[2019] UKUT 111 (TCC)

Appeal number: UT/2017/0130

CORPORATION TAX – grant of share options to employees by an employee benefit trust - whether accounting debits arising under IFRS2 deductible as a trading expense of the employing companies - yes - whether that debit was capital in nature-no-whether s 1038 or prevents a deduction from being available-no-whether s 1290 CTA 2009 prevents a deduction from being available – no

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS — **Appellants**

- and -

NCL INVESTMENTS LIMITED
SMITH & WILLIAMSON CORPORATE SERVICES LIMITED — **Respondents**

TRIBUNAL: The Hon. Mr Justice Mann
Judge Timothy Herrington

Sitting in public at The Rolls Building, Fetter Lane, London EC4 on 13 and 14 February 2019

Julian Ghosh QC and Jonathan Bremner QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Appellants

Jolyon Maugham QC, for the Respondents

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DECISION

Introduction

5 1. The appellants ("HMRC") appeal against a decision by the First-tier Tribunal ("FTT") (Judge Jonathan Richards) released on 14 June 2017 (the "Decision"). The FTT held that in principle the respondents, Smith & Williamson Corporate Services Limited and NCL Investments Limited (together the "Taxpayers") were entitled to claim deductions for corporation tax purposes as expenses against trading profits for 10 accounting debits relating to the grant of share options to the Taxpayers' employees that were recognised in their respective income statements pursuant to International Financial Reporting Standard 2 ("IFRS 2").

2. Permission to appeal against these findings was given by Judge Richards on 29 August 2017.

15 3. The share options concerned (the "Options") were options to acquire shares in the ultimate holding company of the Taxpayers, namely Smith & Williamson Holdings Limited ("SWHL"), in the accounting periods to 30 April 2010, 2011 and 2012. The grant was made by trustees of employee benefit trusts in respect of which SWHL was the settlor. The Taxpayers, who employed the employees who worked for 20 the companies within the SWHL group, paid fair value in return for the granting of the Options.

4. As we explain in more detail later, the consequence of the grant was that the Taxpayers were required by generally accepted accounting practice to recognise that the services of employees, paid for in part by the Options, had been consumed in 25 generating their profits. Accordingly, as required by IFRS 2, debits (the "IFRS 2 Debits") had to be recognised on the grant of the Options. Generally accepted accounting practice imposed a requirement to make the IFRS 2 Debits when the Options were granted. It follows that the payments made by the Taxpayers for the Options were simply balance sheet entries.

30 5. HMRC contend, as they did before the FTT, that no corporation tax deduction was available in respect of the IFRS 2 Debits because:

(1) The IFRS 2 Debits were not expenses incurred wholly and exclusively for the purposes of each Taxpayer's trade (with the result that section 54 of the Corporation Tax Act 2009 ("CTA 2009") bars a deduction).

35 (2) In the alternative, the IFRS 2 Debits were items of a capital nature (and thus not deductible under s 53 CTA 2009).

(3) In the alternative, s 1038 CTA 2009 barred a deduction in respect of the IFRS 2 Debits.

(4) In the alternative, s 1290 CTA 2009 barred a deduction in respect of the IFRS 2 Debits.

The Facts

6. The FTT made its primary factual findings at [8] to [41] of the Decision. It made certain inferences from those findings which we refer to in our summary of the Decision at [40] to [56] below. The FTT's primary findings of fact, including its findings as to the terms of IFRS 2, on which it was assisted by expert accounting evidence, can be summarised as follows.

Business of the Taxpayers

7. The Taxpayers are both companies in the group of which SWHL is the ultimate parent. The Taxpayers employ staff pursuant to contracts of employment and then make those staff available to other companies in the group in return for a fee (the "Management Charge") which is based on the costs the Taxpayers incur in employing the staff marked up by an appropriate amount. The activities that the Taxpayers perform in order to earn the Management Charge constitute a trade for corporation tax purposes.

SWHL's establishment of incentive schemes and the purpose of such schemes

8. SWHL operates various incentive schemes for employees within its group and established an employee benefit trust ("EBT") on 6 March 2003. As part of the incentive schemes, employees of the Taxpayers can be granted options over shares in SWHL that are held by the EBT. Options were granted to employees of each Taxpayer in the accounting periods ending 30 April 2010, 2011 and 2012. A significant number of Options that the Trustee of the EBT granted were never exercised (with the result that the Options lapsed) either because the vesting conditions were not satisfied or because the Options were out of the money when they came to be exercised.

9. The Options are contractual rights to acquire shares in SWHL as against the Trustee of the EBT for a specified price and did not give employees any proprietary right over shares. In practice the Trustee of the EBT acquired shares in SWHL so that it would be able to satisfy its obligations if Options were exercised. The Trustee of the EBT did not at all times hold sufficient shares to satisfy all the Options it had granted but ensured that, whenever a particular Option was exercised, it would hold sufficient shares to satisfy its obligations under that Option. SWHL made payments to the Trustee of the EBT from time to time so as to enable the Trustee to purchase, or subscribe for, shares in SWHL.

10. When the Options were granted, the relevant Taxpayer would recognise an indebtedness to SWHL for an amount equal to the fair value of the Options concerned and which was settled monthly (the "Recharge"). The Taxpayers passed the cost of the Recharge on to other group companies (with a mark-up) by including it within the Management Charge.

11. Senior management regarded the Options as part of the remuneration package of employees of the group. The schemes were established with the objective of incentivising the Taxpayers' employees and there was no suggestion that the Options were awarded for any ulterior, non-business purpose, nor was there any suggestion that the grant of the Options formed part of any tax avoidance or tax mitigation scheme. The Taxpayers' object in paying the Recharge was to benefit their trade by paying SWHL for the grant of the Options to incentivise the Taxpayers' employees.

Accounting treatment of the grant of the Options and the Recharge

12. The FTT had expert evidence on accounting matters from Mr David Chopping, a chartered accountant and partner in Moore Stephens LLP on behalf of the Taxpayers. HMRC relied on expert accounting evidence from Mr David Henworth, a Fellow of the Institute of Chartered Accountants who works for HMRC. The FTT accepted the evidence of both experts.

13. It was common ground that the applicable accounting treatment of the grant of the Options for the Taxpayers was determined by the application of the accounting standard IFRS 2, entitled "Share-based Payment" and it was common ground that the Taxpayers' statutory accounts for all the three years which are relevant for the purposes of this appeal complied with the applicable provisions of IFRS.

14. Paragraph 7 of IFRS 2 provides:

> "An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.
>
> When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses."

15. A section of IFRS 2 sets out the basis of the conclusion set out in that standard at paragraph BC 31 as follows:

> "The rationale for recognising all types of share-based payment transactions – irrespective of whether the equity instrument is a share or a share option, and irrespective of whether the equity instrument is granted to an employee or to some other party – is that the entity has engaged in a transaction that is in essence the same as any other issue of equity instruments. In other words, the entity has received resources (goods or services) as consideration for the issue of shares, share options or other equity instruments. It should therefore account for the inflow of resources (goods or services) and the increase in equity. Subsequently, either at the time of receipt of the goods or services or at some later date, the entity should also account for the expense arising from the consumption of those resources."

16. As the FTT found, this treatment had created some controversy within the accounting profession when IFRS 2 was being proposed. In particular, some within the profession thought that the grant of equity settled options to employees did not involve an entity incurring any expense that should be recognised in the accounts. This controversy was addressed at paragraphs BC 40 and BC 41 of the standard as follows:

> "BC40 Some argue that because share-based payments do not require the entity to sacrifice any cash or other assets, there is no cost to the entity, and therefore no expense should be recognised.
>
> BC41 The Board regards this argument is unsound, because it overlooks that:
>
> > (a)Every time an entity receives resources as consideration for the issue of equity instruments, there is no outflow of cash or other assets, and on every other occasion the resources received as consideration for the issue of equity instruments are recognised in the financial statements; and
> >
> > (b)The expense arises from the consumption of those resources, not from an outflow of assets."

17. As far as the quantification of the expense is concerned, IFRS 2 requires that given the practical difficulties in measuring directly the fair value of the employee services received, it is necessary to measure the other side of the transaction, that is the fair value of the equity instruments granted, as a surrogate measure of the fair value of the services received. As the FTT found, that obligation arose whether or not the Taxpayers had to pay anything to anyone else (such as SWHL or the Trustee of the EBT) in relation to the grant of the Options, so that even if the Taxpayers were not party to the Recharge arrangement, their obligation to reflect an expense in their income statements in respect of the fair value of the options granted would have been the same.

18. For the purposes of the statutory accounts of the Taxpayers in this case, the grant of the Options had to be treated as "equity settled". The Taxpayers had no obligation to settle the share-based payment transaction because they were under no obligation to provide employees with shares or share options, or to procure that they were provided with shares or share options. Consequently, the Taxpayers were treated as receiving the services of the employees under a share-based payment transaction that involved those employees being granted share options by the Trustee of the EBT which resulted in IFRS 2 imposing an obligation on the Taxpayers to account for the goods and services received.

19. As the FTT found from Mr Henworth's evidence, IFRS 2 requires that in this situation the Taxpayers should account for and recognise an expense as they are the entities "receiving and consuming the employees' services" and because the Taxpayers have no obligation to settle the Options, no liability is recognised and no intragroup repayment arrangement (i.e. the Recharge) should change how the transaction was classified or measured by the Taxpayers. Thus, according to Mr Henworth, the accounts would not be in accordance with IFRS 2 if they recognised a

debit for the recharge as an employee expense with a liability settled by a cash payment.

20. As Mr Henworth stated in his report, IFRS 2 required the Taxpayers to reflect an expense or debit for the services received from their employees in exchange for the Options granted to such employees. Since the services that the employees provided were regarded as consumed immediately on receipt, IFRS 2 required the Taxpayers to recognise an expense reflecting the fact that the services had been consumed.

21. As far as the related credit for the debit entered in respect of the consumption of the employee services was concerned, IFRS 2 required each of the Taxpayers to recognise a credit of an amount corresponding to the IFRS 2 Debit as a capital contribution received from SWHL on their respective balance sheets. The rationale for this was that, by issuing share options to employees of the subsidiary, a parent company was providing a benefit to its subsidiary and was in substance making an investment in its subsidiary.

22. IFRS 2 made it clear that even if the costs of granting share options were being "recharged", a subsidiary still had to recognise a balance-sheet credit in respect of the capital contribution.

23. As Mr Henworth found, however, this credit is not to be found on the Taxpayers' balance sheets because the credit was simultaneously offset by a debit of equal value against the contribution of an amount representing the Recharge which resulted in the repayment of the capital contribution to SWHL. The amount of the Recharge was credited against intercompany balances and settled in cash.

24. As the FTT found from Mr Henworth's evidence, IFRS 2 did not set out the accounting treatment for recharges or intragroup repayment arrangements in respect of options granted by a parent so that, under general accounting principles, there was some scope for alternative treatments of the Recharge. Mr Henworth set out other alternatives that could have been adopted including:

(1) to treat the Recharge as an expense in the income statement resulting in a capital contribution in equity and a double debit in the income statement (once for the IFRS 2 Debit and once for the Recharge); or

(2) record the payment of the Recharge as a distribution with the capital contribution remaining in equity.

25. So far as the accounting treatment of SWHL was concerned, the FTT found that the end result shown in that company's statutory accounts was that it recorded a credit on its balance sheet in respect of an equity reserve (reflecting the fact that options have been issued over SWHL's shares) and a debit (an asset) on its balance sheet in respect of the intercompany debt owed by the Taxpayers pursuant to the Recharge. Where that intercompany debt had been settled, that asset would be replaced by the cash received on settlement of the intercompany debt.

The Law

Provisions relevant to the calculation of trading profits

26. Companies are subject to corporation tax on the profits of a trade under the provisions of Part 3 of CTA 2009. Section 46 (1) of CTA 2009 as in force at the relevant times provided as follows:

> "The profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes".

27. It was common ground that, since the Taxpayers drew up accounts under international accounting standards, "generally accepted accounting practice" for this purpose meant international accounting standards as set out in IFRS (section 1127 of the Corporation Taxes Act 2010).

28. Section 48 of CTA 2009 emphasises the role of accounting entries in determining trading profits as follows:

> " (1) In the Corporation Tax Acts, in the context of the calculation of the profits of a trade, references to receipts and expenses are to any items brought into account as credits or debits in calculating the profits.
>
> (2) It follows that references in that context to receipts or expenses do not imply that an amount has actually been received or paid.
>
> (3) This section is subject to any express provision to the contrary."

29. Section 53 of CTA 2009 denies relief for capital expenditure as follows:

> "(1) In calculating the profits of a trade, no deduction is allowed for items of a capital nature.
>
> (2) Subsection (1) is subject to provision to the contrary in the Corporation Tax Acts."

29. Section 54 of CTA 2009 contains a restriction on the deduction of expenses in the calculation of trade profits under the heading "Expenses not wholly and exclusively for trade and unconnected losses" as follows:

> "(1) In calculating the profits of a trade, no deduction is allowed for—
>
> (a) expenses not incurred wholly and exclusively for the purposes of the trade, or
>
> (b) losses not connected with or arising out of the trade.
>
> (2) If an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade."

Statutory provisions providing for relief for employee share acquisitions

30. Part 12 of CTA 2009 contains provisions giving a company relief in respect of certain employee share acquisitions. Part 12 also contains provisions that disapply other reliefs where relief under Part 12 is available. These provisions are relevant in 5 this case because HMRC consider that Part 12 prevents the Taxpayers from obtaining relief (in their calculation of trading profit) in respect of the grant of the Options.

31. Section 1001 of CTA 2009 sets out the Overview of Part 12. Section 1001(1) provides for corporation tax relief to be available "in relation to employee share acquisitions" but not explicitly in relation to the grant of employee share options. 10 However, s1001(4) provides that Chapter 3 of Part 12 provides for relief if:

> (a) an employee or another person obtains an option to acquire shares because of the employee's employment by a company, and
>
> (b) shares are acquired pursuant to the option.

15 Relief under Chapter 3 is therefore provided when shares are actually acquired pursuant to an option. Section 1015 sets out the basic requirements for relief under Chapter 3 as follows:

> " (1) Relief under this Chapter is available to a company ("the employing company") if—
>
> 20 (a) a person ("the employee") has employment with the employing company,
>
> (b) that employment ("the relevant employment") is in relation to a business within subsection (2) ("the qualifying business"),
>
> (c) the employee or another person obtains an option to acquire 25 shares because of the relevant employment,
>
> (d) the person who obtains the option acquires shares pursuant to the option, and
>
> …"

30

32. Section 1018 of CTA 2009 sets out how any relief under Chapter 3 should be calculated as follows:

> "(1) If the shares acquired are neither restricted shares nor convertible 35 shares, the amount of relief to be given is an amount equal to—
>
> (a) the market value of the shares when they are acquired, less
>
> (b) the total amount or value of any consideration given by any person in relation to the obtaining of the option or to the acquisition of the shares."

40 33. Sections 1018 to 1020 of CTA 2009 determine the amount of relief that is due. Section 1021 of CTA 2009 sets out how the relief is given as follows:

"(1) The relief is given for the accounting period in which the shares are acquired.

(2) The amount of relief is allowed as a deduction in calculating the profits of the qualifying business for corporation tax purposes (subject to subsections (3) and (4))

…"

34. Section 1038 of CTA 2009 makes provision for the disallowance of other deductions where relief is available under Part 12 in certain circumstances. At times relevant to this appeal, s1038 read as follows:

"(1) If relief under this Part is or, apart from condition 2 in section 1009(1), would be available for an accounting period, no other deduction in relation to expenses within subsection (2) is allowed for the purpose of calculating any company's profits for corporation tax purposes for any accounting period.

(2) The expenses within this subsection are the expenses directly related to the provision of the shares.

…"

35. As the FTT observed, Section 1038 did not deal expressly with whether a deduction would be available on grant of an employee share option. However, with effect for accounting periods ending after 20 March 2013 (and thus after the period relevant to this appeal), Parliament changed the law so that deductions associated with the grant of employee share options were expressly dealt with. As amended s 1038 reads as follows:

"(1) Subsection (2) applies if relief is or, apart from condition 2 in section 1009(1), would be available under this Part.

For this purpose, it does not matter if the amount of the relief is or would be calculated as nil.

(2) Except as provided for by this Part, for the purpose of calculating any company's profits for corporation tax purposes for any accounting period, no deduction is allowed—

(a) in relation to the provision of the shares or to any matter connected with the provision of the shares, or

(b) so far as not covered by paragraph (a) in a case in which the shares are acquired pursuant to an option, in relation to the option or to any matter connected with the option

36. Also for periods later than that relevant for the purposes of this appeal, a new s1038A of CTA 2009 was introduced which excluded deductions for share options where shares had not been acquired pursuant to the options in the following terms:

" (1) Subsection (2) applies if—

(a) a person obtains an option to acquire shares and the requirements of section 1015(1)(a) to (c) are met in relation to the obtaining of the option, or

(b) so far as not covered by paragraph (a), a person obtains an option to acquire shares and the obtaining of the option is connected with an option previously obtained in a case covered by paragraph (a) or this paragraph.

5 (2) For the purpose of calculating any company's profits for corporation tax purposes for any accounting period, no deduction is allowed in relation to—

(a) the option, or

(b) any matter connected with the option,

10 unless the shares are acquired pursuant to the option.

37. As the FTT observed, Section 1290 of CTA 2009 seeks to ensure that there is broad symmetry between the time at which a company obtains relief for an "employee benefit contribution" and the time at which the employee receives taxable "qualifying benefits" out of that contribution. That result is achieved by the following provisions:

15 " (1) This section applies if, in calculating for corporation tax purposes the profits of a company ("the employer") of a period of account, a deduction would otherwise be allowable for the period in respect of employee benefit contributions made or to be made (but see subsection (4)).

20 (2) No deduction is allowed for the contributions for the period except so far as—

(a) qualifying benefits are provided, or qualifying expenses are paid, out of the contributions during the period or within 9 months from the end of it, or

25 (b) if the making of the contributions is itself the provision of qualifying benefits, the contributions are made during the period or within 9 months from the end of it.

38. Section 1290 therefore applies to deductions in respect of "employee benefit contributions". That, and other, defined terms are set out in s1291 of CTA 2009 as
30 follows:

"(1) For the purposes of section 1290 an "employee benefit contribution" is made if, as a result of any act or omission—

(a) property is held, or may be used, under an employee benefit scheme, or

35 (b) there is an increase in the total value of property that is so held or may be so used (or a reduction in any liabilities under an employee benefit scheme).

(2) For this purpose "employee benefit scheme" means a trust, scheme or other arrangement for the benefit of persons who are, or include,
40 present or former employees of the employer or persons linked with present or former employees of the employer.

..."

The Decision

39. The FTT made its decision by determining the four issues summarised at [4] above on which HMRC relied for its contention that the expenses in question were not deductible for corporation tax purposes as follows.

5 ***Issue 1: whether the IFRS 2 Debits were expenses incurred wholly and exclusively for the purposes of each Taxpayer's trade***

40. The FTT held at [63] that in the absence of any express provision to the contrary, s 48 CTA 2009 does not require any further examination of whether the IFRS 2 Debits satisfy any legal definition of an "expense": the fact that they are 10 validly recognised as a debit in the Taxpayers' income statement is sufficient for s 48 to apply and causes each IFRS 2 Debit to be treated as an "expense". The FTT rejected HMRC's submission that s 48 applies only if the IFRS 2 Debit has the "general legal qualities of an expense".

41. The FTT also held at [65] that, in circumstances where the IFRS 2 Debit is 15 treated as an expense by s 48, it is an expense that is "incurred". It held that s 54 CTA 2009 does not impose a separate, free-standing requirement that the IFRS 2 Debit must satisfy in order to be regarded as "incurred" and so deductible. Rather s 54 is concerned with identifying the object of expenditure and identifying expenses that have some duality of purpose (or losses that have no connection with the trade. 20 Consequently, the FTT held that when Parliament uses the word "incurred" it does so simply as a participle that takes its colour from the word "expenses" and does not intend to impose a freestanding requirement to be applied to accounting debits of the kind for which HMRC argued. The FTT was reinforced in its conclusion by the fact that Parliament would have been aware, when enacting s 46 and s 48 CTA 2009 that it 25 was legislating against a background of court decisions that emphasise the central importance of accounting principles in determining taxable profits: see [67] and [68] of the Decision.

42. The FTT then considered whether the IFRS 2 Debits were incurred "wholly and exclusively for the purposes of the trade", stating that in order to determine that 30 question it was necessary to determine the Taxpayers' object in incurring the expenditure and whether the expenditure was incurred in order to enable the Taxpayers to carry on and earn profits in their trade. In determining that question the FTT applied the test laid down by Lord Brightman in his speech in the House of Lords case of *Mallalieu v Drummond* [1983] STC 665 in that regard. For the reasons 35 summarised at [43] to [45] below, the FTT concluded at [76] that taking a realistic view of the facts, the IFRS 2 Debits were incurred wholly and exclusively for the purposes of the Taxpayers' trades.

43. The FTT observed at [72] that the IFRS 2 Debits did not of themselves reference an actual outlay of cash by the Taxpayers. Nevertheless, the FTT said at 40 [73] that it did not consider that Parliament intended to deny deduction simply because a particular debit was mandatory as an accounting matter. The FTT therefore

considered that in order to apply Lord Brightman's approach to the IFRS 2 Debits, it was necessary to consider the circumstances in which those debits arose.

44. In that regard, the FTT made the following findings at [74] of the Decision:

> " The relevant circumstances are that the Appellants carry on trades that involve employing staff and making those staff available to other group companies. The profits of that trade come from the fact that the Appellants charge a margin over and above their employees' payroll costs. The Appellants' employees operate in a professional services business whose success depends on the availability of skilled and motivated professionals and the grant of share options to those employees is part of their remuneration package. The IFRS2 Debit arises only because options have been granted to the Appellants' employees. Moreover, as noted at [13], the Appellants charge group companies an amount corresponding to the IFRS2 Debit (appropriately marked up) when making employees available to them, and therefore the incurring of the IFRS2 Debit has a direct link with the earning of revenue profits. There is no suggestion that the options were granted, and the IFRS2 Debit thus incurred, for any ulterior motive not related to the Appellants' trades."

45. That finding was not challenged by HMRC on this appeal. At [75] the FTT considered that it was relevant that the Taxpayers were prepared to pay SWHL under the Recharge arrangement, which demonstrated that the Taxpayers thought they were obtaining a benefit from the grant of options sufficient to warrant them paying an amount equal to the fair value of those options to SWHL. The FTT held that this was a further indication that the IFRS 2 Debits, which arose only because the Options were granted, were incurred wholly and exclusively for the purposes of SWHL's trade. In addition, the FTT observed that the IFRS 2 Debits were intended, as an accounting matter, to represent a measure of the value of employee services that the Taxpayers consume in return for the grant of the Options and that the Taxpayers consume those services in the course of the trades that they conduct.

Issue 2: whether the IFRS 2 Debits were items of a capital nature

46. The FTT held at [79] that whilst the Taxpayers were treated for accounting purposes as receiving a capital contribution from SWHL, as the "contra" item in its accounts to the IFRS 2 Debits, that did not determine whether, as a matter of law, the IFRS 2 Debits were capital in nature.

47. At [81] the FTT held that the IFRS 2 Debits were not capital in nature for the following reasons. The IFRS 2 Debits arose because the Taxpayers' employees were remunerated with share options and the remuneration of employees has a revenue, not a capital, nature. In addition, the IFRS 2 Debits were recurring costs that had a connection with the Taxpayers' earning of income and reflected the consumption of employees' services by the Taxpayers.

Issue 3: whether s 1038 CTA 2009 barred a deduction in respect of the IFRS 2 Debits.

48. The FTT held at [87] that relief was not “available” under s 1038 unless and until an option is exercised so that the restriction in s 1038 is not capable of applying to restrict expenses associated with the grant of a share option unless and until that option is actually exercised. The FTT accepted that if an option were exercised, then s 1038 would impose a restriction on a deduction for expenses “directly related to the provision of the shares” in any accounting period.

49. As a consequence, the FTT stated at [90] of the Decision that the issue then reduced to a consideration of whether the IFRS 2 Debits were “directly related to the provision of shares” and the FTT held at [90] that they were not for the following reasons:

> “(1) The IFRS2 Debits arise in respect of the grant of options, irrespective of whether shares are provided on exercise of those options. The possibility of options not being exercised was real and not fanciful as noted at [14]. Since the IFRS2 Debits can arise even where no shares were issued, I do not consider that they are “directly related to the provision of shares”.
>
> (2) As an accounting matter, the IFRS2 Debits are intended to measure the consumption of employees’ services by the Appellants. That is not directly related to the provision of shares.
>
> (3) As noted at [25], the accounting standards seek to measure the value of employees’ services consumed by ascertaining the fair value of the options granted. The value of the IFRS2 Debits takes into account a number of factors, some of which are not at all related to the SWHL shares. For example, the extrinsic value of the options takes into account prevailing market interest rates and the duration of the option which have nothing at all to do with SWHL shares. Moreover, the IFRS2 Debit will also take into account the Appellants’ changing estimates of the number of options that will vest, a factor that depends more on patterns of staff turnover than on the provision of SWHL shares.”

50. At [91] the FTT concluded that the fact that s 1038A CTA 2009 was subsequently enacted so as to amend s 1038 did not help in determining what Parliament meant by expenses being “directly related to the provision of shares”.

Issue 4: whether s 1290 CTA 2009 barred a deduction in respect of the IFRS 2 Debits.

51. At [92] the FTT observed that it was common ground between the parties that the act of granting share options to employees did not involve employees receiving “qualifying benefits” for the purposes of s 1292 CTA 2009, largely because s 473 of the Income Tax (Earnings and Pensions) Act 2003 provides that the grant of an option to employees does not give rise to an income tax charge for employees.

52. The question was therefore whether the grant of options to employees involved the making of an “employee benefit contribution” as defined in s 1291 CTA 2009. As

the FTT observed at [97] this reduced to the question as to whether, as a result of the grant of the Options, either (i) property is held, or may be used, under an "employee benefit scheme" or (ii) there is an increase in the total value of property that is so held or may be used (or a reduction in any liabilities under an "employee benefit scheme").

5 53. At [98] the FTT held that the Options embody contractual rights that employees held in their own names, absolutely. When the employees received their Options, they had received their benefit and those options were no more held "under" an employee benefit scheme after they were granted them than was an employee's salary.

54. At [99] the FTT held that the fact that the Trustee of the EBT needed to obtain 10 shares to meet its contractual obligations when Options were exercised did not cause those shares to be held "under" the EBT. It held that those shares were acquired to enable the Trustee of the EBT to honour the contractual benefit that had already been provided in the form of the option and were not acquired to confer a separate benefit on employees.

15 55. The FTT was not satisfied on the evidence that a "result" of granting share options was that the EBT would hold shares in SWHL or an increased value of shares, finding that if the Trustee of the EBT granted share options, it would not necessarily need to acquire shares to "cover" those options. Therefore, the FTT was not satisfied that there was the necessary causal link between the grant of any particular option and 20 the Trustee's acquisition of shares to conclude that as a "result" of the grant of any particular option, the Trustee of the EBT acquired shares or an increased value of shares: see [100] of the Decision.

56. At [101] the FTT held that this interpretation was consistent with the overall purpose of s 1290. Its reasoning on this point was as follows:

> 25 "Section 1290 is not seeking to establish a general principle that a company is denied a corporation tax deduction whenever it makes outright payments to employees that are not subject to tax in the employees' hands. If that were the purpose of s1290, it could have been expressed much more briefly. Rather, s1290 is concerned with situations in which an employer incurs expenses in 30 putting property into an arrangement that can be expected (in due course) to result in employees receiving benefits but the corporation tax deduction is taken before employees are subjected to a tax liability on their benefit. That is emphasised by the fact that s1290(2) permits a deduction to be given where qualifying benefits are provided "out of" employee benefit contributions 35 (suggesting that an employee benefit contribution is something other than an outright transfer to employees). It is also emphasised that by the fact that the definition of "employee benefit arrangement" envisages that there is some sort of intermediary arrangement standing between the provision of property by the employer and the receipt of benefits by the employee. The options arising in this 40 appeal were not within the evident purpose of s1290: as noted above, as soon as the EBT Trustee granted the options, the employees received their benefit (consisting of the option itself) and no further action was needed for them to receive that benefit."

Grounds of Appeal and issues to be determined

57. On 29 August 2017 Judge Richards granted HMRC permission to appeal against the Decision, in summary, on the following grounds:

(1) The FTT erred in holding that the IFRS 2 Debits were an "expense" within the meaning of s 48 CTA 2009 because such debits represented consideration that the Taxpayers had received (not monies that they had laid out), namely the services of the employees, that as a matter of accounting practice was treated as immediately consumed and therefore as giving rise to an accounting debit. Consequently, the IFRS 2 Debits did not represent items brought into account as a debit in calculating the profits of a trade for tax purposes and was therefore not an expense within the meaning of s 48.

(2) The FTT misdirected itself in relation to the meaning of "incurred" in s 54 CTA 2009 because Parliament had imposed in that provision separate requirements that (a) there must be an "expense" and that (b) that expense must be "incurred". On the FTT's analysis, a company obtains a deduction for corporation tax purposes even though it has not spent any money in respect of the IFRS 2 Debits.

(3) The FTT erred in law in holding that the IFRS 2 Debits were incurred "wholly and exclusively for the purposes of the [Taxpayers'] trade" within the meaning of s 54 (1) (a) CTA 2009 because the IFRS 2 Debits were not for monies spent and an expense which relates to monies which are neither actually spent nor to be spent which is recognised as a result of the requirements of accounting practice cannot sensibly be said to have any "purpose" so far as this statutory provision is concerned.

(4) The FTT erred in law in concluding that the IFRS 2 Debits were not capital in nature because it failed to have regard to the effect of the expenditure as opposed to the purpose of the expenditure. Since the corresponding credit which relates to the IFRS 2 Debit is required to be recognised in shareholders' funds and represents a capital contribution to each Taxpayer from SWHL the expense recognised a result of the grant of the Options is capital in nature and is disallowed by s 53 (1) CTA 2009.

(5) The FTT further erred in concluding that s 1038 CTA 2009 did not disallow the deduction sought by the Taxpayers because it should have held that in all relevant accounting periods relief was "available" under s 1015 CTA 2009. The FTT erred in holding that the IFRS 2 Debits were not "directly related to the provision of the shares" because those debits were required to be recognised precisely because the Options had been granted to the employees concerned. On the FTT's analysis, relief is available upon the grant of options regardless of compliance with the detailed conditions of Part 12 of CTA 2009 and double deductions may be available for the IFRS 2 Debits on the grant of options if there is thereafter relief under Part 12 of CTA 2009 upon their exercise.

(6) The FTT should have held that the amendments made to Part 12 of CTA 2009 effected by the Finance Act 2013 (including the introduction of s 1038A) were made merely for the avoidance of doubt as was made clear by the relevant Explanatory Notes and ministerial statements.

(7) The FTT erred in law in concluding that s 1290 CTA 2009 did not apply so as to defer the corporation tax deductions claimed in respect of the IFRS 2 Debits until qualifying benefits were provided. The grant of the Options is an act under which property (either the shares in SWHL or the contractual rights granted under the Options) become subject to an arrangement (set out in the terms of the Options) which is for the benefit of employees. Furthermore, until the point at which the Options are exercised, the Options (or the contractual rights under the Options, or the shares to which the Options relate) are property which is held, or which may be used, under an "employee benefit" scheme. The grant of the Options was therefore an "employee benefit contribution" in respect of which deduction is deferred by s 1290. The FTT's analysis results in corporation tax deductions being obtained by the Taxpayers without matching charges to income tax and national insurance contributions on the employees.

58. We shall deal with these grounds of appeal by reference to the four issues which were the subject of the Decision. We repeat them for convenience as follows:

(1) Whether the IFRS 2 Debits were expenses incurred wholly and exclusively for the purposes of each Taxpayer's trade (with the result that section 54 of the Corporation Tax Act 2009 ("CTA 2009") bars a deduction).

(2) In the alternative, whether the IFRS 2 Debits were items of a capital nature (and thus not deductible under s 53 CTA 2009).

(3) In the alternative, whether s 1038 CTA 2009 barred a deduction in respect of the IFRS 2 Debits.

(4) In the alternative, whether s 1290 CTA 2009 barred a deduction in respect of the IFRS 2 Debits.

Discussion

Issue 1: whether the IFRS 2 Debits were expenses incurred wholly and exclusively for the purposes of each Taxpayer's trade

59. We shall take this issue in two parts as follows. First, we shall consider whether the IFRS 2 Debits can properly be said to be an "expense" within the meaning of s 48 CTA 2009. If we find that the IFRS 2 Debits were not an "expense" then that will dispose of the appeal in HMRC's favour. However, if we conclude that the IFRS 2 Debits are an "expense" we will go on to consider whether that expense was "incurred wholly and exclusively for the purposes of the [Taxpayers'] trade" within the meaning of s 54 (1) (a) CTA 2009.

Expense

60. It was common ground that the combined effect of s 46 (1) and s 48 CTA 2009 is that if a trading expense is brought into account as a debit on a taxpayer's income statement in its statutory accounts and that expense is calculated in accordance with generally accepted accounting practice then the amount shown in the accounts as representing that expense is, subject to what we say at [61] below, properly deductible for corporation tax purposes as an expense against trading profits. As the legislation makes clear, that is the case even if no money has actually been paid in respect of that expense.

61. That principle is subject to any express statutory provision to the contrary or any adjustment required or authorised by law: see s 46 (1) and s 48 (3). In that context, we consider later whether any of ss 53, 54, 1038 or 1290 CTA 2009 makes provision to the contrary. Therefore, if we find that the IFRS 2 Debits can properly be regarded as an "expense" and there is no express statutory provision to the contrary or any other adjustment required or authorised by law then, notwithstanding the fact that the IFRS 2 Debits were only brought into account as debits in the Taxpayers' statutory accounts because of need for the statutory accounts to comply with the requirements of IFRS 2 and thereby comply with generally accepted accounting practice, then the amounts representing those debits are, as found by the FTT, properly deductible for corporation tax purposes. That is the case even though there was no actual expenditure on the part of the Taxpayers in relation to those debits.

62. This principle has been consistently recognised in the authorities. In particular, in *Odeon Associated Theatres Limited v Jones* (1971) 48 TC 257, a judgment of the Court of Appeal, Salmon LJ having referred to the earlier authorities, said at page 281:

> "In my judgment the true proposition of law is well-established, namely, that, in determining what is capital expenditure and what is revenue expenditure in order to arrive at the profit for tax purposes in any particular year, the Courts will follow the established principles of sound commercial accounting unless they conflict with the law as laid down in any Statute."

63. In the same case, in the High Court Pennycuick VC dismissed the suggestion that there is a distinct requirement that the profit of the trade must be ascertained for the purpose of income tax in the following terms at page 273:

> "It was not clear to me… precisely what standard the Court should adopt, apart from that of the ordinary principles of commercial accountancy, in arriving at the profit of a trade for the purpose of income tax. [Counsel for the Crown] used the word "logic". If by that he intended no more than to say that one must apply the correct principles of commercial accountancy, I agree with that, as I will explain in a moment. I think, however, he intended to go beyond that and meant that the Court must ascertain the profit of a trade on some theoretical basis divorced from the principles of commercial accountancy. If that is what is intended, I am unable to accept the contention, which I believe to be entirely novel."

64. The same point was made in *Johnston v Britannia Airways Ltd* [1994] STC 763 where Knox J said at page 782 g:

> "The court is slow to accept that accounts prepared in accordance with accepted principles of commercial accountancy are not adequate for tax purposes as a true statement of the taxpayer's profits for the relevant period. In particular, it is slow to find that there is a judge-made rule of law which prevents accounts prepared in accordance with the ordinary principles of commercial accountancy from complying with the requirements of the tax legislation. As long ago as 1957 Lord Radcliffe in *Southern Railway of Peru Ltd v Owen* said that he would view with dismay the assertion of legal theories as to the ascertainment of true annual profits which were in conflict with current accountancy practice and were not required by some special statutory provision of the Income Tax Acts…"

65. Before considering whether there are any applicable statutory exceptions to this principle in this case, we need to consider HMRCs contention that the concept of an "expense" as that term is used in s 48 CTA 2009 does not go so far as to embrace the IFRS 2 Debits. Mr Julian Ghosh QC, who led for HMRC on this appeal, submits that the IFRS 2 Debits cannot be regarded as an "expense" for the following reasons:

(1) they were not an expense which reflects any monies actually spent by the Taxpayers or any monies to be spent by them;

(2) they did not fall to be included in the calculation of trading profit provided by s 46 CTA 2009 because they represented consideration that the Taxpayers had received (not monies that they had laid out), namely the services of the employees, that as a matter of accounting practice was treated as immediately consumed and therefore as giving rise to an accounting debit;

(3) to arrive at the calculation of the profits of the trade, it is necessary to modify the company accounts to exclude any entries in a company's profit and loss account which do not, in accordance with income tax law, form part of the calculation of the profits of the company's trade: in the same way that accounting entries that relate to other non-trading company activities, such as investment or property business would be excluded, these debits should be excluded on the basis that they did not represent trading items.

66. Mr Ghosh referred us to the opinion of the House of Lords in *Lowry v Consolidated African Selection Trust* (1940) 23 TC 259 in support of his submissions. That case concerned an issue of shares at par by the taxpayer company to employees in consideration of their services in circumstances where the market value of the shares was considerably above par. The company contended that the difference between the market and par values of the shares so issued was allowable as a deduction in computing its profits for income tax purposes.

67. Viscount Maugham referred at page 284 to the fact that upon an issue of shares the assets of a company are increased by the amount obtained from the subscribers and those amounts were obviously not profits or gains of a trade and were not liable to be brought into the accounts for income tax, whether or not the shares were allotted at par or at a premium. He observed that the issue of shares by a limited company was not a trading transaction at all; although the corporate entity becomes pro tanto larger,

the receipts of the trade and the amount of the costs expenditure necessary for earning these receipts remain unaltered. He also referred to the principle that profits and gains must be ascertained on ordinary commercial principles.

68. At page 285 Viscount Maugham referred to the fact that the company was not discharging a debt or liability to the employees when it issued the shares to them at par. He accepted that if the shares were given in part payment of the employee's salary then the amount of the liability so discharged would find its way into the profit and loss account. He then said:

> "All we really have before us is that the Company has chosen to issue 6,000 shares at par to the employees and that they receive the benefit of that issue. There is really nothing more. The employees have given up nothing. The Company has not lost or parted with any asset….. There is here, in my opinion, no transaction of trade at all, nor an item of any kind that ought to be carried to either side of the profit and loss account…. I am myself wholly unable to understand how it can be said that [the Company's] profit has been reduced to the extent of a farthing by reason of the fact that the Company has 6000 fewer shares to issue to the public… The issue of shares by a Company, whether at par over, does not affect the profits or gains of the Company for the purposes of income tax."

69. Mr Ghosh submits that Viscount Maugham's observation to the effect that the taxpayer in that case had not lost or parted with an asset supports the view that every debit is not an expense and if the company, as in that case, had not parted with an asset in return for the employees' services there cannot be an expense to be brought into account in the company's profit and loss account.

70. We reject all of Mr Ghosh's submissions on this point. In full agreement with what the FTT said at [63] of the Decision, in the absence of any express statutory provision to the contrary, s 48 CTA 2009 does not require any further examination of whether the IFRS 2 Debits satisfy any legal definition of an "expense". As the FTT said, the fact that the IFRS 2 Debits are validly recognised as a debit in the Taxpayers' income statement is sufficient for s 48 to apply and causes the IFRS 2 Debits to be treated as an expense. The correct position is therefore as described at [61] above. In the absence of any statutory provision to the contrary, the IFRS 2 Debits must properly be regarded as an "expense" for the purposes of ss 46 and 48 CTA 2009.

71. Therefore, the fact that the expense recognised by the application of IFRS 2 does not reflect any monies actually spent by the Taxpayers or any monies to be spent by them is of no consequence. Nor does it matter that the IFRS 2 Debits represented consideration for services that had been received but had been treated as immediately consumed.

72. We do not think that *Lowry* assists Mr Ghosh. It was quite clear that the transaction concerned, the issue of shares, was not a transaction that needed to be reflected in the taxpayer's profit and loss account at all and the observation that the company had not parted with any asset in allotting the shares to the employees at par

value was directed at the position as regards the company's trading account. As Mr Maugham submitted, the issue in that case was whether a company could claim a deduction for a profit which the company had foregone. There is nothing to suggest that the point can be read across to a situation where the question is, as in this case, whether the fact that an expense is reflected in the profit and loss account of a trade purely as a matter of accounting practice is sufficient to enable a deduction to be made for corporation tax purposes in circumstances where no asset has been parted with.

73. Mr Ghosh's third submission, as summarised at [65] above, seems to us to fly completely in the face of the principle established by the authorities referred to at [62] to [64] above that there is no basis for calculating a company's trading profits otherwise than by reference to the statutory accounts prepared in accordance with generally accepted accounting practice, in the absence of a statutory exception. To do otherwise, would be to create judge-made law which the authorities clearly indicate is not permissible.

Incurred wholly and exclusively for the purposes of the trade

74. This point only arises because we have found that the IFRS 2 Debits can properly be regarded as an "expense" for the purposes of ss 46 and 48 CTA 2009. The essence of the point is whether the effect of s 54 CTA 2009, when the nature of the IFRS 2 Debits is tested against that provision, is to provide a statutory exception to the IFRS 2 Debits being brought into account as debits in calculating the Taxpayers' profits for corporation tax purposes. On HMRC's case there is such an exception for two reasons. First, HMRC contend that as well as being an "expense" the IFRS 2 Debits must have been "incurred" by the Taxpayers and because the Taxpayers had not spent any money in respect of those debits they could not be said to have been "incurred". Secondly, the IFRS 2 Debits were not incurred "wholly and exclusively for the purposes of the [Taxpayers'] trade" because they were not for monies spent by the Taxpayers and an expense which is only recognised as such as a result of the requirements of accounting practice cannot sensibly be said to have any "purpose" so far as s 54 is concerned.

75. Mr Ghosh's submissions on this point can be summarised as follows:

(1) As well as meeting the requirements of s 48 CTA 2009, in order to be deductible an expense must in addition be "incurred wholly and exclusively for the purposes of the trade".

(2) The IFRS 2 Debits do not reflect any monies actually spent by the Taxpayers or any monies to be spent by them; in cases where the Options lapsed, no monies will ever be expended by the Taxpayers. Therefore, the IFRS 2 Debit cannot have been "incurred" in any relevant manner for the purposes of s 54 (1) (a).

(3) An expense which relates to monies which are neither actually spent nor to be spent which arises only as a function of accounting practice cannot be characterised as having any "purpose".

(4) The FTT erred by taking into account the irrelevant consideration that the Taxpayers were prepared to pay SWHL sums under the Recharge arrangement. Such payments had nothing to do with the recording of the IFRS 2 Debits in the Taxpayers accounts which arose independently of any recharge arrangement and the existence of the recharge could not therefore inform the purpose of the IFRS 2 Debit.

76. We were referred to three cases which were decided by reference to the predecessor provisions of s 54 (1) (a). It should be noted that as part of the Tax Rewrite Project, s 54 (1) (a) rewrote s 74 (1) (a) of the Income and Corporation Taxes Act 1988. That earlier provision prohibited deductions for corporation tax purposes for "any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade…". CTA 2009 was a consolidation statute and therefore, in accordance with normal principles, we should rely on pre-consolidation authorities only when there is a real and substantial difficulty in interpreting the provisions, or there is an ambiguity which classical methods of construction cannot resolve: see Sales J in *Eclipse Film Partners (No 35) LLP v HMRC* [2013] UKUT 639 (TC) at paragraph 97.

77. Mr Ghosh contended that s 54 (1) (a) was ambiguous and therefore it is permissible to refer to the previous legislation which referred to "money… laid out or expended" rather than "incurred" and the cases which interpreted that provision.

78. The first authority is *Odeon Associated Theatres*, which we have already referred to at [62] and [63] above. The Court of Appeal had to consider whether monies which the taxpayer spent in respect of deferred repairs in a particular accounting period which had appeared as a provision in the accounts for earlier years be regarded as money laid out or expended for the purposes of the trade carried on by the taxpayer. The Court of Appeal held that the money spent on the repairs was deductible as it had been spent, notwithstanding that it had appeared in the accounts in an earlier period as a deferred expense. Mr Ghosh relies on this case for support for the proposition that it is only expenses where monies have been actually spent or where there is provision for them to be spent in the future that the expense is deductible.

79. The second authority is *Lowry*, which we have also already referred to, at [66] to [69] above. Mr Ghosh submits that the basis of the decision in that case was that the sum foregone by the company by reason of the shares concerned being issued at par rather than market value was not in any sense laid out or expended for the purposes of the trade and is therefore authority for the proposition that an expense is not deductible unless it is so laid out or expended.

80. The third authority is *Jenners Princes Street Edinburgh Ltd v IRC* [1998] STC (SCD) 196, which was another case relating to deductions claimed for repairs to premises used by the taxpayer for the purposes of its trade. The taxpayer had made a provision in its accounts for one year for the estimated cost of the repairs, the profit and loss account showing a deduction, in accordance with the normal principles of commercial accountancy, for substantially all of the amount of the provision. HMRC accepted that deduction of the provision was not prohibited by s 74 (1) (a) ICTA 1988

since it was money expended for the purposes of the trade but refused a claim to deduct the provision on the ground that s 74 (1) (d), which provided that no sum could be deducted in respect of any sum expended for repairs of premises occupied for the purposes of the trade, beyond the sum "actually expended" for those purposes, restricted deductions to money physically spent on repairs in the relevant accounting period.

81. The Special Commissioners held that "expended" as used in s 74 (1) (a) was not restricted to money physically spent, having regard to the use of contrasting phrase "laid out" in the same paragraph. They also said that was no obvious reason why the same word (expended) should be given an entirely different meaning when used in s 74 (1) (d). HMRC argued that the phrase "actually expended" as used in the latter provision, did have that effect.

82. The Special Commissioners held that adverbs such as "actually" might dilute or enforce the strength of the verb they qualified however they did not generally change the meaning of the verb. The qualification in this case of the verb "expended" by "actually" added precision to the verb and meant no more than what was truly expended in the accountancy sense. The natural meaning of "actually expended" was therefore actually expended in the accountancy sense. That simply required an accurate assessment as opposed to a broad or notional figure. There was no rational basis for restricting the deductions allowable under s 74 (1) (d).

83. In our view, and in full agreement with both the FTT and Mr Maugham's submissions on this point, the word "incurred" as used in s 54 (1) (a) cannot bear the weight that Mr Ghosh seeks to place on it. We do not accept his characterisation of s 54 (1) (a) as having the effect of imposing additional requirements on what might be regarded as an "expense" for the purposes of ss 46 and 48 CTA 2009. Rather, this provision is designed purely to ensure that such expenses which have a dual purpose are not deductible. We therefore do not regard s 54 (1) (a) as being, in the words of s 48 (3), an "express provision" which is contrary to the provisions of s 48 (1). As we have found, that latter provision is sufficient to enable the IFRS 2 Debits to be regarded as an expense on the basis that they have been brought into account as debits in calculating the Taxpayers' profits. As Mr Maugham submitted, HMRC's interpretation would defeat the clear purpose of s 48 which is to regard items as expenses whether or not monies have been laid out or expended on them.

84. We are reinforced in our findings of the purpose of s 54 by the heading to the section which simply says "Expenses not wholly and exclusively for trade and unconnected losses". It is clear that in the context of this section, no particular significance is to be given to the use of the word "incurred" which, as the FTT said, operated simply as a participle that takes its colour from the word "expenses".

85. Therefore, we do not think that either *Lowry* or *Odeon Associated Theatres* can assist Mr Ghosh. As we have already said in relation to *Lowry*, the point at issue in that case cannot be read across to this case where the question is whether the fact that an expense is reflected in the profit and loss account of the trade purely as a matter of accounting practice is sufficient to enable a deduction to be made for corporation tax

purposes. Therefore, even if the basis of the House of Lords' opinion was that the profits foregone by the issue of the shares at par rather than at a premium was not deductible because the company had expended no money, it is of no relevance to this case.

5 86. Furthermore, *Jenners* indicates that the terms "actually expended" or "laid out", which Mr Ghosh seeks to argue are synonymous with "incurred" do not require spending of money in any physical sense; the inclusion of the items concerned as debits according to normal commercial accountancy practice is sufficient.

87. Therefore, even if it could be said that the word "incurred" was ambiguous, 10 which we doubt, in our view neither the previous statutory provisions nor the authorities which interpret them are of any assistance to HMRC in this case.

88. We now turn to the question as to whether the IFRS 2 Debits may be regarded as having been incurred "wholly and exclusively for the purposes of the trade".

89. Mr Ghosh relies on the well-known case of *Mallalieu v Drummond* [1983] STC 15 665 where the House of Lords had to consider whether the costs of a lady barrister's sober court dress were deductible as being wholly and exclusively incurred for the purposes of her profession when her evidence was that she would not have purchased those clothes had it not been for the requirements of court dress code since she had an ample supply of other clothes to keep her warm and decent.

20 90. It was clear that the issue in this case was whether the barrister's court dress had a dual purpose, namely to be worn in accordance with the requirements of the court dress code as well as to keep her warm and decent.

91. Lord Brightman said at pages 667 to 668 said that the words "expended for the purposes of the trade, profession or vocation" in the statutory provision meant 25 "expended to serve the purposes of the trade, profession or vocation" or "for the purpose of enabling a person to carry on and earn profits in the trade etc" so that the focus is on the purposes of the business which was a different concept to the purposes of the taxpayer. He then said this:

> "To ascertain whether the money was expended to serve the purposes of the 30 taxpayer's business it is necessary to discover the taxpayer's "object" in making the expenditure… As the taxpayer's "object" in making the expenditure has to be found, it inevitably follows that (saving obvious cases which speak for themselves) the commissioners need to look into the taxpayer's mind at the moment when the expenditure is made. After events are irrelevant to the 35 application of [the statutory provision] except as a reflection of the taxpayer's state of mind at the time of the expenditure."

92. On the basis of this test, it was held that the expenditure had a dual purpose because it was inescapable that one object, although not a conscious motive of the taxpayer, was the provision of the clothing that she needed as a human being.

93. Mr Ghosh does not seek to argue that the expenses represented by the IFRS 2 Debits had a dual purpose. Rather he submits that an expense which relates to monies which are neither actually spent nor to be spent (which is recognised a result of the requirements of accounting practice) cannot be characterised as having any "purpose" so far as s 54 (1) (a) is concerned.

94. Contrary to Mr Ghosh's submissions, in our view it is necessary to focus not purely on the accounting debit itself, but on the nature of the transaction which that debit records and look at the purpose of the transaction which that debit records. In this case, the IFRS 2 Debits record the effects of the issue of the Options which took place as part of the remuneration package of the employees and which formed part of their remuneration package. The purpose of the transaction, as found by the FTT as a matter of fact, was therefore to reward employees and therefore the FTT was fully entitled to find, as it did, at [74] of the Decision that there was no purpose not related to the Taxpayers' trades for which the Options were granted. The provision of the employees' services was clearly to enable the Taxpayers to make a profit and the expenses represented by the issue of the Options and the subsequent recording of the IFRS 2 Debits in the Taxpayers' profit and loss accounts were clearly made for that purpose. In our view the FTT correctly applied the principle enunciated by Lord Brightman in *Mallalieu v Drummond* in the particular circumstances of this case.

95. In any event, it would appear, as recognised by Lord Brightman, that this is one of those obvious cases in the passage quoted at [91] which speaks for itself, in the absence of any other purpose not related to the Taxpayers' trades.

96. We do not think it was necessary for the FTT to rely on the fact that it made payments under the Recharge arrangements, which the FTT said had a direct link with the earning of revenue profits. We therefore agree with Mr Ghosh that the Recharge arrangements were irrelevant to this question. However, we do not think that the fact that the FTT did have regard to that arrangement has made any difference to the soundness of its conclusions which, for the reasons we have given, was entirely correct on this point.

97. We therefore determine Issue 1 in favour of the Taxpayers.

Issue 2: whether the IFRS 2 Debits were items of a capital nature

98. If the IFRS 2 Debits can properly be regarded as items "of a capital nature" within the meaning of s 53 (1) CTA 2009, then the IFRS 2 Debits may not be brought into account as debits in calculating profits pursuant to s 46 (1) CTA 2009. In those circumstances, s 53 (1) will act as an "adjustment required or authorised by law" as provided for in s 46 (1).

99. As Mr Ghosh and the FTT correctly identified, the question whether particular expenditure is revenue or capital is one of law. Mr Ghosh submits that in concluding that the IFRS 2 Debits were revenue expenditure the FTT erred at [81] of the Decision in placing reliance upon the fact that the IFRS 2 Debits arose because the Taxpayers'

employees were remunerated by the share options and the remuneration of employees has a revenue, not a capital, nature.

100. Mr Ghosh submits that the FTT erred by failing to have regard to the effect of the expenditure as opposed to its purpose. The corresponding credit required to be made in respect of the IFRS 2 Debits was required to be recognised in shareholder funds and represents a capital contribution to each Taxpayer from SWHL. Therefore, Mr Ghosh submits, for tax purposes the expense recognised a result of the grant of the Options is capital in nature and is disallowed by s 53 (1).

101. Contrary to these submissions, and in full agreement with the FTT, in our view the fact that the Taxpayers were treated for accounting purposes as receiving a capital contribution from SWHL does not determine whether, as a matter of law, the IFRS 2 Debits were capital in nature. Once again, it is necessary to look at the nature of the transaction which has given rise to the need to record the IFRS 2 Debits in the Taxpayers' profit and loss accounts and, as we have already found, those transactions are clearly revenue transactions. Therefore, it does not follow that the IFRS 2 Debits should be regarded as entries which arise as a result of a transaction which is capital in nature simply because the corresponding credit is dealt with on the balance sheet rather than on the profit loss account and is therefore treated as capital in nature.

102. We therefore determine Issue 2 in favour of the Taxpayers.

Issue 3: whether s 1038 CTA 2009 barred a deduction in respect of the IFRS 2 Debits.

103. There are two questions which potentially arise in respect of this issue. First, we have to determine whether "relief is available" under Part 12 of CTA 2009 so that the restriction in s 1038 applies so as to disallow the expenses represented by the IFRS 2 Debits in the Taxpayers' profit and loss accounts in relation to the grant of the Options. Second, if we find that condition is satisfied, we would then need to consider whether the IFRS 2 Debits are "expenses directly related to the provision of shares" with the result that by virtue of s 1038 (2) the Taxpayers are denied relief in respect of those expenses.

104. As Mr Maugham correctly submitted, Part 12 confers relief from corporation tax when shares are acquired by the relevant employee as a result of the exercise of a share option. Therefore, relief is only available where both an option has been granted and shares have been acquired pursuant to the option. That is readily apparent from the wording of ss 1001 (4) and 1015 CTA 2009 as set out at [31] above.

105. Part 12 therefore comprises a statutory adjustment to the generally accepted accounting practice calculation required by s 46 CTA 2009 in circumstances where a share is acquired by an employee from his employer and where it applies it gives a specific statutory relief to the employer and excludes other forms of relief.

106. Mr Ghosh submits that ss 1015 and 1018 make clear that relief could be "available" without necessarily being given. In other words, because the relief is given when an option is exercised, it must be regarded as being "available" once the

option has been granted, even though the relief is not given until the option is actually exercised and shares are issued.

107. We reject those submissions. In our view, s 1015 (1) makes it clear that relief is only "available" once all of the four sub-paragraphs of that provision have been satisfied and that means that not only must the employee have obtained an option but he must have acquired shares pursuant to it.

108. As Mr Maugham submitted, the question as to whether s 1038 applies so as to deny relief for the IFRS 2 Debits has to be answered at the point in time at which those debits are claimed. They are claimed when the Options are granted, and at that point all the requirements of s 1038 will not have been satisfied. Section 1038 relief is not "available" at that point, so exclusion of other reliefs is not operative. When the Option is granted, there is no certainty that statutory relief is or will become available. In many cases the Options will have lapsed with the result that no statutory relief will ever become available. We therefore agree with what the FTT said at [87] of the Decision on this point.

109. There were limited submissions before us on the question of what might happen to the IFRS 2 Debits in a case where an option was actually exercised. The possibility of retrospective removal of relief was referred to, as was the notion of some qualified claim to IFRS 2 Debits which envisaged their reconsideration in the event of a subsequent exercise of the option. However, these notions were not fully developed and it is not necessary to decide them for the purposes of this appeal, which does not turn on any transactions in which there was an actual subsequent exercise of the option. Accordingly, we do not embark on that less than fully argued analysis. This appeal stops at the stage of determining the question which we were invited to determine, which is the effect of section 1038 at the time the IFRS 2 Debits were claimed.

110. In addition, in the light of our conclusions on "available" we do not need to consider the question of whether the IFRS2 Debits are "expenses directly related to the provision of shares", a question which the FTT decided in the negative. The question does not arise and we prefer to express no view on it.

Issue 4: whether s 1290 CTA 2009 barred a deduction in respect of the IFRS 2 Debits

111. As Mr Ghosh explained, s 1290 CTA 2009 restricts the availability of a corporation tax deduction which would otherwise be allowable in respect of "employee benefit contributions", as that term is defined in s 1291 CTA 2009. Where a corporation tax deduction is claimed in respect of an employee benefit contribution and would otherwise be allowable, the deduction is delayed until "qualifying benefits", that is payments giving rise to an employment income tax charge or a charge to national insurance contributions, are provided.

112. Mr Ghosh submitted that s 1290 was engaged for the following reasons:

(1) Even viewed in isolation, the grant of the Options is an act under which property (in particular the shares in SWHL or, alternatively, the contractual rights granted under the Options) becomes subject to an arrangement (set out in the terms of the Options) which is for the benefit of employees. The grant of the Options is therefore an "employee benefit contribution" in respect of which deduction is deferred by CTA s 1290.

(2) Even if the grant of the Options themselves is not an employee benefit contribution, the share incentive schemes were, on any view, "employee benefit schemes" within the meaning of s 1291 (2) CTA 2009. Until the point at which the Options are exercised the Options (or the contractual rights under the Options, or the shares to which the Options relate) are property which is held, or which may be used, under an "employee benefit scheme". They are part of an arrangement for the benefit of persons who include employees. The grant of the Options was therefore an "employee benefit contribution" in respect of which deduction is deferred by s 1290.

113. Those are essentially the same submissions as Mr Ghosh made before the FTT. They were rejected by the FTT for the reasons they gave at [98] to [101] of the Decision, as summarised at [53] to [56] above. We agree entirely with the FTT's reasoning on this issue and there is nothing that we could usefully add save for one point. It was common ground that the grant to an employee of a share option is specifically exempted from income tax. It would have been very easy for Parliament to have removed explicitly any corporation tax deduction that would otherwise apply in respect of that grant and thus avoided what Mr Ghosh submitted was the surprising result that the corporation tax deduction was obtained by the Taxpayers without matching charges to income tax and national insurance contributions on the employees. But, as Mr Maugham submitted, it did not do so. As the FTT held at [101] of the Decision, s 1290 does not establish a general principle that a company is denied a corporation tax deduction whenever it makes outright payments to employees that are not subject to tax in the employees' hands.

Disposition

114. Our conclusion is that the IFRS 2 Debits are a deductible trading expense of the Taxpayers. As a consequence, the appeal is dismissed.

MR JUSTICE MANN **JUDGE TIMOTHY HERRINGTON**

UPPER TRIBUNAL JUDGES
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