[2012] UKUT 273 (TCC)
Appeal number: FTC/22/2011

Income Tax avoidance scheme – accrued income provisions: ICTA 1988 ss 710-714, 727(2) – stock lending arrangements and capital gains tax exemption: TCGA 1992 s 263B – manufactured interest provisions: ICTA 1988 schedule 23A - "chargeable to income tax"

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

NICHOLAS BARNES **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S

REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: The Hon Mr Justice Roth and Judge Julian Ghosh QC

Sitting in public at Rolls Building, Royal Courts of Justice, Fetter Lane, London EC4A 1NL on 30 and 31 January 2012

Mr Rex Bretten QC and Ms Amanda Hardy (instructed by NT Advisors LLP) for the Appellant

Mr Malcolm Gammie QC (instructed by the General Counsel and Solicitor to HM Revenue and Customs) for the Respondents

DECISION

1. This is an appeal, brought with permission granted by the First Tier Tribunal ("the FTT"), against its decision ("the Decision") dismissing an appeal by the Appellant (Mr Barnes) against the closure notice issued by the Respondents ("HMRC") reducing to nil his claim for a deduction of £1.2 million in his self-assessment income tax return for the tax year 2004-05. The case involves a tax avoidance scheme designed to achieve an income tax saving by way of such a deduction.

2. The scheme sought to exploit the interaction of two distinct parts of the UK income tax legislation: first, the accrued income provisions of Chapter II of Part XVII of the Income and Corporation Taxes Act 1988 ("TA 1988"); and secondly, the manufactured interest provisions of TA 1988, Schedule 23A. The object of the scheme was to allow participating taxpayers to claim relief against income tax where there was no corresponding economic loss. Mr Barnes is one of a number of taxpayers who participated in the scheme.

The Facts

3. In essence, the scheme sought to enable the participant to obtain a tax deduction equivalent to the amount of a coupon payment on borrowed gilts. In Mr Barnes' case, the gilts involved were UK Treasury Gilts 8.75% 2017 ("Gilts") which went ex-dividend on 16 February 2005. The relevant transactions were as follows:

(1) On 16 February, 2005 –

(a) pursuant to a Stock Loan Agreement, Mr Barnes borrowed from Clement View Limited ("CVL"), a British Virgin Islands company, £27,428,571.41 (nominal value) Gilts ("the Borrowed Gilts"), being part of a much larger parcel of such Gilts which had been acquired by CVL on that date from BGC International under a Purchase and Re-sale Agreement;

(b) the Borrowed Gilts were credited to Mr Barnes' custody account with S.G. Hambros Bank & Trust (Jersey) Limited ("Hambros");

(c) pursuant to the Stock Loan Agreement, Mr Barnes posted with CVL cash collateral of £38,586,239, Mr Barnes having been put in funds for that purpose by Société Générale Bank & Trust ("SocGen");

(d) Mr Barnes purchased further Gilts of £2,742.86 (nominal value) ("the Margin Gilts"), which were credited to his custody account with Hambros; the cost of the purchase was debited to Mr Barnes' account with S.G. Hambros Bank (Channel Islands) Limited ("the Bank");

(e) the Borrowed Gilts and the Margin Gilts in Mr Barnes' custody account were charged to secure his obligations to SocGen; and

(f) a further (subordinated) charge over those Borrowed Gilts and the Margin Gilts was created in favour of CVL.

(2) On 17 February, 2005-

(a) pursuant to the Stock Loan Agreement, Mr Barnes transferred back to CVL £27,431,314.27 Gilts, comprising both the Borrowed Gilts and the Margin Gilts;

(b) CVL repaid to Mr Barnes (with interest) the collateral which he had posted under the Stock Loan Agreement; and

(c) Mr Barnes repaid to SocGen (with interest) the moneys which he had borrowed to fund that collateral.

(3) On 25 February, 2005-

(a) Mr Barnes received into his account with Hambros the sum of £1,200,120, being the interest payable (record date 17 February, 2005) on his holdings of both the Borrowed Gilts and the Margin Gilts;

(b) Mr Barnes borrowed from SocGen a further sum of £1,200,000, which was paid into a separate account set up by Mr Barnes with the Bank;

(c) out of the newly set up account, Mr Barnes paid to CVL the sum of £1,200,000 as required under the terms of the Stock Loan Agreement; and

(d) out of the interest which had been paid into his original account with the Bank, Mr Barnes repaid the loan of £1,200,000 which had been made to him by SocGen.

4. The FTT found that all of the transaction documents were executed as stated on the face of those documents and were implemented in accordance with their terms: Decision, para 29.

5. The FTT made additional findings of fact as follows: Decision, para 102:

> "(1) The Scheme was a designed and marketed tax avoidance scheme."
>
> (2) The Scheme had no commercial purpose, other than the intended obtaining of a fiscal benefit.
>
> (3) The parties intended that each of the steps and transactions comprising the Scheme would be carried out and executed exactly as envisaged from the outset. There was a standard set of documentation which had been used on several occasions by many taxpayers. In the February 2005 round there were some 39 participants, each undertaking near identical transactions all with Hambros and SocGen as the counterparties. This all took place over two consecutive days, and any departure from the agreed plan would not have been feasible without derailing the Scheme.

> (4) Once Mr Barnes had decided to participate in the Scheme his only real involvement was to sign in escrow a set of the documentation and to pay the agreed fee. In particular, … there was no realistic possibility that the gilt loan could be unwound other than by redelivery of the exact securities borrowed and then held by Hambros as custodian (plus the Margin Gilts, which only featured for the tax technical reasons already explored above). It is all but inconceivable that on the morning of 17 February Mr Barnes would have decided to unwind the gilts loan by arranging a delivery of £39 million worth of alternative "near equivalent securities". There was no practical possibility that Mr Barnes could do anything with the borrowed gilts other than return them the following day – and that was the definite intention of all the parties from beginning to end. "

The Law

6. It was common ground that the Gilts were gilt-edged securities within s.115(1)(a) of the Taxation of Chargeable Gains Act 1992 ("TCGA") and were exempt from capital gains tax by reason of TCGA, s.115. Hence, for capital gains tax purposes, the acquisition and disposal by Mr Barnes of the Borrowed Gilts and the Margin Gilts were to be ignored.

7. As regards income tax, the primary charging provisions in relation to interest on the Borrowed Gilts and the Margin Gilts are in TA 1988, as follows:-

Section 1(1):

> "Income tax is charged in accordance with the Income Tax Acts on (a) all amounts which, under those Acts, are charged to tax under any of Schedules A, D and F (set out in Sections 15, 18 and 20) …"

Section 18:

> "(1) The Schedule referred to as Schedule D is as follows. Tax under this Schedule shall be charged in respect of … (b) all interest of money, annuities and other annual profits or gains not charged under Schedule A or under ITEPA 2003 as employment income, pension income or social security income, and not specially exempted from tax.
>
> (2) Tax under Schedule D shall be charged under the Cases set out in subsection (3) below, and subject to and in

> accordance with the provisions of the Tax Acts applicable to those Cases respectively.
>
> (3) The Cases are … Case III: tax in respect of…(c) income from securities which is payable out of the public revenue of the United Kingdom or Northern Ireland …"

Section 59(1):

> "… income tax under Schedule D shall be charged on and paid by the persons receiving or entitled to the income in respect of which the tax is directed by the Income Tax Acts to be charged."

8. It was common ground that the interest on both the Borrowed Gilts and the Margin Gilts received by Mr Barnes in his Hambros account was Case III income within TA 1988, s. 18. It was also common ground that Mr Barnes took those monies constituted by the interest coupons with full beneficial ownership. We also take it to be common ground that Mr Barnes was chargeable to income tax on the interest coupon on the Margin Gilts (£120). However, for reasons that will appear below, a central issue between the parties is whether Mr Barnes was chargeable to income tax on the interest coupon on the Borrowed Gilts (£1.2 million). The FTT held that he was not: Decision, para 99. On this appeal, Mr Bretten challenged that conclusion whereas Mr Gammie supported it. This issue depends on the interpretation and effect of the accrued income provisions of TA 1988.

<u>The accrued income provisions</u>

9. The primary provisions creating the accrued income regime are in TA 1988, sections 710-714.

10. It is clear that pursuant to those provisions:

a) the Gilts were "securities": s. 710(2);

b) the loan of the Gilts under the Stock Loan Agreement constituted a "transfer" of securities: s. 710(5);

c) the transfer of the securities here was made on 16 February 2005: s. 710(6);

d) the "interest payment day" was 25 February 2005: s. 711(2);

e) the "settlement day" was 16 February 2005: s. 712(2).

f) the securities were transferred "with accrued interest" since they were transferred with the right to receive interest payable on 25 February: s. 711(5).

11. Sections 713-714 TA 1988 provide as follows, insofar as material:

"**713 Deemed sums and reliefs**

(1) Subject to sections 714 to 728, this section applies whether the securities in question are transferred before, on or after 6th April 1988; and in this section references to a period are references to the interest period in which the settlement day falls.

(2) If securities are transferred with accrued interest -

(a) the transferor shall be treated as entitled to a sum on them in the period of an amount equal to the accrued amount; and

(b) the transferee shall be treated as entitled to relief on them in the period of the same amount.

…

(4) In subsection (2) above "the accrued amount" means -

(a) if the securities are transferred under an arrangement by virtue of which the transferee accounts to the transferor separately for the consideration for the securities and for gross interest accruing to the settlement day, an amount equal to the amount (if any) of gross interest so accounted for; and

(b) in any other case, an amount equal to the accrued proportion of the interest applicable to the securities for the period.

…

(6) In this section –

(a) the accrued proportion is A/B …
where -

A is the number of days in the period up to (and including) the settlement day, and
B is the number of days in the period…

714 Treatment of deemed sums and reliefs

(1) Subsection (2) below applies if a person is treated as entitled under section 713 to a sum on securities of a particular kind in an interest period, and either –

(a) he is not treated as entitled under that section to relief on securities of that kind in the period; or

(b) the sum (or total sum) to which he is treated as entitled exceeds the amount (or total amount) of relief to which he is treated as entitled under that section on securities of that kind in the period.

(2) The person shall be treated as receiving on the day the period ends annual profits or gains whose amount is (depending on whether subsection (1)(a) or (1)(b) above applies) equal to the sum (or total sum) to which he is treated as entitled or equal to the amount of the excess; and the profits or gains shall be chargeable to tax under Case VI of Schedule D for the chargeable period in which they are treated as received.

(3) Subsection (4) below applies if a person is treated as entitled under section 713 to relief on securities of a particular kind in an interest period, and either -

(a) he is not treated as entitled under that section to a sum on securities of that kind in the period; or

(b) the amount (or total amount) of relief to which he is treated as entitled exceeds the sum (or total sum) to which he is treated as entitled under that section on securities of that kind in the period.

(4) The person shall be entitled to an allowance whose amount is (depending on whether subsection (3)(a) or (3)(b) above applies) equal to the amount (or total amount) of relief to which he is treated as entitled or equal to the amount of the excess; and subsection (5) below shall apply.

(5) Any amount to which the person is entitled by way of interest which -

(a) falls due on the securities at the end of the interest period, and

(b) is taken into account in computing tax charged for the chargeable period in which the interest period ends,

shall for the purposes of the Tax Acts be treated as reduced by the amount of the allowance; but if the period is one which does not end with an interest payment day, he shall be treated as becoming, in the next interest period, entitled under section 713 to relief on the securities of an amount equal to the amount of the allowance."

12. As observed by the FTT, the accrued income regime is designed to address the situation of a vendor selling a security before it goes ex dividend. In the absence of such provisions, since the interest is actually received by the purchaser, the vendor would avoid paying tax on the interest accrued to the date of sale although the amount of that interest is included in the sale price; and although the proceeds of sale would be a capital receipt, in the case of gilt-edged securities any gain is also exempted from capital gains tax. On the other hand, the purchaser would be taxable on the whole of that interest although most of it would have accrued before the purchase date. Therefore, the purpose of these provisions is to tax each party on that part of the interest which accrued during that party's ownership of the security: Decision, para 87.

13. However, the method by which this is achieved is not to treat the interest as divided between the parties for the purpose of Case III income. Instead, the statute makes an allocation to the transferor who is treated as receiving "an amount equal to the accrued amount" which is taxed as income in his hands under Case VI: ss. 713(2)(a), 714(2). The transferee is granted a corresponding "relief" in the accrued amount by way of an "allowance" against the interest which he receives: ss. 713(2)(b), 714(4)-(5).

14. Here, it was common ground that for the purpose of s. 713(1), the "interest period" is a period of six months within which 16 February 2005 falls. If the accrued income regime applied, then CVL as transferor would have allocated to it an amount equal to the accrued amount, and Mr Barnes as transferee was entitled to relief on the same amount. As CVL was not UK resident it would not be liable to tax on the accrued amount, but there was no dispute that Mr Barnes would be entitled to this relief despite no charge to UK tax actually applying to CVL: nothing in s.713 or s.714 required the transferor to be actually taxed on the accrued amount allocated to it in order for the transferee to be entitled to relief.

15. However, s. 727(2) TA 1988 disapplies the accrued income provisions if any disposal and acquisition are disregarded for the purposes of capital gains tax by virtue of section 263B of the TCGA. This provides, insofar as material:

> "**263B Stock lending arrangements**
>
> (1) In this section "stock lending arrangement" means so much of any arrangements between two persons ("the borrower" and "the lender") as are arrangements under which –
>
> (a) the lender transfers securities to the borrower otherwise than by way of sale; and
>
> (b) a requirement is imposed on the borrower to transfer those securities back to the lender otherwise than by way of sale.
>
> (2) Subject to the following provisions of this section …, the disposals and acquisitions made in pursuance of any stock lending arrangement shall be disregarded for the purposes of capital gains tax.
>
> …
>
> (5) References in this section, in relation to a person to whom securities are transferred, to the transfer of those securities back to another person shall be construed as if the cases where those securities are taken to be transferred back to that other person included any case where securities of the same description as those securities are transferred to that other person either -
>
> (a) in accordance with a requirement to transfer securities of the same description; or
>
> (b) in exercise of a power to substitute securities of the same description for the securities that are required to be transferred back.
>
> (6) For the purposes of this section securities shall not be taken to be of the same description as other securities unless they are in the same quantities, give the same rights against the same persons and are of the same type and nominal value as the other securities."

16. Accordingly, this section provides that certain stock lending arrangements should be disregarded for capital gains tax purposes. The purpose of this provision is that the disposal and reacquisition of securities should be ignored where a single arrangement (or part of an arrangement) means that the economic reality is that the transferee has only a temporary ownership of the securities and (equally) the transferor only temporarily loses its ownership of the securities. Section 263B(5) and (6) extend

s.263B(1) by stating that the notion of "those" securities mentioned in s.263B(1) includes securities transferred by the transferee to the transferor which, although not (for whatever reason) the identical securities initially transferred by the transferor, are in the same quantities, give the same rights against the same persons and are of the same type and nominal value.

17. TA 1988, s.727(2) applies that same policy of disregarding transactions comprising such stock lending arrangements for the purposes of the accrued income provisions. Accordingly, if s.263B applied to the relevant arrangements here, the accrued income provisions would be disapplied in their entirety and relief under ss.723(2)(b) and 714(4)-(5) would not be available to Mr Barnes.

18. The FTT held that the arrangements in this case do not fall within the terms of s. 263B TCGA: Decision, paras 89-94. On this appeal, HMRC challenges that conclusion.

The manufactured interest provisions

19. The provisions dealing with so-called "manufactured interest" payments are in Schedule 23A of TA 1988. Paragraph 1 of the schedule sets out definitions including the following:

> "interest manufacturer" has the meaning given by paragraph 3(1) below;
>
> "manufactured dividend", "manufactured interest" and "manufactured overseas dividend" shall be construed respectively in accordance with paragraphs 2, 3 and 4 below, as shall references to the gross amount thereof; …
>
> "securities" includes any loan stock or similar security;
>
> "transfer" includes any sale or other disposal; …
>
> "United Kingdom securities" means securities of the government of the United Kingdom, of any public or local authority in the United Kingdom or of any company or other body resident in the United Kingdom, but does not include United Kingdom equities. …

20. Paragraph 3 is the relevant provision for present purposes and provides, insofar as material:

> "3(1) This paragraph applies (subject to paragraph 3A below) in any case where, under a contract or other arrangements for the transfer of United Kingdom securities, one of the parties (an "interest manufacturer") is required to the pay to the other ("the recipient") an amount ("the manufactured interest" which is representative of a periodical payment of interest on the securities.

(2) For the relevant purposes of the Tax Acts, in their application in relation to the interest manufacturer -

(a) the manufactured interest shall be treated, except in determining whether it is deductible, as if it -

(i) were an annual payment to the recipient, but

(ii) were neither yearly interest nor an amount payable wholly out of profits or gains brought into charge for income tax;

(b) the gross amount of that deemed annual payment shall be taken -

(i) to be equal to the gross amount of the interest of which the manufactured interest is representative; and

(ii) to constitute income of the recipient falling within section 1A; and

(c) an amount equal to so much of the gross amount of the manufactured interest as it not otherwise deductible shall be allowable as a deduction against the total income or, as the case may be, total profits of the interest manufacturer, but only to the extent that -

(i) it would be so allowable if it were interest, or

(ii) so far as not falling within sub-paragraph (i) above, it falls within sub-paragraph (2A) below.

(2A) An amount of manufactured interest falls within this sub-paragraph if and to the extent that the interest manufacturer –

(a) receives the periodical payment of interest on the securities which is represented by the manufactured interest, or receives a payment which is representative of that periodical payment of interest, and is chargeable to income tax on the periodical payment or representative payment so received; …"

21. The purpose of these provisions was explained by the FTT, in terms that we gratefully adopt: Decision, para 85. After a sale or other disposal of securities, the interest or dividend received on those securities clearly belongs to the disponee. But the price of the securities is likely to include compensation for the interest or dividend that the disponee will receive. The same applies on a loan of securities, which is why such transactions contain an obligation on the borrower to make a compensatory payment to the lender calculated by reference to the interest and dividends which the borrower will receive. In the absence of any statutory provisions, the transferee will be taxable on the full amount, although he is contractually obliged to account for it to the transferor. The manufactured interest payment code addresses that situation.

22. Here, it is common ground that:

(a) The Borrowed Gilts were UK securities within paragraph 1(1).

(b) Under the Stock Loan Agreement, Mr Barnes was required to pay to CVL an amount which was representative of a periodical payment of interest on those securities, within paragraph 3(1).

(c) Mr Barnes was an "interest manufacturer" within paragraph 3(1) and the payment of £1.2 million made by Mr Barnes to CVL on 25 February 2005 was "manufactured interest".

23. The effect of Schedule 23A, para 3(2)(c)(ii) and (2A) is to give Mr Barnes as the interest manufacturer relief in the amount of £1.2 million (i.e. the manufactured interest) against his total income *provided that* he is "chargeable to income tax" on that £1.2 million. The FTT held that he is not entitled to this relief because the £1.2 million which he received is not to be regarded as chargeable to income tax by reason of the operation of the accrued income provisions: Decision, para 99.

The Scheme and the Issues Arising

24. We consider it is helpful to set out the essential features of the scheme before addressing the issues that arise on this appeal.

25. On 25 February 2005, Mr Barnes received £1.2 million of interest on the Borrowed Gilts and £120 interest on the Margin Gilts. Mr Barnes also borrowed £1.2 million, which he used to make the manufactured interest payment to CVL. Mr Barnes used the £1.2 million of interest that he received on the Borrowed Gilts to repay the loan. Mr Barnes had already re-transferred the Borrowed Gilts (together with the Margin Gilts) to CVL on 17 February 2005. Therefore, after the 25 February 2005 transactions, Mr Barnes was economically neutral: he had made neither a profit nor a loss, (ignoring any professional fees and Mr Barnes' acquisition and transfer of the Margin Gilts).

26. The scheme envisaged that Mr Barnes would not be subject to a charge to income tax on the £1.2 million interest which he received on the Borrowed Gilts. This is because Mr Barnes sought the relief afforded under ss.713(2)(b) and 714(4)-(5) of the accrued income provisions which reduced the quantum of this interest to nil for the purposes of the Tax Acts. However, the payment made by Mr Barnes to CVL of £1.2 million, being a manufactured interest payment, was considered to give rise to a further deduction of £1.2 million to Mr Barnes under the provisions of TA 1988, Schedule 23A, para 3(2)(c)(ii) and (2A). Thus, the scheme was intended to have the effect that Mr Barnes obtained a net income tax deduction of £1.2 million despite making no corresponding commercial or economic loss.

27. However, it was accepted that this further deduction was only available under those provisions of TA 1988, Schedule 23A if the £1.2 million of interest received by Mr Barnes was "chargeable to income tax", despite this interest having been reduced by the accrued income provisions in TA 1988, ss.713(2)(b) and 714(4)-(5). Mr Bretten's

essential proposition was that despite this reduction by reason of the relief given by the accrued income provisions, Mr Barnes was "chargeable to tax" for the purposes of TA 1988, Schedule 23A, para 3(2)(c)(ii) and (2A), on the £1.2 million of interest he received on the Borrowed Gilts.

28. Mr Barnes would of course only obtain this dual deduction (once under the accrued income provisions, another under the manufactured interest provisions) if the accrued income provisions applied to the transfer and re-transfer of the Borrowed Gilts. Therefore, it was critical to the success of the scheme that those provisions were not disapplied by reason of TA 1988, s.727(2): i.e. that the transfer and retransfer of the Borrowed Gilts did not constitute a "stock lending arrangement" to be disregarded under TCGA 1992, s.263B.

29. Therefore, for Mr Barnes has to show:

(1) that the accrued income provisions were not disapplied by a combination of TA 1988, s.727(2) and TCGA 1992, s.263B; and

(2) that he was "chargeable to income tax" on the £1.2 million of interest on the Borrowed Gilts for the purpose of TA 1988 Schedule 23, para 3(2A), despite the effect of the accrued income provisions.

Discussion

30. As set out above, the question of whether the accrued income provisions were disapplied by reason of TA 1988, s. 727(2) is conceptually anterior to the question of whether or not Mr Barnes was "chargeable to income tax" on the £1.2 million interest on the Borrowed Gilts. If the accrued income provisions were disapplied in their entirety, it is common ground that Mr Barnes would be "chargeable to income tax" on the £1.2 million of interest on the Borrowed Gilts and accordingly be entitled to relief for the manufactured interest payment which Mr Barnes paid to CVL. However, as noted above, the FTT held in his favour on issue (1), but decided against him on issue (2). Because this is an appeal by Mr Barnes against the decision of the FTT, we consider issue (2) first.

(a) *Was Mr Barnes "chargeable to income tax" on the interest on the Borrowed Gilts?*

31. For this purpose it is to be assumed that the accrued income provisions apply. On that assumption, Mr Barnes is entitled to an allowance under TA 1988 s. 714(4) in the amount "equal to" to the amount of the relief to which he is entitled under s. 713(2)(b), which is the amount of the accrued interest: i.e. £1.2 million. Section 714(5) then provides that the amount to which he is entitled by way of interest which is taken into account in computing his tax charge, (i.e. the £1.2 million that he received) "shall for the purposes of the Tax Acts *be treated as reduced* by the amount of the allowance" (our emphasis).

32. Accordingly, the treatment of the accrued interest "relief" as an "allowance" is mandatory: there is no option or discretion which permits the transferee to take this relief in any other form. That "allowance" is, in turn, treated as reducing the amount of actual interest paid to the transferee at the end of the interest period for the purposes of the Tax Acts: the transferee cannot take this allowance in any other form.

33. Mr Bretten submitted that the whole amount of the interest credited to Mr Barnes' account on 25 February 2005 in respect of the Borrowed Gilts (£1.2 million) and the Margin Gilts (£120) was his income, such that Mr Barnes was prima facie "chargeable to income tax" on that whole amount by reason of TA 1988 ss. 18 and 59. The effect of the accrued income provisions was that he was entitled to claim a relief in an amount which effectively eliminated his liability to tax in respect of the interest on the Borrowed Gilts, but this did not affect the basic point that he was "chargeable to tax" on that interest.

34. However, the relief in the accrued income provisions, and in particular s. 714(5), operates expressly to reduce the quantum of the interest received for the purposes of the Tax Acts. This is not a case where a taxpayer has his tax charged on a *prima facie* taxable receipt that is reduced by some relief, such as losses. The relief arising under the accrued income provisions actually quantifies the taxable receipt itself for the purpose of the Tax Acts. After the application of those provisions, there is nothing left of the interest on the Borrowed Gilts on which Mr Barnes can be "chargeable to income tax." Accordingly, there is nothing which can attract the further deduction provided under the manufactured interest provisions in TA 1988, Schedule 23A, para 3. The point is a simple one, and the FTT expressed its conclusion succinctly: Decision, para 99. Despite the valiant efforts of Mr Bretten, we consider that the FTT's conclusion was clearly correct.

35. It does not, in this case, matter whether the "relief" in ss. 713(2)(b) and 714(4)-(5) is a "relief" which is conferred on an automatic and mandatory basis, or whether, alternatively, that "relief" is only attracted upon the taxpayer making a claim. These provisions do not, of course, on their face require the making of a claim. But even if a claim were required, it is clear that Mr Barnes made a relevant "claim", since he expressly sought the benefit of the "relief" in these provisions in his self-assessment return. However, we would add that, in our view, the relief in respect of accrued interest to which the transferee is "entitled" is automatic and mandatory. We do not detect any option in the wording of s. 714(4)-(5) which indicates that the taxpayer may forebear to claim this "allowance" or in any other sense to disclaim it. The relief in s. 713(2)(b) is a relief which is specific to the application of the accrued income scheme. We do not accept Mr Bretten's argument, made in the course of his oral submissions, that the notion of being "entitled" to a "relief" implies by necessity the option to claim or not claim the relief. We have already observed that the transferor is treated as "entitled" to an amount, on which the transferor is subjected to a charge to tax. That happens automatically. We see no reason to construe s. 713(2)(b), which "entitles" the transferee to relief as being any less automatic.

36. The scheme accordingly fails. If the accrued income provisions applied to the transfer and re-transfer of the Borrowed Gilts, Mr Barnes is not entitled to the relief he seeks

under the manufactured interest provisions. This means that Mr Barnes' income tax position reflects his economic position: he is taxed on a nil sum but has no further tax relief.

37. That is sufficient to dispose of this appeal. However, because it was fully argued and is indeed important for the proper application of the relevant statutory provisions, we shall also address the question of whether the accrued income provisions apply in this case at all.

(b) *Are the accrued income provisions disapplied by TA 1988 s 727(2) and TCGA s 263B?*

38. The FTT held that the conditions of TCGA s. 263B were not fulfilled on the basis that by reason of the inclusion of the Margin Gilts, the redelivered securities were not "in the same quantities" as the borrowed securities, for the purpose of s. 263B(6): Decision, paras 89-94. However, the starting point is s. 263B(1). It was an express finding by the FTT that the gilts transferred to Mr Barnes were the "exact" securities which Mr Barnes re-transferred to CVL, with only the addition of the Margin Gilts: Decision, para 102(4). Mr Barnes was in no position to transact with the Borrowed Gilts at all. We therefore consider that in relation to the gilts transferred by CVL to Mr Barnes on 16 February 2005, it was "those" same gilts which were re-transferred by Mr Barnes to CVL (and which Mr Barnes was obliged to re-transfer to CVL). The text of s. 263B(1) and its reference to "those" securities applies therefore to the Borrowed Gilts which CVL transferred to Mr Barnes, Mr Barnes transferred back to CVL and with which Mr Barnes did not (and could not) transact in the meantime.

39. We reject Mr Bretten's submission that the fact that CVL had a large quantity of Gilts, which were then parcelled up for a number of taxpayers, including Mr Barnes, who participated in the scheme, means (as a matter of principle) that it cannot be said that the arrangement between CVL and Mr Barnes was one whereby CVL transferred securities to Mr Barnes which same securities (i.e. "those securities") Mr Barnes was to transfer back to CVL. It may well be that the Gilts were fungible in the hands of CVL, prior to being parcelled up and disposed of to the various taxpayers participating in the scheme. But once they were parcelled up, specific Gilts were credited to specific taxpayers, including Mr Barnes: indeed without that happening, there would be no disposal and no acquisition.

40. The inclusion in the arrangement of a requirement to transfer to CVL also the Margin Gilts was intended to preclude this result. Mr Bretten candidly conceded as much during the course of his oral submissions. He contended that the inclusion of the Margin Gilts meant that it could not be said that Mr Barnes' obligation to transfer the Borrowed Gilts *and* the Margin Gilts to CVL was an obligation within s. 263B(1) to transfer "those" Gilts which CVL had transferred to Mr Barnes. We reject that argument. Section 263B(1) applies to "so much" of any arrangements where securities are transferred and re-transferred. In this case, s.263B(1) applies to "so much" of the arrangements between CVL and Mr Barnes as encompassed the Borrowed Gilts. Mr Bretten accepted that where numbered shares are transferred and then re-transferred either with cash or additional shares, s. 263B(1) would apply so as

to disregard, for TCGA 1992 purposes, those numbered shares. It was Mr Bretten's case that it made all the difference that the transaction here involved unnumbered securities (or, as Mr Bretten would have it, "fungible" securities), which by their nature could not be identified and therefore could not be said to be "those [*same*] securities" which had been transferred to Mr Barnes by CVL. However, for the reasons we give above, we view this as entirely unrealistic on the facts.

41. It follows that TCGA s. 263B (and therefore TA 1988 s. 727(2)) applies to the Borrowed Gilts which means, in turn, that the relief under accrued income provisions in TA 1988 ss 713-714 is not available to Mr Barnes. Mr Barnes is therefore "chargeable to income tax" on the full amount of interest which he received on 25 February 2005 but would, of course, be entitled to relief under manufactured interest payment rules in TA 1988, Schedule 23A, para 3(2)(c) and (2A).

42. It is therefore unnecessary to consider the further provisions in s. 263B(5)-(6) However, in case we are wrong about s. 263B(1), on the basis that the Stock Loan Agreement did not in its terms *require* Mr Barnes to re-transfer the same securities but only near equivalent securities, we have no doubt that the conditions of s. 263B(5)-(6) are then fulfilled.

43. Section 263B(5) provides that "those securities" should be construed as including the case where the securities transferred back by the transferee are not the identical securities initially transferred by the transferor but securities "of the same description"; and s. 263B(6) provides a negative definition of that phrase, such that if securities are not of the same type and nominal value, and in the same quantities, they will not be "of the same description." In that regard, the FTT held that this condition was not satisfied by reason of the inclusion of the Margin Gilts.

44. Mr Bretten sought to uphold that conclusion by arguing before us, as he did below, that the fact that the aggregate nominal value of the Borrowed Gilts and the Margin Gilts amounted to 100.01% of the nominal value of the Borrowed Gilts meant that the nominal value (and the quantities) of the Gilts re-transferred to CVL by Mr Barnes was not the "same" as the nominal value (or quantities) of the Gilts transferred by CVL to Mr Barnes. However, this ignores the governing terms of s. 263B(1), whereby a "stock lending arrangement" for the purpose of the section means "so much of" any arrangements between two parties as satisfy the specified conditions. As we have observed, sub-sections 263B(5) and (6) extend the meaning of "those securities" for the purpose of s. 263B(1): see para 16 above; they do not restrict it. Hence, in the circumstances of this case, where the Borrowed Gilts were transferred by CVL to Mr Barnes and the same quantity of gilts of the same type and nominal value as the Borrowed Gilts were re-transferred by Mr Barnes to CVL, together with other gilts, s 263B(1) read in conjunction with s 263B(5)-(6) means that so much of the arrangement as concerns the nominal value of the Borrowed Gilts constitutes a "stock lending arrangement", which is disregarded for the purpose of capital gains tax under s. 263B(2). As Mr Gammie put it in his skeleton argument: "an agreement [imposing] the requirement to transfer securities representing 100.01 per cent necessarily encapsulates a requirement to transfer securities representing 100 per cent of the securities lent."

45. We should add, for completeness, that we would not accept Mr Gammie's alternative submission which invited us to ignore the Margin Gilts on the basis that they simply comprised a fee paid by Mr Barnes to the promoters of the scheme. Of course we accept that the Margin Gilts were priced by reference to the fee which was payable by Mr Barnes to CVL. But this does not mean that the Margin Gilts were not securities which Mr Barnes had an obligation to deliver, along with Borrowed Gilts, to CVL on 17 February 2005. Indeed, it was critical to Mr Barnes' prospects of success for the scheme that the Margin Gilts were so delivered. This is not a case of "mislabelling" where, for instance, a prepayment of principal is mislabelled as a "premium" merely to attract relief. We accordingly agree with the FTT that the pricing of the Margin Gilts by reference to the fee which Mr Barnes would otherwise have to pay in cash does not mean that the Margin Gilts fall to be treated for the purpose of these provisions as being anything other than securities which Mr Barnes had to transfer to CVL under his contractual obligations.

Ramsay/Furniss

46. HMRC advanced on appeal, as they had in the FTT, an alternative ground of challenge to the scheme on the basis of the *Ramsay*/*Furniss* doctrine, whereby the transactions should be treated as a composite whole or commercial unity. The FTT reached no conclusion on that ground, and in view of the conclusion we reached on the grounds set out above, we did not hear oral submissions upon this alternative ground. We therefore do not address the application of the *Ramsay*/*Furniss* doctrine to this arrangement.

47. Accordingly, this appeal is dismissed.

The Hon Mr Justice Roth

Judge Julian Ghosh QC

Release date: 30 July 2012