay made no comment on the specific facts of the instant case but limited his opinion to whether a CFD could "commercially and conceivably have provisions to this effect."

(e) A CFD provider would not allow a contract to be assigned without its prior written consent;

(f) A CFD is not a transferable security; it is a contract between two parties and therefore termination can only happen between the contracting parties. If terminated, commercially the difference between the value at termination and the initial value would have to be paid by one party. No Payment would only occur if the formula for payment indicated nil;

(g) Bankruptcy of the buyer is a standard CFD contract term;

(h) There are ordinarily one or more fees charged in a CFD product and the provisions for termination and suspension are supplied by the provider;

(i) Margin management is a common part but not a required part of a CFD. The absence of margin management could have risk management consequences for the provider.

231. Mr Alpay confirmed that he was asked to give his expert opinion on what were contracts for differences and had considered an example of a Jones Brothers' Confirmation Agreement and Master Agreement, but no material relating to Britannia. He was not asked to provide a general opinion as to whether the Jones Brothers contracts were or were not contracts for differences. Instead, Mr Alpay was asked to consider certain features of the contracts and opine as to whether those features were inconsistent with being CFDs.

232. The features considered included disproportionate outcomes as between employer and employee, leaver provisions and the provisions relating to transfer or lack of.

233. If a CFD was viewed as being a promise to pay future value depending on the variation of the underlying reference asset, a non-payment due to health and safety or disciplinary events could be included in a CFD, as Mr Alpay explained:

> "A…The way I see this…is that these events – you wouldn't find them in an ordinary CFD made between a retail client and a provider of the CFDs, but if they use it under an employment incentive scheme then I suppose I would liken it to a kind of doors, you know, a kind of doors on the hallway, so the CFD is at the very end of the hallway and there are a few doors they need to get through until they get to the CFD, if that makes some sense, hopefully.
>
> Q. Do you mean that the CFD is or is not something which includes these gateway provisions?
>
> A. It could include these provisions in that case, yes."

234. Mr Alpay gave an example of employee stock options which may have gateways and be more restrictive. That would not, in Mr Alpay's view, alter the nature of the CFD itself. He believed that they were called conditional statements:

> "If this happens, then a check back, and if that happens, then another check mark, and then you come at the end of it to the formula, hopefully, which is the operating times, whatever it was in these contracts. So it is either one or zero, depending on these events having occurred or not. So if a disciplinary event has occurred then the pay-out is zero. If a disciplinary event has not occurred, then the next condition, did a health and safety inspection condition occur. If the answer is yes to that, then the answer to the payoff is again zero, and if the answer is no to that, then you come to the actual CFD which is in its core, I believe, the same as you would find in kind of like CFD provider."

235. Although Mr Alpay agreed that the appeal was not concerned with employee share options, he did not agree that such features were inconsistent with the concept of

a CFD stating that the difference was no more than an employee share option against a share option bought under a CFD. He accepted that a CFD with these conditions would not be found from a commercial provider:

> Q. It is completely unlike what you would find from a commercial provider, is it not?
>
> A. "Completely unlike". I must think about this. I believe commercial providers have to standardise what they are doing so that many thousands of people can buy it. If these need to be adapted to some extent I wouldn't see them because I use commercial providers at all times, but would this change the nature of the CFD massively? Again, I will have to go back to the hallway example. There are a few doors but at the end at the corridor you find a CFD.
>
> … At the very end of the CFD itself is very much like the CFD with a few bells and whistles hanging over it, but I have not seen it in like a commercial CFD I have traded, that is for sure.
>
> As I said before, when these CFD providers provide these CFDs they have to think about 50,000/60,000 people buying them. They do not know individually the people who are buying these things. It is a cookie cutter regime, if you will, so they need to be quick…otherwise razor thin margins, they cannot make money out of it."

236. Mr Alpay was taken to a Confirmation Agreement; the standard terms of the agreements were all similar although the way in which the payment was calculated differed across different categories of employees. Mr Alpay's description of the Agreement was as follows:

> "A. I see what you mean. A formula is a formula, and the market is very creative. The fact that the formulas are different, that does not really mean anything in the world of CFDs. Even to the FTSE index, it is called "plain vanilla" in our speak. On the most plain vanilla ones will have differences because one of them could have a multiplier of ten, the other one could have a multiplier of one, so one really needs to look at the terms. Some of them to be linked to the FTSE in dollars, and the other ones could be linked to the SMP500 in pounds, so all this needs to be carefully checked. That could happen. That is very standard.
>
> Q. Would you expect in a CFD to find a provision that the buyer can alter its terms unilaterally?
>
> A. No, that would be very odd I would say."

237. Mr Alpay did not believe that the provision replacing the calculation agent of a normal CFD and giving board discretion to the directors to alter the terms of the CFD was unreasonable but noted that such provisions should ordinarily not be used. It was desirable, but not necessary, to have some element of independence between the provider in his capacity as seller and the provider in his capacity as calculation agent.

238. Mr Alpay clarified that payment is determined in reference to a formula that is then linked to the movement of the asset. Although that was not the situation in the instant case, as the payment was not linked to a formula depending on the value of the underlying asset, the value of the underlying asset is simply a threshold over or below which the figure must fall as a condition precedent to payment being made. Mr Alpay explained that binary options work in this way:

A. … I would regard this kind of payment as a sum of multiple little binary options if you will, so – for example, if I were to pay you £100 if the FTSE was going to end up above 7200 that would be a CFD despite the fact that ... You could call that a condition precedent for me to pay you that £100 the FTSE going above 7200 because once they are both there you don't get more, so it's not like a straight line, as my fellow expert witness, Ms Mayr has reported. It is just like, if you will, a step function. It goes up to 100 and remains there as long as it doesn't go down by its maturity, so whether you call that a condition precedent or not, that is ... I mean, both regulatory and commercially that is a CFD. The way I see it in these contracts is – so imagine I sold you this, like the FTSE – I will pay you £100 when the FTSE ends up above 7200 or whatever and I ask you to sell me another contract that you will pay me, for example, £20, not £100 but £20 if the FTSE falls below 7100. These two are individually CFDs because they are binary options and the combination of them has to be a CFD as well in my opinion. It is more creative, for sure, than the simple plain vanilla binary bet but the combination has to be the same. That is how I treat it.

Q. Is that typical of the industry, the way you treat it?

A. I would think so, yes. The industry is quite creative. I mean, they will come up with many things. These binary bets are what they call exotics because they are not easy to hedge, they are not easy to ensure the profits of.

239. Specifically, in relation to the Jones Bros' contract, Mr Alpay explained he would treat them as binary exotic CFDs. However, he clarified:

"Q. In this sense, we know from the contract confirmations in Jones Brothers that there were a number of constituencies of individuals whose entitlement was to be calculated by reference to their particular participation in the business of Jones Brothers and a percentage of income and deductions of elements of cost and so on. None of that had anything to do with the underlying variable which provides the threshold over which the index must claim in order to entitle the individual to payment.

A. I looked only at one confirmation agreement I am afraid, and in that one it is the operating profit that is the threshold and that would certainly make it qualify, I think, as an exotic binary CFD as you also said. The other ones, they could use something else, I mean, there is nothing that stops a CFD provider – obviously, I don't know who would buy it but there is nothing that stops a CFD provider from referencing the revenues of a sub-division in there. The CFD providers are very, very creative. They come up with lots of these products and then most of them die out and some of them remain there and we see them finally regulated at some point."

240. Mr Alpay confirmed that in an exotic binary, a buyer was entitled to be paid out when the threshold was reached. It was highlighted that there are examples in the Jones Bros case whereby the threshold was reached but the employee was not entitled to be paid:

A. Yes, if you will the treasure box is at the end of the hallway. I think we have discussed that already.

Q. No, it's not that, the treasure box is at the end of the hallway. The door is opened to him. He thinks, "Ah, I've got over the threshold" but when he opens the treasure box he doesn't get paid.

A. If that was the case that would be very weird but in that case you would see some court cases I suppose, you know, if he was expecting to be paid and he is not paid because of those conditions then he would say, you know, "I was deceived". That's what he would do.

Q. Not that he was deceived, it is just that he wasn't entitled, having entered into a binary exotic, as you would term it, he still gets nothing, so he goes over the threshold, the ---

A. Are you referring to the board discussion kind of events, the health events or something entirely different?

Q. I am referring to a calculation event. Let's look at a document…dated 9 March 2012, "I am writing to you in connection with GSOP 1 ... the 'hurdle' ... of £875,000 has been met, therefore you become eligible for payment..." It says the payment due is dependent upon cumulative financial performance of the portfolio. "The payment due to you has been assessed has nil."

A. That looks a little odd I have to say. I don't know the other conditions in this contract, why it has become to be nil. It could be if there are like, apart from the operating profit, if there is something else there that needs to be taken account of that could cause it as nil that would be fair and square in my opinion, but I didn't review this contract. I can't say how it has come to be nil…the individual contracts that this CFD was referring to didn't go well I suppose.

Q. Right, but the point is that the underlying metric worked in his favour. The threshold was reached, all other condition precedents are met, but he gets nothing…I may have misled you, I am sorry, on what I said about contract reference asset…We now know Mr McLaughlin got zero, and this is his underlying confirmation. We see definitions and so on, references to disciplinary events and so on. We then have a distinction, and this is the point I wanted to draw your attention to, between the contract reference asset and that adjusted operating profit…So the contract reference asset is adjusted operating profit and that rose and so it got over the threshold but then there is something called the contract reference asset value which is to be calculated in accordance with schedule 1… So that gives us a formula for what he would be entitled to.

A. That's right, yes, so I don't see – oh, here it is, RP residual profit margin from gross site margin after deduction of 4 per cent head office overhead.

…

Q. Yes, but the point is the difference, looking at a contract for differences, the reference asset is "adjusted operating profit" but once the threshold is reached, that has nothing to do with what he is paid or indeed whether he is paid at all. This contract does not depend on whether he gets a positive or negative outturn on the movement in the contract reference asset. All the contract reference asset gives him is a condition precedent to being able to enjoy the outturn of a different calculation all together.

A. My gut feeling is that you are right. It looks like this is even more exotic, if you will, there are two assets. As you say, the real contract reference asset is contract value because this is what this payment is linked to. Then the contract reference asset is kind of like a condition precedent because they did not want to make a payment unless a profit was reached, so it looks like this is very exotic, even more exotic than our binaries.

Q. Yes, a super-exotic binary, which is nothing like what you would expect as a retail contract for difference, is it; nothing like?

A. In retail I would not see something like that, but in the institutional world I have seen even more exotic stuff.

Q. I do not doubt that Deutsche Bank and Goldman Sachs could enter into something between themselves and it might not even have a margin attached, but let us try to operate in the real world of a comparatively modestly paid employee of a construction company.

A. Yes. The issue I want to highlight is when we look at retail products. As I said, the FCA is super-protective of them, as they should be no doubt, and they need to be standardised so they can be offered to multiple people. It does not preclude anyone, even if they are not Deutsche Bank, to be able to do something exotic, but this is quite exotic, I agree with you in that sense.

Q. …Can you agree with this, now that we have looked through super-exotic characterisation: a contract under which the amount paid by the provider to the employee is determined by a formula that does not relate to the reference asset, does not fall within the ordinary business meaning of a CFD?

A. When you say "the ordinary business meaning", are you restricting yourself to what would be provided by a CFD provider for their retail clients, or are you trying to have a more general commercial meaning?

Q. Let us break it down. For something which could be provided in a retail market, which would be regulated, as I think you were telling us, if the outturn in fact does not depend on the value of the reference asset, save in relation to triggering the condition, that is not what you would regard as a CFD, is it?

A. I would not regard that, no, but in this particular case I think they just made a mistake. They should have put the RP as the contract reference asset and all seems to be okay then.

Q. They would have to redesign the entire thing then because the contract reference asset was the same contract reference asset across a number of constituencies of employees?

A. Okay, in that case you are right.

Q. I am right. If we are looking at something in the regulated retail environment, this would not be a CFD within the ordinary business meaning of CFD?

A. No, no one could sell this product in the regulated CFD environment because the reference asset itself is not what the pay-out is only, so there need to be contract reference assets, if you will, will be possible and feasible, so it is bad drafting for that purpose.

Q. That is the regulated regime dealing, as it would be, with retail users of CFDs. Help us, not that it is relevant directly in our present circumstances, with what would be the position as between Deutsche Bank and Goldman Sachs; would that be a CFD?

A. I think the legal teams would have amended this long before this comes to the signature stage.

Q. You just would not have it in the real world, is that correct?

A. I do not think so, no; it would have been corrected. Have I never seen anything that was erroneously drafted, if you will, and signed afterwards, yes, this happens, so people would know the intention of it.

Q. You are not suggesting that there is a discernible intention here which is not represented in the documents because we know that the contract reference asset, as adjusted OP, and the contract reference asset value as something else, is what it was intended to be?

A. I think the master agreement as well as the -- I would love to reread it for that -- but my take on this is that the contract reference asset on its own is not enough to make a payment, to decide whether a payment would be made, so there are contract reference assets, not one contract reference asset, and that would be cleaner drafting."

241. Mr Alpay agreed that in a retail environment a provider would almost certainly require a margin of some kind. However, a margin might not be required in cases where there was an employer/employee relationship between the parties.

Ms Esther Mayr

242. Mrs Esther Mayr is a managing director of FTI Consulting LLP, a member of FTI Consulting Inc. group, a global consulting firm specialising in, inter alia, economic and financial consulting. Mrs Mayr provided a report dated 4 October 2019 on instructions from HMRC which provided an opinion on the commerciality of GSOPs offered by the Appellants to their employees.

243. Mrs Mayr's report specifically addressed the Appellant's respective GSOP arrangements in addition to general issues. The report dealt with each of the following:

General issues:

Issue 1.1: relevant regulatory requirements under the FSMA 2000, or otherwise and whether the CFDs appear to satisfy the relevant requirements?

Issue 1.2: The significance of provision for margin in a CFD and whether it would be routinely ignored in a commercial CFD made between parties acting in their own interests at arm's length?

Britannia GSOPs:

Issue 2.1: The structure of the CFD contract including:
(a) cessation of employment and other conditions;
(b) Lack of evidence of margin payments.

Issue 2.2: Whether the arrangements might reasonably be entered into in a bona fide commercial arrangement, considering:
(a) The commerciality of the instrument.
(b) Whether it would be entered by parties acting in their own interests at arm's length;
(c) The fact that almost 6 months of the reference period had already elapsed when the CFD was signed.

Issue 2.3: The valuation of the Britannia GSOPs, including:
(a) The hurdle and how this figure was arrived at.
(b) The imbalance in amount between upside and downside.
(c) The Premium paid by the employee for the CFD and how it was calculated.

Issue 2.4: The alleged aim of the GSOPs to increase share value, including:
(a) the effect they had on company operating profits and the company's contention that it was "designed to incentivise growth in the value of the business and not growth in operating profit".
(b) Whether Mr Langsam's 100% interest affects Ms Mayr's view of the arrangement.

Jones Bros GSOP 1:

Issue 3.1: The structure of the CFD contract underlying the GSOP scheme including the following aspects:
(a) The apparent similarity and overlap between the GSOP and the bonus scheme and whether it is consistent with a commercial arrangement?
(b) Whether a restricted assignment of rights is consistent with the character of a commercial CFD made between parties acting in their own interests at arm's length.
(c) Whether the conditions relating to disciplinary and health and safety matters are consistent with the character of a commercial CFD.
(d) The absence of evidence to show margin was demanded or paid.

Issue 3.2: Whether the Jones Bros GSOP 1 is such as might reasonably be entered into in a bona fide commercial arrangement, including the level of the hurdle.

Issue 3.3: The valuation of the Jones Bros GSOP 1, including:

(a) How likely it was that the GOP would exceed the hurdle and how likely was it that the GOP would fall below the GSOP Floor;
(b) The Premium paid by the employee for the CFD, how it was calculated and whether the amount realistically reflected the value at acquisition;
(d) The discrepancy between upside and downside risk in these arrangements, and the fact that the downside payment was capped whereas the upside payment was not.

244. Mrs Mayr approached issue 1.1 (requirements of a CFD) by reference to descriptions of CFDs provided by the Financial Conduct Authority ('FCA'), one of the banking regulators in the UK and the European Securities and Markets Authority ('ESMA') which forms part of the European System of Financial Supervision. That approach was reflected in Mrs Mayr's analysis as providing context for the commercial understanding of what a CFD is and what its typical characteristics are.

245. Ms Mayr considered the ESMA (European Securities and Markets Authority) definition a reasonable working definition of a CFD:

> "A derivative agreement, the purpose of which is to give the holder a long or short exposure to fluctuations in the price level or value of an underlying... irrespective of whether it is trade on or trading value and that must be settled in cash, or may be settled in cash at the option of one of the parties other than by reason of default or other termination event."

246. Ms Mayr explained that the relevance of the statutory references is that they define what a CFD is and how it behaves against the underlying index. They effectively describe the very basic definition and characteristics of a CFD which Ms Mayr's report then supplemented with a more market or commercial angle as to how those products work in reality.

247. She did not agree that it was possible for CFDs to fall outside the statutory definitions. In her view the statutory definitions define what is an option or what is a contract difference and give the very nature of those products.

248. In cross-examination Ms Mayr explained that her report focused on what the FCA required, rather than looking at the question of the CFD more widely for two reasons. First, the instructions she was given referred to the regulatory requirements and second, most of the publicly available references related to retail investors and Ms Mayr considered it helpful for courts to regard as market that set by an entity such as the FCA, or in other cases, an industry association. Her report set out legal statutory definitions and the characteristics of a CFD which she cross-referenced to FCA and ESMA publications. She then developed the range of criteria that described the typical character of a CFD. She explained that she did not draw on her wider experience, for instance with energy related CFDs because the FCA and ESMA publications not only set out market restrictions for retail investors but also contained descriptions of what a CFD looks like. She used the content of the publications to develop the criteria as opposed to the market restrictions imposed by regulators on retail clients. Ms Mayr agreed that the publications to which she had referred were aimed at the "cookie-cutter" market. Ms Mayr explained that she had focused on commercial CFDs because the expert opinion she had been asked to provide specifically referred to commercial rather than non-commercial contracts. The majority of CFDs that are traded are traded in the

retail market and the purpose of her report was to describe how a CFD typically looks and feels in the market, rather than to look at any possible feature possessed by a particular one, and then see how many of the criteria applied to the Appellants' contracts. Ms Mayr did not suggest that a CFD must be a typical one and agreed that a CFD might not have the typical or commercial characteristics she identified.

249. Having considered publications from the FCA and ESMA which set out the commercial purpose of CFDs, Ms Mayr developed five criteria which in her view characterise typical CFDs. Those are:

> (1) whether the payoff profile (and thus profit or loss) is determined by reference to fluctuations in the underlying reference metric only;
> (2) whether margin payments should have been posted and, in reality, were posted;
> (3) whether the contracts are non-transferable;
> (4) whether the instruments do not have a fixed maturity; and
> (5) whether the participants were allowed to take both long and short positions.

250. In testing her criteria against the Appellants' GSOPs Ms Mayr found that Britannia GSOPs fulfilled but one of the criteria, and the Jones Bros GSOP fulfilled none of them.

251. In relation to the payoff profile, Ms Mayr explained in cross-examination that although the ITEPA definition of a contract for differences differs slightly from other publications to which she had referred: "the nature of the second instrument by reference to fluctuation seems to be the same, or very similar, language."

252. She highlighted the FCA publication "Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products" from which she derived the view that the payoff must be one-for-one:

> "Similar to CFDs, the value of futures moves one for one with the change in price of the underlying asset."

253. In disagreeing with Mr Alpay that the payoff need not be linear, Ms Mayr explained:

> "A. In my experience CFDs move one to one with the underlying asset. The digital or binary option that Mr Alpay discussed yesterday, that is referred to in my supplemental report, is the exception to that. The reference that I have included here is from the FCA where they state that that future moves one to one and that that is similar to a CFD.
>
> Q. If I took this example then, let us suppose that we were to enter into a contract where the underlying is interest rates, LIBOR, or something like that, and the contract says that for every basis point that it goes up I pay you £100 and for every basis point that it goes down you pay me £200. Forget about the economics of that for the moment; you would say that is not a CFD?
>
> A. No, I do not believe that is a CFD.

Q. What is it then?

A.I am not sure what it is. It is similar to a fixed odd bet in sport betting. I have never seen a financial contract with a derivative that would do that because, as you say, it would not be economical.

Q.Forget about the economics of it. Assume it is economic in the sense that everybody is expecting interest rates to go up and therefore it makes complete commercial sense to be at risk twice as much on it going down as it going up. Let us suppose the contract makes total commercial sense. You simply say it is not a CFD because it is not linear?

A.I would say that because it does not move in a linear one on one with the underlying, in this case being the LIBOR rate, that excludes it from being a CFD.

Q. It is not actually regulated then?

A. Potentially. Like I have said, I have never seen that product in reality. The FCA in this paper describes products that are similar to CFDs, they call them "CFD-like options" I believe, and the regulation, the protection of retail customers actually includes those on purpose, and the FCA has gathered a new definition for those particular products exactly for that reason so that providers do not file accounts under CFD as easily as they could in the past, so they tweaked it slightly. In this case it has a downside of protection meaning that if the value drops and there is significant loss to the customer, the product automatically disappears, knocks out, and the FCA was worried because that is not a CFD that it might be abused and therefore has included these types of contracts under a new definition within the market restrictions. Because there is innovation in finance, the FCA has anticipated, if you want, that innovation and I think that is a parallel example to the one you were describing in a real-world environment."

254. In response to Mr Alpay's evidence regarding the terms exotic binary or super exotic, Ms Mayr explained:

A. So, we clearly, the FISMA says from, I believe some time in 2018 binary options included and the way they -- binary options are described as, if the share price goes above X, you get £100, so it's a fixed, or the fixed outcome of it. What then happens in reality in banks, and this is the innovation aspect that Mr Alpay was referring to, is people take the structures that, the product developers in bank take a product, say a CFD, and then they add features to it, they might add optionality to it, they might make, attempt to make it cheaper to the market by adding an option, a trigger that might only pay out in a remote possibility, but because you earn a fee for selling that option that the overall structure gets cheaper. And that is a very common thing to happen, that you take the basic, the vanilla products and you add complex features to it. <u>To my mind the big question here is, at which point does it, does the nature of the product change. How much optionality, how many features can I add to a straightforward CFD for it to, not to be a CFD, but an option or a structure product, which you have referred to earlier.</u> And, to my mind, the inclusion of optionality makes it not a CFD and with the exception of the binary example that we have described and actually the FCA paper that I have referred to earlier supports that view because it refers to turbos, and if I may a turbo is a linear product, it looks the same way as the graph I have in my report. The main difference is that apart from trade trading menus, et cetera, but the main difference in the structure is that once the product falls below a certain threshold, it's gone, it's not alive any more, the product doesn't exist any more. And on the face of it one could say, well, we have taken a CFD and you have added a, what is called a 'lookout' option to it, so it's still a CFD. But actually the FCA disagrees and has therefore created a new category in its regulations for that." (emphasis added)

255. As to whether there would be any significant difference in the meaning of CFD as between more sophisticated commercial operators such as Deutsche Bank and Goldman Sachs in a more exotic market, Ms Mayr explained:

> "A.What typically happens in the market is that the name of the product is continued to be used, so people may still be referring to it as a contract for differences, but they have added additional features that contain, so it might be a contract that as well as containing an apostrophe, so a vanilla CFD might also contain an option, the working language would be like you still refer to it as a CFD, but that's a distinction that I'm trying to make in my report is that the name of the product and the label under which it is sold is not, is not relevant to the nature of the product. One needs to look at those definitions to understand what is actually behind it, look at the contract. That then tells us whether the product that is called the CFD in, into investment banks is still a CFD or whether it's something else."

256. In cross-examination Ms Mayr agreed, in relation to the typical characteristic of investors taking take advantage of either increase or decrease in the price of the underlying metric by taking long or short positions respectively, this was only relevant in considering the terms on which the contract is sold rather than the terms of the contract and the meaning of a CFD. She did, however, consider it relevant to look at what the CFD contains and what investors are allowed to do with that product. Ms Mayr agreed that in determining whether the contracts in this appeal were CFDs where the employees took long positions, it was irrelevant that the participants were not given the choice of entering into a different contract under which they would have taken a short position. Likewise, the fact that the contracts had a fixed maturity date did not detract from them being CFDs.

257. Ms Mayr agreed that although the fact that a contract provided for one side to be able to transfer his or her rights did not prevent it being a CFD, that was unusual and atypical of a commercial CFD.

258. In relation to the ability to avoid payment, Ms Mayr explained:

> Q. You have been telling us many times about the commerciality of things, the commerciality of the CFDs and so on, surely this is nothing to do with looking at it from a commercial point of view is it, that someone would give up their job to avoid having to make what is a relatively small payment?
>
> A. This is exactly what that last sentence here is aiming at. If the payment was immaterial then, no, clearly, the payment would be a – given their personal wealth, their participation would actually be a very small amount then, no, clearly no-one would give up their job because of it. However, if the amount was material to them and then it could be a consideration and according to the Grant Thornton valuation reports for both Jones Brothers and Britannia, the downside payments are set so that it is not a, I believe the term is, not a negligible amount.

259. As to the Board's discretion, she added:

> "Where events happen which call the board reasonably to consider that any term of this agreement no longer represents a fair objective measure, the board may vary or waive any term in any way it considers appropriate provided that it reasonably considers the term as waived or varied is no more difficult nor easy to satisfy."

Ms Mayr agreed that the Board could vary only if it considered it was not harder or easier but was at the discretion of the board. Therefore, any amendment should not impact on the value of the terms to make an upside or downside payment more or less likely.

260. As to issue 1.2 (the significance of provision for margin in a CFD and whether this would be routinely ignored in a commercial CFD) Mrs Mayr explained that margin requirements are typically applied as protection; whether margin is unilateral or bilateral depends on the relationships between the parties but margin provides insurance to ensure that payments due under the CFD are honoured and so would not routinely be ignored in commercial CFDs. She explained that it is not standard in the market to ignore counterparty risk and it would be highly unusual to have any derivative in the market that did so, and therefore wouldn't have a margin or another metric to manage that. However, the absence of margin does not prevent it from being a CFD although Ms Mayr did not consider that it would be a commercial CFD made between parties acting in their own interests that is transacted at arm's length.

261. Issue 2.1 related to Britannia and the structure of the CFD, in particular terms relating to payment on cessation of employment and the absence of evidence to show that margin was demanded or paid. Mrs Mayr concluded that the payment structure did not resemble that under a CFD as payments were not directly contingent on fluctuations in the underlying metric (as is the case for a CFD), but rather were contingent on the underlying metric reaching certain trigger levels.

262. The ability of participants to avoid a downside payment through cessation of employment and the board's discretion to alter terms of the scheme were not part of the structure of a CFD. Payments contingent on matters other than performance of the underlying reference asset were inconsistent with the character of a CFD.

263. Mrs Mayr claimed that, as margin payments were not required, there was no certainty that participants could meet the downside payments which introduced additional risk not typically found in GSOPs.

264. Issue 2.2 related to the commerciality of the arrangements. Mrs Mayr reiterated the points above that clauses such as cessation of employment allowing a participant to avoid a downside payment, discretion of the board over terms and lack of margin requirements are not typically found in CFDs.

265. The payments under the Britannia GSOPs, were subject to continued employment of a participant until payments under the scheme were made and the board's discretion to amend any term in the schemes it no longer considered *"fair and objective"*. In relation to cessation of employment Ms Mayr commented that this provision effectively granted the participants an option which markedly reduced their downside risk. The board's right to amend terms could impact the value of the scheme, for instance by making an upside or downside payment more or less likely; that was not reflective of a typical CFD structure and is not typically found in a commercial CFD.

266. Mrs Mayr also observed that the Britannia GSOP commenced after the Reference Period had started, which gave the parties knowledge of actual out-turn performance on the commencement date. The actual performance in the quarter ending March 2010 was significantly higher than the forecast GOP and the GOP hurdle. She noted that this information should have been reflected in the valuation of the GSOP leading to a higher premium being paid by participants. Mrs Mayr concluded that the terms of the GSOP were not commercial nor would they have been agreed by independent parties acting in their own interests at arm's length.

267. In relation to the valuation of the GSOP (issue 2.3), Ms Mayr noted that Grant Thornton did not provide sufficiently detailed information on its valuation methodology to allow her to fully analyse its valuation. She explained (at [4.41], [4.42] & [4.48])):

> "I then attempt to reconstruct GT's valuation framework based on the information contained in GT's Britannia Valuation Reports and a broad range of assumptions. I have to make a broad range of assumptions as I lack information from GT and therefore need to ensure that my conclusions are robust under a range of valuation assumptions.
>
> Using this framework, I finally test whether the Premia of the Britannia GSOPs, which GT arrived at, could be consistent with GT's valuation assumptions.
>
> I consider it reasonable to infer that GT uses the forecast GOP as the expected value for the GOP during the Reference Period. For example, GT mentions that:
>
> *"Management has advised that the forecasts supplied are intended to be realistic and represent its best estimate of the out-turn for the 52 week period ended 25 September 2010.""*

268. Ms Mayr noted that according to Grant Thornton the value of Britannia's GSOP was calculated as the upside payment, multiplied by the probability of the upside payment, minus the downside payment, multiplied by the probability of the downside payment. As Grant Thornton assessed the premium to be close to nil for Britannia, Ms Mayr explained that it must hold that the probability-weighted upside and downside payments were equal. However, downside payments were approximately 20 times lower than upside payments. If the scheme was correctly valued at a zero premium, the probability of a downside payment must have been approximately 20 times higher than the probability of an upside payment. Ms Mayr explained (at [4.52] – [4.54]):

> "As GT state that the probability of the GOP being at or below the GOP Floor must be "non-negligible", the probability of the GOP Hurdle being met or exceeded must be comparatively remote in order to achieve a nil value.
>
> For the purpose of an illustration, say the probability of the GOP being at or below the GOP Floor was 5%, then the probability of the GOP being at or above the GOP Hurdle would need to be 0.25% to achieve a nil value. Similarly, if the probability of the GOP being at or below the GOP Floor was 20%, then the probability of the GOP being at or above the GOP Hurdle would need to be 1% to achieve a nil value. Considering these very low probabilities for the GOP Hurdle being reached, the actual GOP – which in fact significantly exceeded the GOP Hurdle – would have been nearly impossible to reach.
>
> This draws into question whether a nil valuation is consistent with the scheme's structure and GT's description of the GOP Hurdle and GOP Floor."

269. Ms Mayr tested her conclusion by reference to a range of assumptions. Having identified a range of assumptions which could support the hurdles and balance the upside/downside risk she concluded that the premium should have been significantly higher and it favoured the participants which, in her view, was inconsistent with a CFD between independent parties at arm's length.

270. Issue 2.4 concerned the alleged aim of the GSOPs to increase share value. Mrs Mayr noted that the GSOPs had a net negative effect on Britannia's operating profit. In relation to the claim that the aim was to increase the value of assets in the business (as opposed to the profits) She explained that that depended on the assumptions used when valuing the business and that the rationale set out by Britannia (at [2.20]):

> "…only holds good if a one-off incentive scheme led to a sustainable increase in operating profit. In the absence of such a sustainable increase caused by the availability of the GSOP, there would be no increase in the value of the assets of the business."

271. Mrs Mayr added that it remained unclear why Mr Langsam, as 100% beneficial shareholder in Britannia, needed the incentive of the GSOP to grow value in the business he owned.

272. In relation to Jones Bros, issue 3.1 concerned the structure of the CFD, in particular the apparent similarity and overlap between the GSOP and bonus scheme, the ability of the buyer to transfer rights to a spouse/civil partner, the terms relating to disciplinary and health and safety conditions to which pay outs were subject and the absence of evidence that margin was requested or paid.

273. Mrs Mayr noted:

> "Whether payments are to be made under Jones Bros GSOP 1 is dependent on operating profit meeting certain hurdles. A low profit, below a certain threshold, triggers a fixed downside payment from the scheme's participants to the company. A high profit, above a certain threshold, triggers an upside payment. The upside payment was not necessarily related to the operating profit but rather followed a similar structure to the company's previous bonus schemes."

274. She commented on the similarities to pre-existing bonus schemes as follows (at [5.10] – [5.12]):

> "According to GT, the payments under the GSOP scheme closely resembled the pre-existing bonus arrangements:
> *"Potential payments due under the GSOP are determined by reference to the current bonus calculation, which is not a graded payment (ie not payments which increase as the chosen index increases), and as such a cap is not required for this security."*
> *"...Bonuses in previous years, which were calculated in accordance with similar formulae..."*
>
> I have been provided with a Service Agreement for a Jones Bros participant…dated 19 May 2010 (the "Service Agreement"). The Service Agreement states the following in relation to discretionary bonus arrangements in place before the Jones Bros GSOPs:
> *"The Employee shall be entitled to be considered for an annual discretionary bonus ("the Bonus") calculated from the net financial contribution from the construction and maintenance contracts for which the employee is deemed responsible after taking*

> *account of outstanding retention monies, any additional costs and full overhead recovery. The percentage-rate applied would be 3%..." (emphasis added)*
>
> From this description, the calculation of the discretionary bonus appears similar to the payment under the Jones Bros GSOPs if the GOP Hurdle is met."

275. Ms Mayr explained that the GSOP payments to Jones Bros participants were not linearly dependent on the Group Operating Profit. Moreover, the participants were required to pay a fixed downside payment that was not a function of the Group Operating Profit. She claimed that was inconsistent with a payoff of a typical CFD.

276. Ms Mayr considered that the following additional provisions would not typically be seen in a CFD and were not commercial:

> (1) A payment is not guaranteed even if the GOP Hurdle is met – for example, the Jones Bros Participant may not be paid a bonus if:
> (a) the cumulative performance of the net financial contribution from the contracts for an employee is lower than the cumulative past bonus payments;
> (b) the Jones Bros Participant does not satisfy other stipulated conditions, including that they have not been "subject to a disciplinary event during the GSOP period" or that the Health and Safety Inspection Condition is met; or
> (c) the Board of Jones Bros decides not to make payment at its own discretion.
>
> (2) A payment for current performance could be made in a future GSOP year, even if the GOP Hurdle is not met – the structure of Jones Bros GSOPs implies that if a GOP Hurdle is not met in the current GSOP year but met in a future year, the amount paid in the future year would include the amount cumulated under the current GSOP year;
>
> (3) While the GOP Hurdle is based on the performance of the civil engineering division of Jones Bros, the GSOP payment can also be based on the performance of the plant hire division;
>
> (4) The Jones Bros GSOPs could be assigned to a spouse or civil partner;
>
> (5) The payments under the Jones Bros GSOPs, were also subject to the continued employment of a participant until payments under the scheme are made; and
>
> (6) The Board has discretion to amend any term in the schemes it no longer considered "fair and objective".

277. Ms Mayr concluded that the structural characteristics meant that payments were contingent upon factors other than the operating profit of the company. That was inconsistent with the character of a CFD. The absence of margin payments added additional risk not typically found in CFDs. She added that assignment without termination of the agreement would typically not be accepted by a commercial counterparty as it would change the counterparty risk faced by the party. Ms Mayr also noted that typically in employee incentive schemes cessation of employment automatically removes the employees' rights to receive payments. In the case of Jones Bros, cessation of employment not only meant that payments to participants would no longer be due but also payments from the participants and the company would refund the premium in full. In Ms Mayr's view this was uncommercial in that it effectively granted the participants an option which markedly reduced their downside risk.

278. Ms Mayr noted that while the Master Agreements referred to Initial and Additional Margin requirements, the requirements were all in fact set to zero in the Confirmation Agreements. That introduced an additional risk in the GSOPs not typically found in CFDs.

279. As to the commerciality of the GSOP (issue 3.2) Mrs Mayr explained that clauses such as additional payment conditions, rights to assign, cessation of employment clauses which provided participants with options to avoid downside payments and board discretion over terms and lack of margin requirements are not typically found in commercial CFDs entered into by parties acting in their own interests at arm's length. She added that the structure would also have made it difficult for a third-party independent assessment of the scheme.

280. Ms Mayr did not consider the GSOP to have been entered into on commercial terms that would have been agreed between independent parties, acting in their own interests at arm's length.

281. Issue 3.3 concerned the valuation of the GSOP. Ms Mayr explained:

> "As the upside payment amount for Jones Bros GSOP 1 is not linked to the GOP's performance, I cannot directly analyse the Premia from my distribution analysis. Rather, I need to perform the analysis in two steps. The first step is a comparison of the probabilities of the GOP reaching the GOP Floor and GOP Hurdle versus the qualitative descriptions by GT…The second step relates the analysis to the level of Premia."

282. As with Britannia, Ms Mayr highlighted the absence of detail provided by Grant Thornton in relation to its valuations. However, Grant Thornton's approach appeared similar to the methodology it applied for Britannia GSOPs and Ms Mayr therefore used the framework she had developed for Britannia to analyse the Jones Bros GOP trigger levels and Premia.

283. She was unable to identify a set of reasonable parameters that could be consistent with the hurdles arrived at and balance the upside and downside risk. She took the view that this was a structural issue in that the hurdle triggering the upside payment was set too close to the forecast operating profit (at [5.59] – 5.60]):

> "…I arrive at probabilities in excess of 30% for the GOP to be at or above the GOP Hurdle across all assumptions for standard deviations, i.e. a level of probability that can clearly not be interpreted as negligible. GOP Floor, GOP as per Worst-Case Scenario and the actual GOP all have zero probability of being reached at lower levels of standard deviation.
>
> I consider this a structural deficiency in Jones Bros GSOP 1 as the GOP Hurdle is set too close to the forecast GOP. I therefore conclude that there is no set of assumptions for standard deviations that produces results which are consistent with the qualitative description by GT for Jones Bros GSOP 1. I arrive at similar results when using alternative assumptions for distributions."

284. Ms Mayr tested her assessment of Premia by reference to one participant, stating (at 2.32 -33] and [5.70]):

> "I have reviewed the different structures for upside payments under Jones Bros GSOP 1. While the underlying metric for calculation of the amount of upside bonus payment differs between the scheme's participants, the upside payment mechanisms are similar enough to allow me to focus on one employee... I conclude that the Premium charged to …was significantly lower than would be expected in a contract entered into between independent parties acting at arm's length. Based on my review of other structures for upside payments, I do not consider the case…to be unique and I would expect similar results to hold for other participants of the scheme.
>
> To ensure that my results are robust, I have analysed the range of historical bonus payments across all participants. I find that the bonus payments historically paid to participants are not consistent with a zero Premium in many, if not all, cases, i.e. the Premia charged should have been higher.
>
> The Jones Bros GSOP 1 was granted to *[the participant]* at a Premium that was significantly lower than the Premium he should have been charged if *[he]* was expected to earn even the lowest bonus paid to him in prior years. I arrive at similar results when using alternative assumption for distributions."

285. Ms Mayr concluded that the terms of the GSOP favoured participants in many cases and were inconsistent with an independent arm's length CFD. She added that Grant Thornton stated that it arrived at the nil premium on the basis that the GOP Hurdle had a negligible probability of being achieved. That was inconsistent with the actual GOP, independently of any assumption she made.

Supplemental report

286. In a Supplemental Report dated 13 December 2019 Ms Mayr responded to the Reports of Mr Bowes and Mr Alpay. Having reconsidered the five criteria that characterise typical CFDs set out in her first report in light of Mr Alpay's comments, Ms Mayr maintained her view that the criteria remain valid and her conclusions unchanged.

287. In relation to Jones Bros Ms Mayr explained that additional information provided by Mr Bowes showed that the probability of achieving the GOP Hurdle was in the range of 70% to 100%, suggesting a high likelihood of the bonus payments being triggered to Jones Bros Participants. On the other hand, Ms Mayr's results also suggested that there was a negligible probability of being at or below the GOP Floor and therefore a negligible chance of Jones Bros Participants having to make any payments under the GSOP scheme. The likelihood of payments being made was higher than Ms Mayr's original valuation of a 30 – 47% probability.

288. In relation to Ms Mayr's view that payments under a commercial CFD typically fluctuate symmetrically, with which Mr Alpay disagreed, Ms Mayr supported her opinion with reference to a consultation paper issued by the FCA. She also noted that Mr Alpay's view appeared to be based on his inclusion of spread bets and options within the definition of a CFD; Ms Mayr agreed that spread bets are classified as CFDs by the FCA, however she highlighted that not all types of spread bets are included. She therefore concluded that Mr Alpay's references to non-financial spread bets and his conclusions drawn from those references were not relevant. In relation to Mr Alpay's view that binary options are included within the definition of a CFD, Ms Mayr

explained that these were only included from January 2018, after the GSOPs in this case were active. Ms Mayr referred (at [3.20]) to FCA guidance which stated:

> "A product is binary… only if the payout is all or nothing. That is, the overall result will be that one party will pay the other a fixed sum. It is a sort of fixed odds bet."
>
> "The main example of a binary product is a binary or digital option."
>
> "A simple binary sporting bet is not a contract for differences as:
> (a) it is not covered by MiFID and so it does not meet the condition in PERG 2.6.24AG(1)(d); and
> (b) it does not come under any other part of the definition of a contract for differences."

289. Furthermore, Ms Mayr considered that binary options are irrelevant as the payments under the GSOP schemes were not binary in nature.

290. In relation to Margin Ms Mayr noted that the GSOPs in question did not require an Initial Margin and therefore Mr Alpay's argument that a high Initial Margin might render Additional Margin unnecessary was irrelevant. She considered Mr Alpay's suggestion that other assets of the buyer, such as salaries in an employer/employee relationship, could be used as collateral to manage counterparty risk. However, she notes that the Master Agreements and Confirmation Agreements did not make provision for salaries to be used in such a way and in fact the Master Agreements suggested the absence of any such cross collateralisation arrangements:

> "The Buyer hereto acknowledges that in agreeing to enter into this CFD it has not relied on any representation, warranty, collateral contract, other assurance or any document except as set out in any CFD." (Clause 7.14)

291. Furthermore, in relation to Britannia, during the relevant periods Mr Langsam did not receive a salary. Ms Mayr also discounted Mr Alpay's alternative suggestions regarding Margin on the basis that they did not apply to the Appellants or there was no evidence in support.

292. In relation to the employer/employee relationship which Mr Alpay considered would not change the nature of a CFD but which might lead to compliance issues, Ms Mayr noted that the issue of insider information (as identified by Mr Alpay) affects the commercial nature of a CFD (at [3.49] & [3.50]):

> "particularly because some the Britannia Participants and some Jones Bros Participants were company owners or directors.
>
> Further, the directors had the right as a matter of discretion to alter the terms of the schemes. This indicates a particularly strong conflict of interest for directors who could use this power in their own interests as beneficiaries of GSOP schemes."

293. Ms Mayr highlighted that no evidence had been provided to show compliance procedures in place at the companies to manage potential conflicts of interest or insider information and the employer/employee relationships that existed were not typical of CFDs entered into on commercial terms.

294. Following receipt of the report from Mr Bowes, Ms Mayr updated her conclusions in relation to commerciality and valuation in relation to both Appellants.

295. In relation to Britannia Ms Mayr took into account historical GOP information from 2007 to 2009 which had not previously been provided (at [4.6] – [4.10]):

> "Mr Bowes concludes that Britannia GSOP 1 had value, given the likelihood of exceeding the forecast GOP and GOP Hurdle for Britannia GSOP 1…
>
> This is consistent with my view that Britannia GSOP 1 had value and thus should have required the payment of a positive Premium. However, Mr Bowes does not provide a valuation for such a Premium.
>
> I consider it appropriate to use the average GOP over the past three years…as the revised forecast GOP for three reasons:
> (1) Mr Bowes considers the historical performance relevant…;
> (2) the 3-year historical average is higher than the actual GOP for 2009 and the GOP Hurdle, making it consistent with Mr Bowes' opinion summarised…above; and
> (3) the 3-year historical average is lower than the actual GOP for 2007 and 2008, making it a more conservative estimate of forecast GOP for the purposes of my valuation.
>
> Using a forecast GOP of £10.87 million, corresponding to the average historical GOP… I find that the probabilities of being at or above the GOP Hurdle or GOP Cap are in the range of 90% to 100%. On the other hand, the probability of being below the GOP Floor or GOP Collar is virtually zero. My analysis suggests that it was highly likely that the GOP Hurdle would be achieved and extremely unlikely that GOP would be below the GOP Floor."

296. Ms Mayr reiterated her conclusion that the Britannia GSOPs were not commercial; the terms favoured the participants and were inconsistent with a CFD contract between independent parties at arm's length.

297. In relation to Jones Bros, Ms Mayr provided the following updates at [5.4] – [5.6] & [5.9] – [5.12]):

> "Mr Bowes' conclusion on the forecast GOP for Jones Bros GSOP 1 is that it was pessimistic…
>
> I have not seen the actual revenue of the Porthmadog Bypass project, a breakdown showing when its revenue and cost was recognised, or how this may have been reflected in invoices. I can therefore not conclude on whether these revenue recognition practices did, in fact, impact the forecast GOP, and I rely on Mr Bowes' view.
>
> In order to illustrate the potential impact of the recognition issue, I have performed a profit adjustment on the actual GOP for 2011 and 2012 in relation to the Porthmadog Bypass project highlighted by Mr Bowes. The revenue recognition policies adopted by Jones Bros are likely to have resulted in an understatement of the project's revenues in 2011 and overstatement of project's revenues in 2012. This would have a direct and proportional effect on the GOP for these two years.
>
> …the forecast GOP was probably understated by £0.73 million. Therefore, I use a revised forecast GOP of £1.51 million...
>
> With a forecast GOP of £1.51 million, I find that the probabilities of being at or above the GOP Hurdle are significantly higher than the comparable probabilities for forecast

> GOP of £0.78 million, ranging from 70% to 100%. This suggests a more optimistic forecast of the Porthmadog Bypass project could increase the expected likelihood of positive bonus payments to Jones Bros Participants, and accordingly the value of the Jones Bros GSOP 1."

298. In relation to her opinion regarding the forecasts and hurdles, Ms Mayr clarified in cross-examination that her experience was in the valuation of securities, derivatives and similar concepts and added that she would not describe herself as an expert in business valuations. She explained that she would not produce business forecasts, she did not have the relevant expertise to comment nor the knowledge of the particular business and therefore deferred to Mr Bowes.

299. Ms Mayr explained how she was able to answer the question as to how likely it was that the group operating profit would exceed the hurdle and how likely it was that it would fall below the floor as follows:

> "A. The way I was able to do that is by reference to how myself and others would value derivatives…What you would do is, without looking at the fundamentals you would look at how does, for example, a share price move and then use a branch of mathematics called stochasticality that is to derive the value of derivatives. That is the standard way how derivatives are valued and that goes back to the 1960s, 1970s when the famous tax codes model was developed.
>
> Q .So where do you say in your report "I have no expertise in relation to viewing businesses and forecasting profits of the businesses and so on, but what I am doing is applying my expertise in relation to derivatives." Where do you explain that?
>
> A.I don't explain that and the reason I don't explain that is because I was asked to opine on the value of a derivative, which falls straight into my expertise…Because I am looking at the valuation of the GSOPs and that the likelihood of exceeding the hurdle or the floor is a by-product of the derivative valuation approach that I have just described, by reference to the probability of distributions.
>
> Q. Let us be clear then, if someone said to you from Jones Brothers at the relevant time, "We have made a forecast, we think it is a realistic forecast that we are going to make a profit of £775,000 next year" you wouldn't feel able to say to them, "Based on that information you have just given me you have a nil probability of making only £150,000 this year." You wouldn't be able to say that, would you?
>
> A. I wouldn't be and the reason why in my report rather than look at a particular probability distribution or a particular set of parameters describing probability is because I don't know; so I am using a broad range of assumptions and within that broad range of assumptions, different distributions…that I refer to in my report, I told that whether with those assumptions there is a realistic probability to fulfil the probabilities of the hurdles and then derive the valuation from that. But, yes, because I don't know that is exactly the reason why I used such a broad range of assumptions…So what I have done is I have reviewed the valuation reports from Grant Thornton and what that gives me is a high level description of the methodology that Grant Thornton says that applied, which is on the face of it very similar or the same methodology that I am using where they are looking at the probability of being below the floor or above the hurdle. Grant Thornton then go on in both cases to describe qualitatively how they think the probability of hitting certain hurdles and floors should be – whether it should be negligible, whether it should be likely, et cetera. That is where Grant Thornton stop. What I then do as a next step is to say, "Fine, so what I have as far as information is concerned, I have the forecast from the company, I have got a description of the valuation approach from Grant Thornton and I

have a qualitative description of how likely or not the hurdles should be." I use three different probability distributions, which are standard distributions to use in the market; I use a wide range of standard deviations, so of calibrations, for those distributions. Then I arrive at my results where I can see whether there is an assumption of a particular distribution, whether there is a possibility that the different hurdles could fulfil the qualitative descriptions of Grant Thornton; and have a £10 or negligible premium and I found that can't be the case."

300. Ms Mayr considered it important to distinguish between the two Appellants. In relation to Britannia she found sets of parameters where her distribution analysis showed probabilities of the hurdles being met that could be aligned with the language Grant Thornton used, but not at the premium that Grant Thornton had used.

301. In the case of Jones Brothers, Ms Mayr noted that the outcome was very high compared to the hurdle. She considered it was not possible to have a very remote chance of the hurdle being hit by an unrealistic chance of the outcome occurring:

> "Q…but you have based those percentages upon Grant Thornton's own decision that £10 was a reasonable premium to pay?
>
> A. No, sorry; that is a misunderstanding…I haven't started with a premium and then looked at what are the percentages. What I have done, as I have said, I use my range of assumptions and I look at what the percentages are and are they consistent with what GT are describing or not, and then I apply the summation that I have just described, effectively, to calculate the premium. The premium isn't an input into my calculations, it is an output. But what I am trying to do is try to find a set of distributions and parameters that could describe reality in the sense that describes the probability of hitting the different hurdles that Grant Thornton are describing. The consequence of the premium is simple mathematics; it is simply multiplying numbers and taking the difference."

302. Ms Mayr confirmed that she applied a distribution analysis to the question of 'what is the chance of the hurdle being met', by ignoring the premium and ignoring the fact that a CFD had been entered into and which did not involve considerations of, for instance, real world economy factors but rather used a mathematical formula.

303. In relation to Britannia, Ms Mayr confirmed that she later made a revised forecast based on the assumption that the figures for the quarter ended March 2010 were either available or that the directors had a good enough grasp of the ballpark that the numbers would fall into even if the exact numbers were not known. Ms Mayr explained that she still set out her analysis against Grant Thornton's language of a "stretching hurdle" and "non-negligible floor" but she accepted that some of Grant Thornton's language might no longer apply and that she did not know what Grant Thornton would have said if they had had a different forecast.

304. In her initial report Ms Mayr conducted an analysis of the probability that the hurdle would be reached by Britannia. She explained:

> "The probability of being at or below the GOP Floor ranges from 12.10% to 34.83%, depending on the standard deviation assumption. I consider that all of these probabilities could be consistent with the language described in paragraph 4.49(1).
>
> The probability of being at or above the GOP Hurdle is 0.21% for a standard deviation of £300,000, which implies that one would expect to achieve the GOP Hurdle in only

approximately 2 out of 1000 years. I do not consider this to be consistent with GT's description quoted in paragraph 4.49(3), which implies a more realistic chance of achieving the GOP Hurdle. On the other hand, the probability of being at or above the GOP Hurdle ranges from 4.29% to 16.99%, based on standard deviation assumptions between £500,000 and £900,000. I consider that these outcomes could be consistent with GT's description quoted in paragraph 4.49(3).

> Moreover, a standard deviation of £300,000 would imply that it was virtually impossible to achieve the actual GOP for the period covered by Britannia GSOP 1. Therefore, I do not consider a standard deviation of £300,000 to be consistent with reality. I note that even for a standard deviation of £500,000, the prospect of achieving the actual GOP was extremely remote at approximately 0.08%.
>
> I obtain a value close to the Premia actually paid by the Britannia Participants for Britannia GSOP 1 for a standard deviation of £355,000, which I consider to be unrealistic as described in paragraphs 4.65 and 4.66. Therefore, the Premia of £10 calculated by GT appear inconsistent with GT's own descriptions of the GOP Floor and GOP Hurdle.
>
> I consider that the standard deviation needs to exceed £500,000 for (1) the actual outcome to have a reasonable probability of occurring and (2) so that the GOP Hurdle and GOP Floor could be considered consistent with the qualitative description by GT for Britannia GSOP 1. Therefore, the Premia paid by the Britannia Participants would have needed to, at least, be in line with those calculated for a standard deviation of £500,000, i.e. significantly higher than those calculated by GT."

305. In relation to Jones Bros, Ms Mayr stated:

> "GT states that the probability of the GOP reaching the GOP Hurdle must be negligible to arrive at a zero Premium.143 It is visually apparent that it is not possible to (1) achieve a non-negligible probability for reaching the GOP Floor, (2) assign a negligible probability to the GOP Hurdle and (3) ascribe a reasonably high probability to the actual GOP.
>
> In fact, I arrive at probabilities in excess of 30% for the GOP to be at or above the GOP Hurdle across all assumptions for standard deviations, i.e. a level of probability that can clearly not be interpreted as negligible. GOP Floor, GOP as per Worst-Case Scenario and the actual GOP all have zero probability of being reached at lower levels of standard deviation.
>
> I consider this a structural deficiency in Jones Bros GSOP 1 as the GOP Hurdle is set too close to the forecast GOP. I therefore conclude that there is no set of assumptions for standard deviations that produces results which are consistent with the qualitative description by GT for Jones Bros GSOP 1. I arrive at similar results when using alternative assumptions for distributions.
>
> …
>
> Using three different distribution assumptions, I am not able to identify a standard deviation which (1) is consistent with GT's qualitative description of the respective GOP Hurdle and GOP Floor, and (2) ascribes a reasonable probability to the actual GOP. I consider this to be a structural issue in Jones Bros GSOP 1, i.e. the GOP Hurdle is set too close to the forecast GOP."

306. In her supplemental report Ms Mayr recalculated the figures based on additional information from Mr Bowes. In relation to Jones Bros, Ms Mayr confirmed thatshe was aware of Mr Ab Ifan's evidence that the figures were not accurate and clarified that if the evidence she had used for the basis of the analysis was incorrect then the analysis

was redundant. Ms Mayr also clarified that she had not looked at historical performance before the recession in analysing future profitability; Mr Bowes had referred to the fact that in 2007/2008 the company had done better than expected but Ms Mayr did not have sufficient knowledge of the business nor was it within her expertise to say whether those operating profits would be relevant or not, she simply relied on Mr Bowes. He set them out and referred back to the relevance of them and the fact that a prudent investor would look at them. Ms Mayr explained that she relied on Mr Bowes as he had the relevant expertise and had the benefit of information and discussions with Britannia that helped him form his opinion:

> "A. What I have done here needs to be put into the context of what I have done in my first report and what I am referring to in the footnote here as well. What I have done in my first report is I have attempted to do the same analysis we have just discussed in relation to 2009 operating profit, I estimate that value from the information in the disclosure that I had at the time. In the supplemental report I realised that the value I had was slightly off against the data in Mr Bowes' report so I replaced that. I have done the analysis against a, effectively, zero growth assumption against 2009. What I am doing here is I am saying "Well, Mr Bowes says that there should be growth against 2009 so what is the level of growth that I should be assuming?" I had no guidance from Mr Bowes on that so I am taking as an example the average of the three years.
>
> Q. Then at paragraph 4.10 you say that using a forecast of £10.78 million, and that is the average of those years isn't it?
>
> A. Yes, it is.
>
> Q. "I find the probabilities of being at or above the GOP Hurdle or GOP Cap are in the range of 90% to 100%." How could one say that there is a 100 per cent chance of a company making a particular profit in the future?
>
> A. One couldn't. This is an output of a mathematical analysis that produces the results based on the assumptions I have made.
>
> Q. So it would be quite wrong for HMRC to use that figure, for example, to say it was certain that the hurdle would be met?
>
> A. Under the assumptions that the relation of that figure – under the assumptions that were made to arrive at that figure their statement would be correct, but that caveat would need to be added to it."

307. However, Ms Mayr maintained her conclusions that the terms favoured the Britannia participants and were inconsistent with a CFD contract between independent parties entered into at arm's length. She did so on the basis that she had reached the same conclusion on all of her calculations, including those which were based on Britannia's own forecast:

> "It is difficult to understand what Mr Bowes' position is in terms of numbers. If Mr Bowes' evidence is now that it was only likely, then perhaps rather than use a forecast of, I believe it was, the average was three years at 10.87, perhaps a lower forecast would be more appropriate, such as the calculations, such as other calculations that I show in my report. If you want, the absolute minimum, the absolute worst case probabilities I have included analysis where I look at the forecast, where I set the forecast to be exactly the same as the actual result in 2009, that is contained within appendix 3 of my supplemental report. The results that I have there would be a floor to the probabilities of the different hurdles being reached. The reason I say that is because Mr Bowes, even on his updated evidence, says that it was likely that the forecast and the hurdle would be exceeded. Therefore, the results that I would present, that I present there are conservative against that."

308. In relation to Jones Bros, Ms Mayr updated the conclusions in her first report by adjusting for Mr Bowes' description of revenue recognition in relation to Porthmadog Bypass, namely:

> "A.-- I was using the information in the forecast that was available at the valuation date and what I'm doing is I'm taking the accounting adjustment and I am adding that to the forecast. The reason I believe that that is a reasonable thing to do is that the way Mr Bowes describes it in his report at least is that, as at the end of January there was a number of invoices that should have, and therefore profit, and therefore revenue that should have been included in the previous financial year that weren't yet issued and weren't yet issued at the valuation date as well, but that should have already been included. So that was work done, in his words, that was already completed. This information would have been available already at the valuation date, but what I do here is I add that to the full cost, though it doesn't include any information that would have not been available at the valuation date. It simply, it simply moves an invoiced revenue into the previous financial year, according to the accounting revenue recognition issue that Mr Bowes has identified."

309. Ms Mayr confirmed that her final conclusions were those contained in her supplementary report, with the qualification that, in the case of Jones Bros, if the factual evidence had changed regarding revenue recognition from the Porthmadog Bypass, then her conclusions were based on incorrect facts.

Submissions

Appellant's Contentions

310. Mr Prosser submitted that the principle in *Abbott and Philbin* had two elements; if by reason of employment an employee acquires an asset which could be turned to pecuniary account then:

> (a) income tax was charged on the value of the asset when it is acquired; and
>
> (b) income tax was not charged again on the later growth in value of the asset. In particular income tax was not charged when the asset was turned to account whether by being redeemed or sold or otherwise turned into money. The profit the employee made due to the growth in value of the asset was not charged to income tax but to capital gains tax.

311. The Appellants submitted that the GSOP arrangements were based on that principle because the idea behind the arrangements was that employees should acquire an asset which was recognised as a security within part 7 of ITEPA. At the time of acquisition of that asset the idea was that it should have little or no value but if, as was hoped, that value increased over time, that increase in value would be subject to capital gains tax, not income tax, in accordance with the principle in *Abbott v Philbin*.

312. Mr Prosser noted that *Abbott v Philbin* involved a share option but submitted that the principle is not restricted to share options (and was in fact reversed in that regard) but is of general application subject to statutory modifications. In relation to the application of *Abbott v Philbin,* Mr Prosser understood HMRC to suggest that the principle only applies to share options, which is simply not correct.

313. In relation to whether the payments were earnings, Mr Prosser submitted that that is the broad Ramsay argument which was rejected in *UBS*. Mr Prosser submitted that, following Lord Reed in *UBS*, viewing the facts realistically in this case the employees could not be regarded as having received cash; they actually received earnings in the form of contractual rights and, therefore, an asset which had a realisable value on day one, but that value on day one was uncertain. In other words, it was uncertain how much cash, if any, they would receive at the end of the day; *UBS* is not authority for the proposition that it must be treated as money from day one simply because it could be turned into money. Mr Prosser submitted that Lord Reed rejected the arguments that (in the *UBS* case) the shares could be disregarded or treated as money in the first instance, or that one can look to the money at the end on the basis that it involved a tax avoidance scheme.

314. The Appellants' primary case was that the GSOPs did fall within Part 7 because they were rights under contracts for differences. However, if the Tribunal were to decide, contrary to the Appellants' primary case, that the contractual rights which the employees acquired did not come within the definition of contracts for differences, that was not the end of the case and the Appellants submitted that *Abbott v Philbin* still applied to the rights, however they were categorised.

315. As to the issue of whether the rights were contracts for differences or similar, it was common ground that, if the rights were rights under contracts for differences or similar, then those rights were securities. It was also common ground that they would be employment related securities because the opportunity to acquire them was made available by reason of the employment. The Appellants submitted that the contracts did fall within s 420(1)(g) or, in the alternative s 420 (4) and that the evidence supported that.

316. In considering s420(4) it does not state "by reference only to" nor does it require a linear or proportionate basis. The Tribunal should consider whether there was something whose fluctuations in value is referred to in the securing of a profit. In relation to Jones Bros, Mr Prosser submitted that the answer is yes because the amount of profit which an employee could obtain did depend upon fluctuations in the value of the group operating profit, but there was something else that the profit depended upon as well and operated by reference to - the profit which the employee could make was also obtained by reference to fluctuations in the value of his portfolio.

317. Even if the group operating profit was considered only a condition, the level of that group operating profit was relevant to whether or not the employee made a profit and the amount of the profit which fed into the portfolio. Mr Prosser contended that the portfolio itself was a factor, by reference to which the amount of the profit was calculated and so it might be said that it was "so exotic" that it did not fall within the business or commercial meaning of a CFD but it could nevertheless fall within s420(4).

318. In relation to the downside, Mr Prosser submitted that there was no evidence to conclude that the downside was not genuine but a sham; although there were references in the Grant Thornton documentation about possible ways of protecting employees against the downside, the evidence from Mr Ab Ifan was that the discussion concerned

potential loans to employees in case they suffered cash flow problems by moving from a quarterly bonus arrangement to an annual one, or to assist if they had to pay the downside. There was no suggestion the loans would never be paid. In relation to Britannia, the document suggesting methods of protecting employees from the downside was not put to Mr Ferrari and therefore the Tribunal should not conclude that there was any arrangement or understanding in place that the employees would not actually suffer the downside.

319. In considering the purpose of the arrangements, the analysis of Leggatt J in *London Capital Group* supports the contention that in this context it was the employee's purpose and not the employer's which was relevant.

320. Mr Prosser noted that HMRC did not seriously argue that if the contracts were contracts for differences or similar, they were not restricted securities, save in respect of Mr Langsam. The employees' rights were subject to restrictions. For instance the Jones Bros contract included a disciplinary condition which was a restriction within s423. In both cases there were cessation of employment provisions, albeit they differed between the Appellants, but again the restrictions fell within s423. Mr Bowes' evidence was that the value of the rights was less as a result and HMRC accepted that the restrictions served a proper commercial purpose.

321. Whilst not formally abandoned, HMRC recognised that the s 447 argument lacked merit; s 447 charges tax where a benefit is received and receipt of something to which the employee was entitled was not a benefit. Chapter 10 of part 3 has no part to play as no cost was incurred in granting the rights to the employees.

322. Mr Prosser submitted that, although no longer an issue in respect of which HMRC sought resolution, the matter of how Mr Langsam is to be treated because he was a director and major shareholder in Britannia raises the question of whether Mr Langsam actually received the payment in his capacity as shareholder, although it is not Britannia's argument that he did. Mr Prosser submitted that the wide-ranging question to be asked is whether the payments came to him as a shareholder as well as a director. HMRC contended that he was appointed as a director only so that he could participate in these arrangements in point and that GSOP could not have been an incentive for him given that he was a major shareholder. If <u>a</u> reason (not necessarily <u>the</u> reason) of Mr Langsam entering into the contracts for differences was being a shareholder then it pointed towards a source of the money he received as being from his shareholding.

323. If the payment fell under s 1000 CTA 2010 as:

> "Any distribution out of assets of a company in respect of shares."

324. By virtue of s 1113(3):

> (3)For the purposes of this Part a thing is regarded as done in respect of a share if it is done to a person—
>
> (a)as the holder of the share, or
>
> (b)as the person who held the share at a particular time.

325. Mr Prosser clarified that the question for the Tribunal to decide, although it is not Britannia's case, was whether Mr Langsam received payment in his capacity as a shareholder. However, the Tribunal did not need to consider whether Mr Langsam did receive it as an employee/director or instead as a shareholder because s716A can apply to something which falls within both; the same payment could have two sources and be received in both capacities. However, if it was received by a shareholder, then s 716 gives priority to the distribution charge.

326. Mr Prosser submitted that both Mr Ab Ifan and Mr Ferrari were honest and direct in their evidence and candid, for instance in relation to the tax advantages they believed were available. Mr Prosser urged us to accept their evidence as reliable, submitting that there was no reason to believe that their recollections were at fault despite the passage of time. He invited us to find that the GSOP was, from the point of view of each company, a commercial tax efficient arrangement; commercial in that it was designed to incentivise the participants in different ways for each company, including Mr Langsam.

327. Mr Prosser submitted that there was no legal significance in the fact that the witnesses agreed that GSOP was a bonus scheme conditional on hurdles being hit. He drew the analogy with *UBS* in which the employees may have regarded the proceeds of redemption of their shares as their bonus but that was of no effect because the tax analysis in that case was that they received earnings in the form of valuable shares and it was that which was taxed, not on the case at the end. Furthermore, an employee bonus scheme is a commercial arrangement, and a tax efficient scheme is not inconsistent with the commerciality of the arrangements.

328. In relation to the profit forecasts, Mr Prosser submitted that the forecasts were genuine and arrived at by the companies after consideration of a range of relevant factors connected with their particular businesses. Forecasts, by their very nature, are not perfect. Although, in relation to Britannia, it is correct that Grant Thornton did not take account of the latest PWC report and no account was taken of the results for January to March 2010, it must be remembered that Mr Ferrari was not aware of the costs figures and it was therefore unclear whether his knowing the sales figures alone would assist in concluding whether the forecast was reliable or not. However, there was no reason to think that the forecast deliberately omitted significant information or was based on deliberately omitting significant information. Although six months of the relevant period had expired, it was not suggested that there was incentivisation to participants in that period but there was no reason to conclude that the remaining period was insufficient to incentivise and the evidence was that although the participants' jobs did not change, they did work harder.

329. Mr Prosser distinguished the issue of reliability; simply because the forecast was beaten was not a reason to conclude that it was not genuine. Similarly, as far as the hurdle was concerned in each case Mr Prosser submitted that it was also a genuinely arrived at figure. Mr Prosser interpreted HMRC's use of the phrase "such that it was highly likely to be hit" as meaning deliberately fixed with the aim of it actually being hit and the pay-outs being achieved. However, he submitted, there was no evidence of the hurdle being a pretence either on the part of Grant Thornton or the Appellants.

330. Mr Prosser submitted that in essence HMRC were alleging that there was a pretence by the Appellants and Grant Thornton of low value when there was in fact upfront value because it was certain that the hurdle would be hit. He submitted that the Tribunal would have to decide whether the GSOPs were, as the documents and witnesses reflected, a genuine incentivisation arrangement structured in a tax-efficient way and which was genuinely based on growth in future value by a stretching hurdle or whether the documents and witnesses were lying. Mr Prosser discounted a middle ground that the parties were genuinely trying to find something that was stretching and was not certain but that they got it wrong and it was certain on the basis that it was unrealistic.

331. Mr Prosser noted that the witnesses had agreed, and the documents demonstrated that the floor was inserted for a tax purpose in order for the contract to be a CFD. However, Mr Prosser submitted, it could not be ignored and there was no significance to attach to the downside being introduced for tax purposes. Furthermore, in relation to Jones Bros, Mr Ab Ifan explained that the floor served a genuine commercial purpose as well; it meant that the participants had some ‘skin in the game’.

332. Grant Thornton determined the floor at a figure which there was a real non-negligible chance of being hit. Both the Appellants’ witnesses insisted in their written statements and in their oral evidence that there was a real possibility that this would happen because of the uncertainties and any suggestion that the floor was fixed to a figure such that it was certain it would not be hit should be rejected.

333. Mr Prosser submitted that a contractual right to be considered for a discretionary bonus was a long way from a contractual bonus, and HMRC’s use of the term “contractual discretionary bonus” was confusing to Mr Ab Ifan who explained that there were Jones Bros employees who failed to qualify for a GSOP payment but who were given a discretionary bonus notwithstanding that there was no understanding that such a bonus would be paid. Mr Prosser added that even if employees were told that a discretionary bonus would be considered if there was no payment under the CFD, nothing turned on there being an extra layer nor does it indicate that the contract was not genuine.

334. With regard to Britannia, the feasibility report and Mr Ferrari’s evidence showed that GSOP made commercial sense in that any increase in profits above those forecast would increase the value of the hotels above their forecast value by a multiple of nine. HMRC were wrong to suggest that the introduction of GSOP had a negative effect, as Mr Ferrari explained the value of the hotels was to do with the profits of the hotels, not the overall profitability of the company; one did not take into account the costs of the pay-out provided that the pay-out does not exceed the increase in value (which it did not).

335. Mr Prosser submitted that the evidence of Mr Alpay should be preferred over that of Ms Mayr as to the meaning of a CFD on the basis that she had agreed in evidence that the typical criteria she had identified should not be regarded as amounting to a definition of a CFD and that the absence of nearly all of the criteria which she identified would not prevent a contract from being a CFD.

336. Mr Prosser invited us to accept Mr Alpay's opinion that the existence of various conditions, such as continued employment, were not inconsistent with a contract being a CFD but were no more than conditions precedent to the operation of the core part of the contract by underlying a reference asset. The fact that these contracts had features which were very different from a 'cookie cutter' CFD in a retail market revealed nothing about the scope of the definition of a CFD. Similarly, information from the Financial Conduct Authority should be read in the context of the particular market they were regulating which was the 'cookie cutter' market.

337. The Britannia contracts had a single underlying reference asset; the group operating profit. The Jones Bros contracts were more complicated and, Mr Prosser submitted, had two underlying reference assets; the profit and the outcome of a particular employee's portfolio. This did not, in Mr Alpay's view, prevent the contracts from being CFDs, and although he suggested that the underlying reference asset should be the fluctuation of the portfolio rather than the profit, he did not suggest that this was more than a drafting issue. Mr Alpay was clearly not interested in labels but rather what the contract actually did, what the outcomes were and by reference to what criteria. His evidence was that however exotic it might have been, it still had the fundamental features of a CFD.

338. Mr Prosser submitted that Ms Mayr had taken too narrow a view in her evidence that at least until 2018, a CFD had to be one to one linear, and the pay-out must be determined by reference only to a price, value or other factor. Although this might be seen in typical CFDs provided to retail customers, the contracts in this case were not such CFDs and there was no reason in principle why a disproportionate fluctuation should not be a CFD as it still maintained the core element of a CFD, namely a fluctuation by reference to the value of an index.

339. Mr Prosser submitted that Ms Mayr's evidence about valuations should be disregarded in its entirety. Firstly, she accepted she has no relevant expertise in the area of valuing businesses or forecasting future business profits, hence her reliance on Mr Bowes views. Ms Mayr's expertise in derivatives and her methodologies were not appropriate for use in this context. Secondly, Ms Mayr was very clear that the approach that she took was all to do with mathematical modelling; she took no account at all of the fundamentals such as the facts in the real world, the past performance, the state of the business or the state of the economy.

340. Ms Mayr's supplementary report relied on the views of Mr Bowes, both in relation to Jones Brothers and Britannia. So far as Jones Brothers was concerned, Mr Bowes made some important factual errors, including the point about the invoices, the value of the Porthmadog contract and the £1.5 million value in a later GSOP report which Mr Ab Ifan was adamant were all fundamentally wrong. As to the accuracy of Mr Bowes' evidence on the facts, Mr Prosser submitted he is not an expert in relation to the business, unlike Mr Ab Ifan whose evidence should be preferred. Ms Mayr, in her supplementary report, used the conclusions from those factual errors and accepted that where her conclusions were based on those factual errors, they were invalid. Mr Prosser submitted that Ms Mayr's evidence was unreliable because it was based upon the errors that Mr Bowes made.

341. Turning to Britannia, where again Ms Mayr relied on Mr Bowes' evidence, and in particular, his view that the forecast profit was pessimistic, and a buyer would devise his own forecast of profits based on the average of those of the last three years, Mr Bowes' amended view was that although it was likely that the hurdle would be overcome, it was not highly likely, thus demonstrating that there was no certainty that the hurdle would be overcome. Mr Bowes expressed no view about the floor which was not relevant to his valuation because obviously the floor was only relevant to whether there was a pay-out by the employee.

342. It would be wrong to rely on Ms Mayr's revised forecast - that averaging out of the last three years' profits, there was 95 to 100% probability of the hurdle in relation to Britannia being hit and a 0% chance of the profit going below the floor. HMRC clearly rely upon those percentages very heavily but they are mathematical models based on an averaging out of profits which failed to take account of the recession. HMRC accepted by implication the figures were not fit for purpose with the result that there is no longer any active suggestion on HMRC's part that it was certain that the hurdle would be hit or that the profits would not go below the floor which is fatal to their case.

HMRC's submissions

343. On behalf of HMRC Mr Brennan submitted that Grant Thornton produced a tax saving product and the Appellants purchased that product which was marketed to them. The Tribunal must look at what happened viewing the fact realistically and apply the statutory provisions purposively.

344. The best guide to events are the words and actions of the parties at the time. Although it is surprising that there has been no evidence from Grant Thornton, inferences as to the realistic position of the companies can be drawn from the documents.

345. Mr Brennan submitted that neither Mr Ferrari nor Mr Ab Ifan was detached, measured or thoughtful; both had a tendency to try to argue the point rather than provide facts to assist the tribunal and both were a little combative, most likely because they are financially interested in the outcome of this litigation. Furthermore, Mr Ab Ifan gave oral evidence which had not been raised before regarding the Portmadog bypass and revenue recognition with no evidence to support his assertions.

346. Mr Brennan submitted that the Tribunal should disregard the whole of the contractual pyramid, which was erected on counsel's advice to try to achieve income tax free status for these payments, as being effectively transparent. It was a case of "money in, money out, paid to employees". Economic activities which exist in the real world involve the remuneration of employees but also tax avoidance schemes which commonly include elements which have been inserted without any business or commercial purpose but are intended to have the effect of removing the transaction from the scope of the charge. In this appeal there are a number of features of the transactions which lack any business or commercial purpose. By way of example Mr Brennan highlighted the existence of the floor and element of risk that an employee

may have to make a payment to the employer. The documents show that the floor was included as an essential part of the design in order for the scheme to work. It did not have a business or commercial purpose other than making the scheme work and this is confirmed because the commercial purpose of the CFD was not to make a profit or avoid a loss by reference to movements in the underlying asset. This was accepted by both witnesses of fact who represent the point of view of both employer and employee.

347. On a realistic view of what happened the structures were simply a device to deliver money. The purported contracts for differences were simply there to give the appearance of being an arrangement within Part 7 which would drive out a money payment. The scheme was intended to operate by delivering a bonus and it should be considered as it was intended to operate without regard to the possibility that it might not work as planned. The floor was inserted because those designing the scheme knew that it required a non-negligible downside; it was there to provide some element of risk but one which the parties were willing to accept. It was an "anti-Ramsay" device in the interests of the scheme which simply enabled the payment of monies to be characterised as an upside win under a contract for differences. It was possible but not likely that the floor would be breached but the possibility is not enough to bring the arrangements within the exemption from tax. The point is strengthened by, in the case of Jones Bros, if the floor had been breached the bonus would have been paid in any event which is evidenced by the employees who failed to achieve the GSOP payment due to disciplinary or health and safety issues but who nevertheless received a bonus. That, Mr Brennan submitted, is an example of the scheme not working as planned but bonuses still being paid.

348. HMRC submitted that the contracts were not contracts for differences or similar. Ms Mayr derived five criterion for a CFD which, Mr Brennan submitted, should be adopted by the Tribunal as being underpinned by statue, regulation and commercial practice. Furthermore, the contracts lacked the essential character of exposure to movement in the underlying metric. They were also dissimilar to any contract for differences dealt with under the regulated statutory definition, dissimilar to exotics and would not be operated in the market.

349. In summary, the fundamental characteristics of a contract for differences were not met. The targets or the thresholds were designed not to be stretching, the companies wanted them to be met, but to allow the companies to argue that they were stretching so that they could maintain a position with HMRC should they come under scrutiny. The downside risk was limited to a predetermined amount set at a relatively low amount and managed such that the participant is effectively protected against suffering any financial loss. It was included because it was necessary if the arrangement was to qualify as a CFD but it was not inserted for a commercial reason. Moreover, the fact that it was envisaged at an early stage that the participant could be protected against loss is further evidence of the lack of commerciality. It was a step inserted into the transaction because it was thought to be necessary for the instrument to qualify as a CFD but it is uncommercial, deliberately set at a low level and it was envisaged that, if it were ever to happen, the individual could be protected from it. The proposal that the downside payment would align the interests of employees to risk and reward was no

more than “window dressing”; it did no such thing because the floor was set so low as not to effect employee behaviour.

350. The purpose of the schemes was misrepresented as incentivisation. The Jones Brothers’ incentive scheme was already there and had been running for years. So, incentivisation simply arose from the illegitimate proposition that employees were more incentivised by a tax-free bonus than by a bonus which is subject to income tax. That element of incentive is not something which legitimately attracts the description of incentivisation in the context of this case. For Britannia the element of incentivisation was also a misrepresentation. The relevant period was six months expired before they entered into the scheme. The Grant Thornton documents show it was decided that although it would be appropriate to take the next financial year, the company wanted to start in the year already commenced for “commercial reasons”. That commercial reason, Mr Brennan submitted, was simply to obtain the tax-free payment as soon as possible. The proposition that Mr Langsam was incentivised is particularly nonsensical as he is directly or indirectly the 100% owner of Britannia.

351. Despite his shift from ‘highly likely’ to ‘likely’, Mr Bowes still accepted that it was likely that the hurdle would be reached in relation to both companies; it wasn’t stretching a target at all and it wasn’t intended to be one. The intention was to aim for zero valuation. The generic GSOP structure is if the value of the underlying asset increases, the employee receives an amount linked to the increase in the value of the asset. That was not in fact implemented by Jones Brothers, which Mr Alpay realised during his evidence; he did not recognise it as the sort of CFD he had seen or would accept.

352. The Jones Bros GSOPs fail due to an implementation error because they implemented it with a single amount determined by application of another formula involving measurement of another metric, not related to movement in the underlying GOP index. The contract reference asset operating profit; the contract reference asset value was defined to be something else. This cannot be a CFD because it does not allow the individual to participate in movement of the underlying reference asset. All the underlying does is provide a conditional threshold which, if passed, allows the individual to participate in the value of another metric all together. It cannot be a CFD because the pay-out is not linked to movement in the underlying metric and it cannot be excused by bad drafting.

353. HMRC submitted that the evidence of Ms Mayr that the Britannia GSOPs did not qualify as contracts for differences should be accepted as again there was no direct one for one movement in the underlying metric.

354. Although Mr Ab Ifan had sought to undermine the report Mr Bowes, by saying that the operating profit figures used for the purpose of comparing GSOP 1 forecast against prior years was not the same operating profit metric used as the contract reference asset, Mr Brennan noted that this issue had never been raised before with Mr Bowes nor was any evidence provided in support, either by way of a statement from Mr Ab Ifan or figures. It was not put to Mr Bowes that his figures were incorrect; to the contrary Mr Bowes confirmed the accuracy of his report save for the amendments

made. The Appellants continued to rely on Mr Bowes and HMRC invited the Tribunal to accept the figures were accurate. Mr Brennan clarified that he maintained reliance on Mr Bowes' evidence that in respect of each Appellant it was likely that the hurdle would be reached.

355. Mr Brennan did not robustly disagree with the proposition that the restriction to continued employment has an effect on what would otherwise be unrestricted market value which could make it a restricted security. HMRC accepted the evidence of Mr Bowes save in the case of Mr Langsam in respect of whom HMRC submitted that any restriction was only inserted for the purpose of the making the security restricted because Mr Langsam was the owner of the company.

356. In relation to Britannia, the forecast was not based on any historic material. In correspondence dated 21 January 2010, Grant Thornton request information to complete the valuation report with a written explanation which will help to demonstrate that the hurdle is stretching and therefore difficult to achieve. It is clear that the concern is not to ensure that the hurdle is a stretching target and difficult to achieve but that they want evidence to present to HMRC that it is. The more optimistic forecast of PWC is not relied on by Grant Thornton in their valuation report. Furthermore, on 10 March 2010, the GSOP is based on operating profit for the 52-week period to 25 September 2010 but nearly half of this period had expired already making any suggestion of incentivisation for the first half of the period nonsensical. The intention of Grant Thornton was to determine if a nil value could be defended as opposed to determine the accuracy of the valuation.

357. HMRC noted that the GSOPs were entered into on 22 March 2010. By the end of the quarter ending March 2010 Britannia was already £664,000 ahead of forecast. HMRC submitted that on the date the GSOPs were entered Mr Ferrari had a good idea of what the sales numbers were and that it looked as if the results would be better than forecast however that information was not provided to Grant Thornton or used to determine the forecast.

Analysis and Decision

Contracts for differences

358. It is common ground that the correct approach to our determining the issues is to apply a purposive construction of the relevant provisions to the facts viewed realistically (per Lord Nicholls of Birkenhead in *Barclays* and the Supreme Court in *Rangers).*

359. We note that simply because the arrangements entered into were designed to achieve tax efficiency or for tax avoidance purposes does not of itself mean that the scheme must fail. However, we bear in mind the comments of Lord Reed in *UBS* (at [77]):

> "Approaching the matter initially at a general level, the fact that Chapter 2 was introduced partly for the purpose of forestalling tax avoidance schemes self-evidently makes it difficult to attribute to Parliament an intention that it should apply to schemes which were carefully crafted to fall within its scope, purely for the purpose of tax avoidance."

360. We do not accept Mr Prosser's submission that a finding of dishonesty is required if we conclude that the scheme fails for as Lord Steyn observed in *McGuckian* (p 1001):

> "…tax avoidance is the spur to executing genuine documents and entering into genuine arrangements."

361. There was no suggestion and no basis upon which we might find that the parties acted dishonestly; the parties entered into real contracts which had legal effects. In taking an unblinkered view of the facts applied to the relevant provisions purposively construed we are entitled to view the arrangements as what they are rather than what they purport to be, and we conclude that they do not, for the reasons we shall set out, meet the purpose of the relevant statutory provisions.

362. We do not derive any assistance from considering the issues in terms of the broad or narrow Ramsay approach. The question for us to determine is whether the relevant statutory provisions, construed purposively, are intended to apply to the arrangements viewed realistically and we begin by considering whether the legislation can be given a purposive interpretation beyond its literal meaning.

363. The principal issue in these appeals is whether the arrangements in point fall within Part 7 and whether the arrangements are securities as rights under contracts for differences or contracts similar to contracts for differences pursuant to s 420(1)(g) or s 420(4).

364. We consider that the legislation indicates that a contract for differences (or similar) is a commercial concept by the reference in s 420(4)(b) to profit and loss and must be construed as requiring a commercial or business purpose. It is also clear from *UBS* that the contracts must be considered in the real world. We take the view that the scope of the provisions does not extend to commercially irrelevant features, the only purpose of which is to bring the arrangements within the legislation to obtain the tax benefit.

365. The Appellants rely on the fact that there is no express requirement within the statutory provisions for the presence of the characteristics identified by Ms Mayr. However, we take the view that this is not the correct approach. Whilst we accept Mr Prosser's submission that the legislation extends beyond a "typical" contract for differences and it would not be appropriate to set out an exhaustive list of features required in order for a contract to constitute a contract for differences or similar, we take the view that the nature and terms of a contract must be considered and the absence or inclusion of certain features, whether typical or not, may inform a conclusion although is unlikely to be determinative. Our approach is to consider whether the contracts have the fundamental and sufficient features to bring them within the notion of contracts for differences.

366. We have therefore approach the issue on the basis that the term "contract for differences or similar" should bear a commercial meaning. For that reason we do not accept the criticism of Ms Mayr's evidence which considered whether the transactions could be considered arm's length, although we do not find this point determinative and we take into account the employer/employee relationships in these appeals which does not necessarily indicate a lack of commerciality. Similarly, we do not accept the criticism of Ms Mayr's evidence which considered the contracts for differences by reference to 'cookie cutter' contracts. In our view, whilst we accept that a contract for

differences could contain more 'exotic' features as described by Mr Alpay, the comparison is nevertheless a valid one as it demonstrates how contracts for differences frequently exist in real world transactions. Further, we take the view that Ms Mayr's reference to the commercial world and regulation therein is a relevant consideration.

367. Both Mr Alpay and Ms Mayr gave clear and detailed evidence. We conclude that the evidence of Ms Mayr provides us with more assistance than that of Mr Alpay in the context of the issues to be determined in this appeal. We find Mr Alpay's evidence to be general and broad, in contrast to that of Ms Mayr who reviewed the relevant contracts in detail and considered the concept of a contract for differences both generally but also specifically in the context of these appeals. We do not accept Mr Prosser's submission that Ms Mayr's qualifications do not give her the relevant expertise to opine on the various matters on which she gave evidence. We consider her to have considerable relevant expertise, and it was clear from her evidence that she had robustly tested her calculations so that the methodology adopted and conclusions to which she came cannot be said to be unsound.

368. We do not accept Mr Prosser's submission that the evidence of Mr ab Ifan as a witness of fact should be preferred to that of Mr Bowes as an expert on the basis that the new evidence given by Mr ab Ifan was factual. Mr Bowes confirmed the accuracy of the figures on which he relied, and we note that he had been provided with a number of documents pertaining to the finances of the company to assist in the preparation of his report. In those circumstances we have no reason to doubt the accuracy of the figures he used and in the absence of any evidence to support Mr ab Ifan's assertions, we are satisfied that Mr Bowes' overall conclusions should be preferred.

369. As stated earlier, we do not accept Mr Prosser's contention that reliance on Ms Mayr's evidence was abandoned by HMRC given the errors asserted by Mr ab Ifan in respect of the figures used by Mr Bowes and subsequently considered by Ms Mayr. Firstly, we note that the Appellants continued to rely on Mr Bowes and did not formally abandon reliance on his evidence. Secondly, we observe that Mr Bowes stood by the accuracy of his figures, which we accept for the reasons set out earlier in this Decision.

370. Mr Prosser submitted that the arrangements made by each of the Appellants fall within the definition of a contract for differences or similar in that they required each party to make a payment to the other depending on fluctuations in a price or index or other factor. We reject Mr Prosser's further submission that no more is required; that represents too literal an approach to the provisions and fails to consider whether there was a business or commercial purpose in the arrangements. It is clear that the overall effect of the scheme adopted is that which we must consider and, in doing so, we must consider the elements which comprised the composite transaction to establish whether the legislation was intended to apply to the arrangements.

371. In so considering, we are satisfied that *Scottish Provident* is in point. We set out below our conclusion on the facts with regard to the principles and we conclude that the contracts used by both Appellants are not contracts for differences or contracts similar to contracts for differences within the meanings of s 420(1)(g) and s420(4) respectively.

372. We then consider the five criteria set out by Ms Mayr as constituting the characteristics of a contract for differences. As stated above, we accept (as did Ms

Mayr) that the absence or inclusion of each criterion is not determinative of the issue; a contract can be a contract for differences with any or none of those criteria. However, we found the evidence helpful in providing guidance in considering what constitutes a contract for differences, giving it an ordinary meaning in the context of real-world transactions.

373. The first criterion Ms Mayr considered, taking into account the statutory definitions in s 420(4) ITEPA, s 582 and 583(4) CTA 2009 and s22(1) FSMA 2000, was whether the payoff profile was to be determined by reference to fluctuations in the underlying reference metric only. We consider Mr Prosser's submission that the legislation does not expressly state that a payoff must be determined only by reference to such fluctuations nor does it require a linear or proportionate basis represents too literal an approach and we do not accept it. The converse of that argument is that the legislation does not state that the purpose is to secure a profit or make a loss by reference to fluctuations in the underlying asset value and other extraneous factors. In our view the wording of the statute is clear; the payoff must relate to the fluctuations and, by implication, nothing else, and a calculation based on wholly separate contingencies would not fall within the scope of a contract similar to a contract for differences. We therefore accept the evidence of Ms Mayr in this regard.

374. In relation to both Appellants the payments were not directly contingent on such fluctuations. For example, in relation to Jones Bros, Grant Thornton confirmed that the calculation:

> "is not a graded payment (i.e. not payments which increase as the chosen index increases)"

375. The structure of the Jones Bros arrangements was such that the payment was dependent on, amongst other factors, payments made in previous years and payment was not guaranteed even if the hurdle was met. A Service Agreement for one employee dated 19 May 2010 confirms that the employee was entitled to be considered for an annual discretionary bonus calculated:

> "…from the net financial contribution from the construction and maintenance contracts for which the employee is deemed responsible after taking account of outstanding retention monies, any additional costs and full overhead recovery. The percentage-rate applied would be 3%..."

376. As Ms Mayr noted, the GSOP letters to participants contain statements of net contribution which include the calculations of the payments due to each participant under the GSOP which are calculated in a similar manner to the bonus payments in that they are based on the cumulative performance of the net financial contribution from the contracts for which employee is responsible such that:

(1) The performance includes net financial contribution from projects taken in historical periods; and

(2) The performance accounts for any historical bonus payments paid under the past GSOP or discretionary bonus schemes.

377. A payment for current performance could also be made in a future GSOP year even if the hurdle were not met.

378. It is clear that the upside payment was not necessarily related to the operating profit but instead followed the structure of the previous bonus scheme, as confirmed in the Grant Thornton Feasibility Report of 24 December 2010 and Valuation Report dated 31 January 2011:

> "Potential payments due under the GSOP are determined by reference to the current bonus calculation"
>
> "It is difficult to estimate the payments that could be made if the Hurdle is achieved, as the payment formulae depend on a number of factors. Bonuses in previous years, which were calculated in accordance with similar formulae, have seen total payments of between around £500,000 and £725,000 across 40 – 50 participants."

379. The GSOP payments to Jones Bros participants were not linearly dependent on the GOP and the participants were required to pay a fixed downside payment that was not a function of the GOP. Furthermore – a matter we consider fatal to the arrangements implemented by Jones Bros - the contract reference asset was the adjusted operating profit. However, the payment is in fact linked to the contract reference value asset which is calculated by a different formula involving another metric which is not related to movement in the underlying GOP index. Mr Alpay agreed that he would not regard a contract under which the amount paid is determined by a wholly different formula that does not relate to the contract reference asset as a contract for differences within the ordinary business meaning, adding that such a product could not be sold in the regulated contract for differences environment. Although Mr Prosser sought to persuade us that this could be excused as a drafting error, the fact remains that the arrangements cannot, as implemented, be characterised as contracts for differences and we do not accept that this can be remedied by an explanation of poor drafting.

380. The structure of the Britannia GSOPs was such that:

(1) If the GOP (in the 52-week reference period) exceeded the GOP hurdle, payments were made to participants on a sliding scale up to a maximum payout (the cap) as set out in the Confirmation Agreements;

(2) If the GOP fell below the floor payments were made by participants on a sliding scale up to a maximum payment set out in the Confirmation Agreements; and

(3) If the GOP fell between the hurdle and the floor no payments were made.

381. The payments were therefore not directly contingent on fluctuations in the underlying metric but were contingent on the underlying metric reaching certain trigger levels.

382. In relation to Britannia and Jones Bros, we conclude that the absence of direct one for one movement in the underlying metric is not consistent with a contract for differences. In reaching this conclusion we have regard to the FCA and ESMA definitions which Ms Mayr agreed were reasonable commercial definitions, and which provided further explanations as to the commercial purpose and characteristics of contracts for differences and which we find to be relevant in informing our approach. The FCA describes contracts for differences as instruments whose value moves 'one-for-one' with the change in price of the underlying asset, and which allow investors to gain indirect exposure to the price movements in an underlying index. The definition provided by ESMA explains:

> "A CFD is an agreement between a 'buyer' and a 'seller' to exchange the difference between the current price of an underlying asset (shares, currencies, commodities, indices, etc.) and its price when the contract is closed. CFDs are leveraged products. They offer exposure to the markets while requiring you to only put down a small margin ('deposit') of the total value of the trade. They allow investors to take advantage of prices moving up (by taking 'long positions') or prices moving down (by taking 'short positions') on underlying assets. When the contract is closed you will receive or pay the difference between the closing value and the opening value of the CFD and/or the underlying asset(s). If the difference is positive, the CFD provider pays you. If the difference is negative, you must pay the CFD provider…CFDs are cash-settled derivative contracts and unlike some other products, such as options, typically do not have a predetermined expiry."

383. We conclude that, whilst features such as a predetermined expiry are couched in terms of "typically" and therefore may not be a fundamental characteristic which determines the nature of an instrument as a contract for differences, the crucial feature is exposure to the underlying asset or metric and the profit or loss must be determined by reference to fluctuations in the asset. In our view, the contracts used by both Appellants lack this fundamental feature such that they do not fall within the scope of the legislation.

384. We consider that Mr Alpay's reliance on spread bets in sporting events, and payments of options such as binary options to support his view that contracts for differences can have asymmetrical payments and the amounts payable do not have to be proportionate do not assist. The arrangements in these appeals were not binary and we note that sporting spread bets such as those referred to by Mr Alpay have recently been excluded from the scope of CFDs. We consider that Mr Alpay's opinion took too broad a view and we prefer Ms Mayr's evidence which clarified:

> "I do not consider that spread bets on sporting events are relevant. Further, a transaction between two parties acting in their own interests at arm's length would indeed require the Premia payable to be proportionate to the risk (i.e. probability-weighted). I note that GT shares this view as clearly stated in its valuation reports.
>
> Mr Alpay quotes the FCA handbook for evidence that the FCA includes spread bets within the definition of CFDs…
>
> I agree that spread bets are classified as CFDs by the FCA. However, not all types of spread bets are included, as explained in the following paragraphs.
>
> The Gaming Act 1968 contains the definition of gaming in section 52(1). The act further specifies that:
> *" "game of chance"* ***does not include*** *any athletic game or sport(…)"*
> *" "gaming"* ***does not include*** *the making of bets by way of pool betting.*
>
> Accordingly, I do not consider Mr Alpay's references to non-financial spread bets, such as spread bets on the outcome of football games, nor the conclusions that he draws from such references, to be relevant.
>
> In contrast, the FCA reports, which I quote in my First Report, explicitly include spread bets *"that qualify as MiFID financial instruments"* in the definition of CFDs. Therefore, the conclusions reached in my First Report are equally valid for financial spread bets.
>
> Similarly, Mr Alpay presents the asymmetric payments of an option to contend that CFDs can have asymmetric payments:

"CFDs can also have non symmetrical payoffs. In particular, an option like payoff would have an asymmetrical positive payoff to one side and a negative to the other."

Specifically, Mr Alpay refers to binary options in the example he presents in his report and does not clarify whether he considers non-binary options to be classified as CFDs.

In my First Report, I note that the provision of CFDs is specified as a regulated activity under FSMA 2000. On 28 March 2017, an amendment to Article 85 of the FSMA 2000 Regulated Activities Order was made to include binary options within the definition of CFDs. This amendment came into force on 3 January 2018…

A binary option has a fixed payment if the underlying reference asset's price or value exceeds a predetermined strike level. It therefore does not fluctuate with the underlying asset's price or value once the trigger level has been reached.

The FCA provides further guidance on the types of binary options that it considers to be CFDs:
"A product is binary… only if the payout is all or nothing. That is, the overall result will be that one party will pay the other a fixed sum. It is a sort of fixed odds bet."

"The main example of a binary product is a binary or digital option."

"A simple binary sporting bet is not a contract for differences as:
(a) it is not covered by MiFID and so it does not meet the condition in PERG 2.6.24AG(1)(d); and
(b) it does not come under any other part of the definition of a contract for differences."

Therefore, binary options are included in the definition of a CFD only from January 2018 onwards; i.e. after the GSOPs of Britannia and Jones Bros were active. In any case, I do not consider that binary options are relevant in this matter as the payments under the GSOP schemes were not binary in nature…

However, the determination of whether or not a contract is a CFD should not be based on the name under which a product is offered in the market, but rather on whether its features meet the required legal or regulatory definitions. For example, the FSMA 2000 Regulated Activities Order defines non-binary options as a separate investment type to CFDs and CTA 2009 explicitly excludes options from the definition of CFDs.33 Similarly, ESMA distinguishes CFDs from options in its description of CFDs quoted in my First Report.

As noted in paragraph 3.17, it is unclear to me whether Mr Alpay considers nonbinary options to be CFDs.

In any case, the structures underlying the GSOPs offered by Britannia and Jones Bros do not correspond to typical exchange traded options. As shown in my First Report, the payment structures under the GSOPs are significantly more complex and, in the case of Jones Bros GSOP 1, payments to Jones Bros Participants were not based on the GOP but calculated based on a separate mechanism."

385. The legislation makes clear that contracts for differences or similar rely on fluctuations in the underlying asset's price or value. In our view, the reference to fluctuation requires a variation or movement and the concept of a contract for differences requires speculation on that movement which the payment then relies upon. As we will set out in due course, the GSOPs in these appeals do not contain the necessary element of speculation nor were the payments determined by the differences.

The payments in both rely on meeting certain triggers levels and in the case of Jones Bros the upside payments rely on a wholly different formula unrelated to the underlying reference asset and the downside payment was fixed.

386. In our view Mr Alpay's opinion as to what constitutes a CFD is too far-reaching. Whilst Mr Prosser sought to persuade us that Mr Alpay was not interested in labels, but rather the how an instrument worked, we find that Ms Mayr summed up the difference in opinions succinctly as follows: (emphasis added)

> "And that is a very common thing to happen, that you take the basic, the vanilla products and you add complex features to it. <u>To my mind the big question here is, at which point does it, does the nature of the product change. How much optionality, how many features can I add to a straightforward CFD for it to, not to be a CFD, but an option or a structure product, which you have referred to earlier.</u> And, to my mind, the inclusion of optionality makes it not a CFD and with the exception of the binary example that we have described…
>
> What typically happens in the market is that <u>the name of the product is continued to be used, so people may still be referring to it as a contract for differences, but they have added additional features that contain, so it might be a contract that as well as containing an apostrophe, so a vanilla CFD might also contain an option, the working language would be like you still refer to it as a CFD, but that's a distinction that I'm trying to make in my report is that the name of the product and the label under which it is sold is not, is not relevant to the nature of the product. One needs to look at those definitions to understand what is actually behind it, look at the contract.</u> That then tells us whether the product that is called the CFD in, into investment banks is still a CFD or whether it's something else."

387. We consider that Mr Alpay's evidence that a contract for differences, which includes exotic binary products and spread bets, includes instruments that go far beyond the fundamental characteristics of a contract for differences. The features he considered could still fall within the scope of the definition, in our view, are such as to change the nature of the instrument:

> "Q. The value of the underlying asset is simply a threshold over which, or going in the other direction below which, the figure must fall which is simply a condition precedent to payment being made under the contract ---
>
> A. Binary options work just like that, so for ---
>
> Q. This isn't a binary option contract is it?
>
> A. Well binary options I see is these, and binary therefore – therefore I would regard this kind of payment as a sum of multiple little binary options if you will, so – for example, if I were to pay you £100 if the FTSE was going to end up above 7200 that would be a CFD despite the fact that ... You could call that a condition precedent for me to pay you that £100 the FTSE going above 7200 because once they are both there you don't get more, so it's not like a straight line, as my fellow expert witness, Ms Mayr has reported. It is just like, if you will, a step function. It goes up to 100 and remains there as long as it doesn't go down by its maturity, so whether you call that a condition precedent or not, that is ... I mean, both regulatory and commercially that is a CFD.
> The way I see it in these contracts is – so imagine I sold you this, like the FTSE – I will pay you £100 when the FTSE ends up above 7200 or whatever and I ask you to sell me another contract that you will pay me, for example, £20, not £100 but £20 if the FTSE falls below 7100. These two are individually CFDs because they are binary options and

> the combination of them has to be a CFD as well in my opinion. It is more creative, for sure, than the simple plain vanilla binary bet but the combination has to be the same. That is how I treat it."

388. We then consider each of the remaining criteria which Ms Mayr had developed. In relation to margin, both Mr Alpay and Ms Mayr agreed that margin is typically required to counter risk to the seller. Although the absence of margin may be atypical, in the context of the relationship of employer/employee we do not find its absence determinative. However, we do note that the Confirmation Agreements include provision for margin but there is no evidence that it was ever paid and we query why the provision was made yet ignored. This indicates to us that the focus on the contracts was form rather than substance; the inclusion of margin provision was clearly considered to be relevant to ensure that the contracts would meet the criteria for contracts for difference, but we are satisfied that there was no intention of the employees being required to make the payments.

389. The Britannia GSOPs were not transferable, which Ms Mayr explained is consistent with a CFD. However, we do not find the fact that the Jones Bros GSOPs were transferable to a spouse or civil partner, prevented them from being contracts for differences in circumstances where commercial safety (such as that which would exist in a retail context) was not a relevant consideration.

390. We do not find the issue of fixed maturity points against the contracts being contracts for differences; both Mr Alpay and Ms Mayr agreed that CFDs could have a fixed maturity. Similarly, we find the issue of participants taking long or short positions irrelevant to whether the contracts were contracts for differences.

391. In relation to other contingent matters, namely "good leaver" provisions and disciplinary events, Mr Alpay considered that CFDs might include such provisions although he did not consider that they were ordinarily found in CFDs:

> "A "Good Leaver" and "Disciplinary Event" are not ordinary parts of a CFD. I have not seen any such terms related to a CFD contract. However, as explained in paragraph 54, CFD providers ordinarily communicate conditions where a contract could be terminated. I can envisage that the salaries of employees could be regarded as cross collateral that the provider can withhold and if that was the case then it would be prudent risk management to not offer a particular CFD to a non-employee or non-Good Leaver with the same terms. Another potential reason to use these terms could be compliance related: exclusions in Article 15 of the Regulated Activities Order provides a safe harbour for dealing in investments as principal. If this exclusion were to apply initially and then cease to apply if an employee ceases to be an employee or Good Leaver, then it would become a major compliance issue for the firm and for proper compliance management it could be envisaged such a clause is placed. Similarly, if a Disciplinary Event triggered an employee to become a non-employee, then this analysis would also apply. For the avoidance of doubt, I am not asked to opine on whether these specific matters are applicable here and therefore I do not opine in relation to the particular case at hand, but only if a CFD could commercially and conceivably have provisions to this effect.

392. Whilst it may be that in certain circumstances such provisions are included within a contract for differences, we do not find that circumstances, such as using salaries as cross-collateral, are relevant to these appeals and we find the provisions do not point towards the GSOPs being contract for differences. Neither Appellant's Master Agreements allowed for employee salaries to be used as collateral, and we note that

during the relevant period Mr Langsam's tax return did not show that he had received a salary. In those circumstances, we conclude that whilst a contract for differences may contain such provisions, the reasons for doing so as counter-risk features, do not apply in these appeals.

393. Both parties' experts agreed that the provision of no payment would be in conflict with a commercial CFD if the provision was probable. As Mr Alpay stated:

> "To the extent the probability of this provision being triggered was reasonably expected to occur when entering into the contract, this would conflict with the ordinary commercial nature of a CFD."

394. Ms Mayr noted that although the documents she reviewed did not explicitly provide a probability of the no payment provision being triggered, the provision was triggered in at least one of the cases for Jones Bros GSOPs and, further, the board of directors of both Appellant companies could trigger this provision at their absolute discretion.

395. In considering whether the contracts fall within the scope of s420(4)(b), namely whether their purpose or pretended purpose is to secure a profit or avoid a loss by reference to fluctuations in the value or price of property or an index or other factor designated in the contract, we interpret the provision in accordance with the general principle that the purpose of the contract must be ascertained objectively by construing its terms in its factual setting (per Leggatt J in *London Capital Group v Financial Ombudsman* [2013] EWHC 2425).

396. In so doing, we reject Mr Prosser's submission that we should only take account of the employees' purposes and not those of the Appellants; although the focus in the *London Capital* case was on customer as the case involved consumer protection, Leggatt J nevertheless expressly referred to ascertaining the purpose and intention of "the parties". Although, as Mr Prosser highlighted, Part 7 focuses on taxing the employee, we take the view that consideration of s420(4)(b) is in the context of whether a contract is similar to a contract for differences and this can only be properly established by having regard to the contract as a whole, including the factual setting, its terms and the purpose and intentions of the parties to it. We consider that following the approach urged by Mr Prosser of confining our assessment to the employees would be too narrow an approach in considering the commerciality and nature of the arrangements and whether they answer to the relevant statutory provisions.

397. For the reasons set out below, we find that the GSOPs were not similar to contracts for differences as the predominant purpose was to pay money to the employees which would otherwise have been paid as cash bonuses. The purpose was therefore not to secure a profit by reference to fluctuations in the value or price of property or an index or other factor.

398. We further find, and indeed it was accepted by Mr Ferrari and Mr ab Ifan on behalf of the Appellants, that their respective purposes in entering into the contracts was not to secure a profit from the employee nor was it to avoid a loss. We also consider the purpose objectively from the employees' perspective. We do not accept, as submitted by Mr Prosser, that the purpose was to make a profit by surmounting the hurdle and obtaining a profit in the form of the tax saving. In our judgment, profit in

this context cannot be read so as to include money that otherwise properly represents the charge to tax. We also find that it was not the parties' intention to make a profit by speculating on fluctuations in an underlying metric. It was plain from the marketing, design and implementation of the arrangements that the predominant purpose of the parties was to obtain the tax benefit.

399. We do not accept that the arrangements were designed to incentivise employees. When viewed in the context of the documentation which clearly marketed the arrangements as a means by which to pay employee bonuses and the purpose of the arrangements it was plain that the Appellants' intention was to avoid the tax on such bonuses. In our judgment, the Appellants' assertion that the driver to implementing the arrangements was to incentivise the employees was implausible and not borne out by the evidence.

400. In relation to Britannia, we find it wholly implausible that Mr Langsam, whose interests were already aligned with the company as shareholder (holding 49.9% of shares directly and the remainder through a trust of which he is the beneficiary) could have been incentivised by the scheme. Mr Langsam's interests were already aligned with that of the company. We also find the evidence of Mr Ferrari that he believed the GSOP had made Mr Langsam work harder was vague and unconvincing. We do not accept the Appellant's submission that he may have been included in the arrangements as a more tax efficient way for him to receive an award as a shareholder. We are wholly satisfied from the documentary evidence that Mr Langsam was included in the arrangements in order solely to receive a payment as an employee, hence his being made a director at the time the arrangements were implemented, and with the intention of his receiving the award substantially tax free. Moreover, the leaver provision in respect of Mr Langsam was, in our view, redundant. As Mr Ferrari accepted, Mr Langsam's interests were already aligned with the company in his role as shareholder and there was no realistic possibility that the leaver provision had any commercial purpose.

401. Nor do we accept that Mr Ferrari or Ms Downey were incentivised by the arrangements; again, we found Mr Ferrari's evidence vague and unpersuasive, accepting as he did that his job did not change. Moreover, the fact that a six-month period had already expired at the time the arrangements were implemented leads us to conclude that there was no real incentive to the directors arising from the GSOP. We do not accept the submission that we should, effectively, only look at the period after implementation as being the period in which the participants were incentivised. In our judgment, the arrangements must be looked at in totality, and we find it implausible that there could in reality be any incentive other than a tax free bonus.

402. We do not accept Mr Ferrari's assertion that the sole aim and objective of the arrangements was commercial, namely to produce an increase in capital value of the hotel assets. The main reason advanced for increasing the value of the business was one-off events such as a volcanic eruption and consequential ash clouds. We much prefer Ms Mayr's evidence, which we found more considered and tested against the evidence, and took the following form, that:

> "If an analyst considered that an increase in GOP was due to one-off events, as is implied…, or that an on-going incentive scheme would be needed to incentivise performance, the analyst would not consider that Britannia's assets (and therefore the value of the company) had increased."

403. We find that there was no commercial objective in the Appellants' arrangements save for the tax saving element; as Ms Mayr stated (and we find) the GSOPs had a net negative effect on the company's operating profits.

404. In relation to Jones Bros, we do not accept Mr ab Ifan's assertion that the main driver for participating in the arrangements was incentive and retention of staff, and we so find. The floor was set so low as to not, in our judgment, have any impact on employees' behaviour. Furthermore, we find from the documents that consideration was given to ensuring the employees were protected from risk, for instance by the use of loans, in the unlikely event of either a downside payment or a cash flow issue arising from the move from quarterly bonuses to annual GSOP payments. Moreover, Mr ab Ifan's contention that that employees had "skin in the game" and were incentivised by the move from quarterly to annual payments was contradicted by the Appellant simply swapping back to quarterly bonuses after the GSOP arrangements ceased.

405. We also noted Mr ab Ifan's evidence that the employees who were invited to participate were more "financially aware" and we inferred from this, and find, that these employees were chosen because they understood the nature and purpose of the arrangements.

406. Although we make no comment on the quantum of valuation figures, we consider that the evidence of Ms Mayr indicated that the premia (£10 paid by participants of both Appellants' arrangements) should have been higher accords with a realistic valuation of the GSOPs; a proposition which appeared supported by the evidence of Mr Bowes. We find this indicative of the lack of commerciality in the terms of the arrangements.

407. In our view, the arrangements were designed to have the characteristics of contracts for differences or similar by the inclusion of the floor, the hurdle and reference to an underlying index. However, we conclude that these elements were carefully crafted to operate as a composite transaction with the intention that the hurdle chosen would be reached and employees would receive a bonus. Given the likelihood of the hurdle being exceeded we find that the purpose was not to make a profit or avoid a loss by speculating on fluctuations.

408. We accept the evidence of Ms Mayr that in both appeals it was highly likely that the hurdle would be met, and that there was a negligible chance that the floor would be hit. We consider the evidence of Mr Bowes, which we found less than persuasive on the basis that his belated change in stance from it being highly likely that the hurdles would be reached to it only being likely appeared to arise from simply accepting what he was told by representatives of the Appellant companies without question or evidence in support. However, on either view we find that there was sufficient evidence for us to conclude that the design of the arrangements was such that in all likelihood the hurdle would be reached. We were not convinced that our conclusion required a finding based on precise percentages of likelihood and we do not accept Mr Prosser's submission that Ms Mayr's evidence should be disregarded on the basis that it included mathematical

calculations in that regard. They only formed part of her overall conclusion that it was highly likely in each case that the hurdle would be reached.

409. In relation to Jones Bros, we find that any fluctuation in operating profit was theoretical to the operation of the GSOP given the likelihood of the hurdle being reached. In our judgment, the scheme was intended to operate such that the hurdle would be exceeded and payment would be generated. We do not accept Mr Prosser's assertion that the risk of not meeting the hurdle was very real, preferring the evidence of Ms Mayr in this regard. We accept that despite a robust analysis using three different distribution assumptions Ms Mayr was unable to identify parameters consistent with the hurdle and floor or which ascribed a reasonable probability to the actual GOP. We also find that the figures used by the Appellant to support the assertion that the hurdle was stretching were unreliable given the inclusion of contracts with the biggest losses.

410. We reject Britannia's claim that there was a "distinct likelihood" that the figure of £8.6 million would not be reached. We find Britannia's failure to take into consideration in its forecast the information available as to the GOP outturn indicated a lack of commerciality in the arrangements. The actual GOP was £720,000 in excess of the forecast for the quarter ending March 2010 and we accept Ms Mayr's evidence that if actual figures had been used the forecast would have been far higher. We are satisfied that the figures were available (even if not the precise figures) and could have been used yet were ignored by the Appellant and Grant Thornton despite the effect this would have had on the valuation of the GSOP and the premium paid. We also accept Ms Mayr's analysis that it was highly likely that the hurdle would be reached and extremely unlikely that the floor would be hit.

411. In taking a realistic view of the facts we remind ourselves of the comments in *Scottish Provident* (at [20] – [22]):

> "The Commissioners adopted (at para 24) the analogy of horserace betting:
>
> > "If the chance of the price movement occurring was similar to an outsider winning a horse race we consider that this, while it is small, is not so small that there is no reasonable or practical likelihood of its occurring; outsiders do sometimes win horse races."
>
> Mr. Aaronson said that a test of "no practical likelihood" derived from the speech of Lord Oliver of Aylmerton in *Craven v. White* [1989] AC 398, at p 514 and assented to by Lords Keith of Kinkel and Jauncey of Tullichettle. In that case, however, important parts of what was claimed by the Revenue to be a single composite scheme did not exist at the relevant date….
>
> Here, the uncertainty arises from the fact that the parties have carefully chosen to fix the strike price for the SPI option at a level which gives rise to an outside chance that the option will not be exercised…It is true that it created a real commercial risk, but the odds were favourable enough to make it a risk which the parties were willing to accept in the interests of the scheme."

412. As we set out earlier in this decision, the documents plainly demonstrate that the advice and design of the arrangements were focused on bringing them within the meaning of a contract for differences by including a stretching hurdle and non-negligible floor. Although the inclusion of the floor as a risk was real, the question is not how 'real' the feature is but rather whether it was inserted for a commercial purpose

and whether it was a risk that the parties were willing to accept in the interests of the scheme.

413. Both Mr Ferrari and Mr ab Ifan accepted that the downside in their respective GSOPs was included to meet the requirements of the legislation. Whilst this may satisfy the legislation in literal terms, we consider that to be insufficient. The issue is whether on a purposive construction the arrangements were ones to which the provisions were intended to apply. It is clear that the downside had no commercial purpose other than to bring the arrangements within the provisions. Taking an unblinkered view, there was simply no practical likelihood of the floor being hit. We accept HMRC's submission that the inclusion of the downside was no more than "window dressing" included as it was believed to be integral to the success of the arrangements from a tax perspective.

414. On the basis of *Scottish Provident* although the contracts could have produced a downside payment, this was highly unlikely. Noting the comments of Lord Nicholls at [22] & [23] we conclude that although the risk of the downside was a real one, it was an acceptable contingency such that it provided the arrangements with a sufficient degree of uncertainty to purport to be a contract for differences. However, the floor was a commercially irrelevant contingent specifically built into the arrangements for the sole purpose of achieving the tax benefit, and one that the parties were willing to accept in the interests of the scheme. Furthermore, if the adverse outcome did occur, we are satisfied from the documentary evidence in both cases that the marketing and design of the arrangements were such that consideration had been given to mitigate any risk to the employees, for instance by way of loans.

415. In relation to the Jones Bros arrangements we reject the notion that key components of a GSOP award were health and safety matters and behavioural standards. Mr ab Ifan told us that payments had been refused to three employees in GSOP1 on these grounds, however two of those employees were in the event given a discretionary bonus. We find that the GSOP had no additional impact beyond the discretionary bonus scheme previously in place, that the bonus scheme was replaced with the same payment calculations under the GSOP arrangements and any amounts paid under GSOP were taken into account in determining the level of any discretionary bonus awarded.

416. The contracts were designed to appear as fulfilling the requirements of a contract for differences, namely reliance on an underlying reference asset and the inclusion of the upside and downside payments as risks. However the outcome did not depend on movements in an underlying index in the sense we consider the legislation envisaged and parties did not enter into the contracts with a view to speculating, either by making a profit or avoiding a loss, by reference to fluctuations in an underlying metric. The arrangements and their commercial effects were designed solely against a background of the intent that the hurdle would be reached and the contracts would operate to pay cash in the amounts determined by the Appellants.

Conclusion on whether the arrangements gave rise to a "contract for differences or a contract similar to a contract for differences" within s 420(1)(g) and (4) ITEPA and therefore a "security" and an "employment related security" for the purposes of Part 7 ITEPA

417. We conclude that in both cases the arrangements lacked the essential character of exposure to movement in the underlying metric and the contracts were inconsistent with the fundamental concept of a contract for differences. The underlying reference asset reaching the hurdle in each case was a condition precedent to payment, but the amount of payment was not dependent on the level the asset reached. We are satisfied that it was not the purpose of the parties to secure a profit or avoid a loss by reference to fluctuations in the value or price of an index or other factor designated in the contract. We conclude that on an unblinkered view of the facts, it cannot be said that the parties were, in any real commercial sense, speculating on fluctuations in circumstances where it was highly likely that the hurdles would be reached. The downsides had no commercial or business purpose and were included solely to achieve the tax benefit. The arrangements were, in our judgment, preordained in that there was no realistic possibility that the payments would not be made. Reaching the hurdle cannot be said to be an 'upside win' as the relevant provisions envisage. We hold that, viewed realistically, the arrangements cannot be characterised as contracts for differences or similar.

418. We are also satisfied that the arrangements of Jones Bros failed on implementation; the pay-outs were determined by a formula which did not relate to the contract reference asset.

Whether the arrangements gave rise to a "restricted security" or "a restricted interest in securities" for the purposes of Part 7 Chapter 2 ITEPA;

419. Following the evidence of Mr Bowes, HMRC accepted that if the arrangements were contracts for differences, they gave rise to a restricted security. We accept the evidence of Mr Bowes in this regard and we are satisfied that if we are wrong in our conclusion that the arrangements were not contracts for differences, then the relevant conditions had a commercial or business purpose such that s 423 would apply.

420. However, we conclude that this was not the case in respect of Mr Langsam. It was clear from the evidence that the conditions which could bring the securities within s 423 simply had no relevance to Mr Langsam and had no business or commercial purpose such that s 423 does not apply to facts in relation to him.

The earnings issue

421. Payments are taxable as employment income under s6 if they are "*earnings from an employment* in a tax year". S 10(2)) defines "earnings" as: "(a) any salary, wages or fee, (b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or (c) anything else that constitutes an emolument of the employment" (s 62(2)).

422. The Court of Appeal in *Kuehne & Nagel Drinks Logistics Ltd v HMRC* [2012] STC 840 considered what is required for an emolument from employment. Mummery LJ stated (at [33]):

> "All I need say at this point is that the use of "from" in the idea expressed in the statutory expression "earnings from an employment" and "earnings derived from an employment"

> in a fiscal context indicates, as matter of plain English usage, that there must, in actual fact, be a relevant connection or a link between the payments to the employees and their employment."

423. We note that in *Rangers* Lord Hodge stated (at [64]) that the relevant provisions for the taxation of emoluments/earnings are "drafted in deliberately wide terms to bring within the tax charge money paid as a reward for an employee's work".

424. The Appellants posed the question whether, on a realistic view of the facts, the employees received securities or other rights which could be turned to pecuniary account or did they receive money. The Appellants submitted that even on a finding that the contracts were not contracts for differences or similar, the rights could be ignored and *Abbott v Philbin* applied.

425. Mr Prosser submitted that the employees received earnings in the form of contractual rights and, as the amount to be paid was uncertain, the Tribunal should follow the reasoning in *UBS* in which the Court held that the shares received by their nature had a value and could be turned to pecuniary account upon receipt or risk the uncertainty of the performance in which the assets were invested which meant the amount to be received was not ascertainable.

426. We do not accept this submission. In our view, the facts and circumstances of this appeal are materially distinguishable from those in both *Abbott v Philbin* and *UBS*. We consider that in taking a purposive approach on a realistic view of the facts we are entitled to consider the wider circumstances relevant to the receipt of the payments in order to determine their character and assess whether the rights should be ignored.

427. We also reject Appellant's submission regarding uncertainty; although Mr Prosser sought to persuade us that HMRC's case relied entirely upon percentage figures given by Ms Mayr and which HMRC abandoned, as we stated earlier we do not understand or accept this to be the case.

428. The evidence demonstrated that the employees entered into the contracts which were devised and intended to operate as a mechanism for the Appellants to pay cash bonuses as reward for the employees' services without the liability to tax which would otherwise be due. The employees as either staff or directors were intended to receive the earnings under the arrangements and the Appellants intended to pay those earnings.

429. In *Abbott v Philbin* the Court held that a taxable benefit was provided by the grant of a share option and any further benefit did not constitute earnings as the link with employment ended and instead came from the rights under the option. There was a clear distinction between the realisation of the employment related benefit upon its grant and the subsequent uncertainty in value which derived its source from ownership of the asset and not the employment.

430. We consider that the observations made by Lord Reid in *Abbott v Philbin* are relevant on this point:

> "If the condition is one with which the taxpayer can easily and immediately comply, it does not in my opinion, form an obstacle to turning the option to pecuniary account. If the condition is one which cannot immediately be complied with that may make a difference. In *Bridges* v. *Hewitt and Bearsley* the taxpayer still had to earn his perquisite

> by a further four years' service, and it may well be that in such a case an agreement to confer a future benefit gives no immediate perquisite…
>
> I think that I have already dealt with the reasons which he gives, but I can sum up my view by saying that conditions and restrictions attached to or inherent in an option may affect its value but are only relevant on the question whether the option is a perquisite if they would in law or in practice effectively prevent the holder of the option from doing anything when he gets it which would turn it to pecuniary account."

431. In our view, the conditions attached to the contracts in point prevented the employees from turning them to pecuniary account and there was therefore no immediate perquisite in the contract.

432. We also hold that the insertion of the elements which created the purported contracts for differences do not alter the nature of the payments as earnings and the grant of the contracts was no more than a process for delivery of the bonuses. In our view, the legal mechanism by which the payments were did not alter the character of the payments. The Appellants entered into contracts with the employees in respect of which it expected and intended to pay the employees at the settlement date. Looking at the reasons and background to the payments, their purpose was to deliver bonus payments and the cause of the payments was employment. In reality, the payments were not calculated by reference to fluctuations but were instead the amounts the Appellants had decided to award the employees as bonuses.

433. In our view, these are not cases in which the employees received contractual rights to earnings and the source of the payments can be said to be the rights and not the earnings. There was a distinction in *Abbott v Philbin* and *UBS* between the securities received at the outset, which had a value, and the payments subsequently received in the capacity of holders of the securities, the source of which was not employment. In these appeals, the creation of the contracts formed part of the arrangements under which the rights were created to bring the scheme within the legislation. We consider the correct approach is to look at the substance of the contracts and not their form; the precise legal nature of the rights under the contracts does not alter the character of the payments made and received by the employees as earnings when viewed in the context of the totality of the arrangements.

434. The Appellants relied on the upfront payments of £10 as preventing s62 or s201 applying. No evidence was adduced to show that the employees did in fact make those payments. However, even if such payments were made, we consider that the documentary evidence shows that that they were paid for the purpose of bringing the arrangements within the legislation and had no commercial purpose. The payments do not therefore prevent the amounts received by the employees falling within the scope of earnings.

Conclusions on whether the payments of money made by each relevant company to each relevant employee were taxable as earnings

435. In our view, the comments of Lord Reed in *UBS* (at 97) apply to the facts of these appeals:

> "It may well be that, in an appropriate case, the statutory term "money", construed purposively, might apply to arrangements which, viewed realistically, were no more than disguised or artificially contrived methods of paying cash to employees."

436. On a purposive construction of the legislation, taking a realistic view of the facts and overall effect of the arrangements, we hold that the arrangements were devices by which the Appellants intended to reward their employees for their employment services without tax. The source of the payments was employment and the uncertainty upon which the Appellants relied was analogous to that in *Scottish Provident*; they were carefully crafted as part of the design to bring the arrangements within s420. The rights the contracts purported to provide were contracts for differences and if, as we have concluded, they did not so provide we do not accept that they provided rights or securities in the manner of shares or share options as per *UBS* and *Abbott and Philbin*. Moreover, anything the contracts could be said to provide, was not something that could be turned to pecuniary account. The relevant payments are properly characterised as "earnings from an employment" and the Appellants are required to account for income tax and are liable for NICs in respect of those earnings.

437. In relation to whether s 447 ITEPA applied to the payment received by the employee, HMRC maintained this issue only "as a matter of form" as it may have a bearing on a follower case. No submissions were advanced in support of the argument and we consider it would be inappropriate to address it; if a follower appeal involves facts of direct relevance to this point, it should be determined after full argument.

438. Similarly, the parties did not pursue the issue relating to Part 3 Chapter 10 but rather focussed their submissions on the earnings issue under s62 which we have addressed above. We have therefore not addressed the arguments that were not pressed at the hearing.

Mr Langsam as shareholder

439. The final issue, which does not form part of the Rule 18 issues, is whether, in relation to Britannia only, any payments to Mr Langsam were not taxable as earnings because they were distributions out of assets of the company in respect of shares in Britannia (taxable under Chapter 3 part 4 of ITTOIA 2005). HMRC did not pursue this argument nor, as Mr Prosser clarified, was it Britannia's case. In those circumstances we do not address this issue in any detail, save to say that our provisional view was that the answer is ascertainable by the facts; Mr Langsam was made an employee for the sole purpose of participating in the GSOP arrangements and he received his payment in that capacity. Irrespective of the reason why he gained the employment, it was his employment in the role of director which was the sole cause of the payment.

Conclusion

440. On the principles to be determined, for the reasons we have given, it follows that the appeals are dismissed.

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.

TRIBUNAL JUDGE
RELEASE DATE: 20 JANUARY 2022