



TC00944

Appeal number: SC 3023 2009

Regulation 80, PAYE Regulations – Section 8, Social Security Contributions (Transfer of Functions, etc) Act 1999 – whether sums paid into a share scheme were earnings of the staff for whom they were paid – whether the shares purchased as part of the scheme were restricted securities within the meaning of Chapter 2 of Part 7 of the Income Tax (Earnings and Pensions) Act 2003 – whether the share scheme was within the scope of that Chapter

FIRST-TIER TRIBUNAL

TAX

DEUTSCHE BANK GROUP SERVICES (UK) LTD

Appellant

and

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

Respondents

**TRIBUNAL: Dr David Williams (TRIBUNAL JUDGE)
Mr David Earle (MEMBER)**

Sitting in public at 45 Bedford Square, London WC1 on 1, 2, 3, 4 and 5 February 2010

David Goy QC and Nicola Shaw for the Appellant

Paul Lasok QC, Mario Angiolini and Anneliese Blackwood, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

5 *Preliminary*

1 The tribunal heard this appeal as one of a number of appeals that raised similar
issues in respect of similar (but not identical) schemes and with reference to similar
(but not identical) facts. By agreement between all concerned, the tribunal heard this
appeal and another appeal concerning the same issues of law consecutively. Both
10 cases called into question the interpretation and application of the same provisions in
the Income Tax (Earnings and Pensions) Act 2003 (“ITEPA”), Part 7, in respect of the
same tax year (2003-04). This case was heard first and the other was then heard
following it.

15 2 The tribunal has decided the appeal in the other case, *UBS AG v HMRC* and
this has been issued as under the reference [2010] UKFTT 366 (TC). As noted below,
the tribunal dealt fully with the arguments of law common to both cases in its decision
in that case (“the UBS case”), taking into account the submissions made to it by both
parties in this case. It adopts the reasoning of that decision in this decision, without
20 extensive repetition, in so far as it is relevant.

3 That decision is not, on its facts, decisive of this case. The tribunal concluded
in that case that the Appellant had not established on the evidence that it was entitled
to the income tax exemption it claimed. The approach taken by the Appellant in this
25 case differed in important details to that in the UBS case and the tribunal must
therefore consider those aspects of this appeal in full.

4 This decision directly concerns only the appeal of the Appellant against
decisions of the Respondents (“HMRC” which includes the Commissioners of Inland
30 Revenue as predecessors in title to the Respondents). The decisions in question were
taken against the Appellant only. It is common ground that the Appellant was the
main employer in the United Kingdom of staff working with the Deutsche Bank AG
group of companies (“the DB Group”) in the year in question. No point was taken by
either party about the identity of the specific employer or of any individual employee
35 working within the DB Group or of the status of any individual serving as an officer
of a DB Group company in addition to or separately from any employment within the
Group. For the purposes of this decision the tribunal assumes that all relevant
employees of the Group are employees of the Appellant, and it refers to the Appellant
as “DB” for brevity. Its references to DB employees includes where appropriate
40 references to any officers of the DB Group receiving relevant earnings or benefits.

5 For convenience, this decision follows the same form as the UBS decision.

45

PART I: GENERAL ISSUES

5 *The issues in the appeal*

6 This appeal concerns the extent to which, if at all, sums paid to DB employees under a scheme (“the Scheme”) through shares in a company called Dark Blue Investment Limited (“DBI”) create a liability on DB to pay to HMRC:

10 (a) income tax by reason of a decision made under regulation 80 of the Income Tax (Pay As You Earn) Regulations 2003, reflecting a liability to income tax under Part 3 of ITEPA, and

15 (b) primary and secondary Class 1 National Insurance (“NI”) contributions by reason of a decision made under section 8 of the Social Security (Transfer of Functions, etc) Act 1999 (“the 1999 Act”).

(The Scheme had various names, being first referred to as STEED with the full name of “Short Term Equity Deferral Plan”. It then gained the mnemonic EDSA: “Employee Discretionary Share Award”, and kept that for some purposes through the operation of the Scheme. Nothing turns on these labels.)

7 The decision made under section 8 of the 1999 Act sought to impose liability on DB in respect of both primary contributions and secondary contributions. There are therefore no other appellants against the section 8 decision.

8 The sums were awarded to individual DB employees by reference to bonuses related to the tax year 2003-04. It is common ground that the tribunal is not concerned in this decision with the precise amounts paid to, or individual liabilities of, specific individuals, but only the issues of principle that arise. As there is no contended liability save for that of DB, and no individual sums in question, the tribunal agreed with the parties that this decision did not require the identification of any specific individual serving as an officer or employee of the DB Group save where that individual gave direct evidence in the appeal. This decision has been written on that basis.

The contentions of the parties

9 In outline, DB arranged for certain bonus sums that were to be payable to identified individual DB employees to be paid into the vehicle created for the Scheme and not directly to any employee. Those sums were used to purchase shares in DBI which were allocated to individual employees. DB employees were given rights to sell their shares and withdraw sums from the Scheme over a period, up to the amount of the individual bonus of the employee subject to any fluctuation in the value of the shares during the period. If this right was used the employee received a cash sum. The Scheme was wound up at the end of a specified period, and sums paid to employees who had not previously received sums from the Scheme. The appeal concerns the

proper designation of the sums paid into and out of these arrangements for income tax and NI contribution purposes.

10 For DB it is contended that:

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(a) Employees received nothing taxable when the sums were paid into the Scheme. This is because the sums paid in were not, and could not be regarded as, earnings of any individual employees at that stage;

10 (b) Employees received shares in respect of the sums paid in, but no income tax or NI contribution liability arose in respect of the receipt of those shares because they were "restricted securities" exempted from liability by section 425 of ITEPA;

15 (c) The restrictions were removed from the shares while held by or for the employees but there was no liability to income tax or NI contributions by reason of section 429 of ITEPA;

(d) Employees disposed of their shares by sale at various times, but there was no income tax liability or NI contribution liability by reason of the sale.

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11 It may be that there was a liability on individuals to capital gains tax, and the individual liabilities of specific employees might be affected by the remittance basis of taxation or double taxation agreement provisions relevant to individuals. In particular, individuals could make use of the two year taper relief for capital gains tax to reduce individual liability. These were matters for those individuals alone and were not a liability of DB. While the Scheme was designed to allow individuals to use the capital gains tax relief if an individual wished to do so, and other relief might be available, that does not affect this appeal. Accordingly those issues are not explored further.

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12 HMRC contends that:

(a) the sums were earnings received by employees for the purposes of section 62 of ITEPA and section 3 of the Social Security Contributions and Benefits Act 1998 ("the 1998 Act") before those sums were paid into the Scheme, and liability to income tax and NI contributions therefore arose at that stage;

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(b) if that was not so, then the shares received by the employees were not restricted securities within section 425;

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(c) if that was not so, then the values of individual shareholdings were not exempted from income tax or NI contributions by reason of any provision in ITEPA;

(d) if that were not so, then the Scheme is to be ignored as merely a preordained arrangement without real effect and the transactions are to be taxed as if there were cash payments directly to the employees.

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13 Save for the allegations in the UBS case that certain aspects of the purported
evidence should be found to be a sham, these issues are essentially the same issues as
5 those considered in the UBS case. Aside from that point, HMRC took the same
approach in both cases that it was for the Appellant to prove that the documentation
represented actual events. While the parties in this appeal were able to agree some of
the facts, the tribunal was therefore given considerable documentation about the
Scheme by both parties.

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14 The tribunal set out the factual pattern common to the UBS case and this case
in paragraph [17] of the UBS case decision, and initially the same legal issues arise
for decision (as stated in paragraphs [18] and [19] of that decision) namely:

15 “(a) Were the bonus sums allocated for individual employees
earnings for income tax and NI purposes at any stage, aside from any allocations
into or from the Scheme?

(b) How are the relevant provisions of Part 7 of ITEPA, and in particular
sections 423 to 429 of that Act, to be interpreted and applied?

20 (c) Can the tribunal ignore the details of the Scheme by reference to the
facts as a whole, and treat the value received as earnings of individuals without
regard to the Scheme?

25 It was common ground between all parties that there is no material difference
between the provisions imposing income tax liability on the bonus sums, and the
provisions imposing liability to National Insurance contributions. With the
agreement of the tribunal the arguments were confined to the legislation imposing
charges to income tax. The tribunal takes the same approach in this decision.”

30 In paragraphs [20] to [40] of the UBS decision the tribunal sets out the
legislation equally relevant to this appeal, focussing on Chapter 2 of Part 7 of ITEPA.
It does not repeat it. In paragraph [41] to [55] of that decision the tribunal set out its
views on the proper interpretation and application of Chapter 2 of Part 7 of ITEPA. It
adopts those views here without repeating them. It notes that since the issue of the
35 decision in that case the Upper Tribunal has decided the appeal and cross-appeal in
HMRC v PA Holdings Ltd [2010] UKUT 251 (TCC). To avoid delay, this tribunal
decided not to invite any submissions from the parties in this appeal about the
application of that decision to this case, but considers it as it is required to do by the
rules of precedent.

40 PART 2: THE SCHEME

Witness evidence

16 The following witnesses gave evidence.

45 17 For DB, oral evidence of fact was given by the following DB employees:

5 (a) John Berry was the only witness who was a DB employee. He was a beneficiary of the Scheme and gave evidence in that capacity. His function at the relevant time was to assist DB in implementing the Scheme. His position at the relevant time was as head of European Execution for the Structured Capital Markets Group. But it was clear from his oral evidence that he had no executive or planning responsibility for the Scheme, and was concerned only in an administrative role with assisting DB Group tax in setting up the Scheme and in protecting DB's interests in the Scheme as it was developed. Further, the Scheme was not a Structured Capital
10 Markets transaction but one being run by DB's human resources team. In his own words, "my involvement in the Transaction was a short and intense period of approximately 14 days". He ceased working for DB in 2004 save for a continuing retainer in connection with the Scheme.

15 (b) Roy Beddows was a transactor working with Investec. He gave evidence under summons about documentation produced about the Scheme and the involvement of Investec in the Scheme. He confirmed that the involvement of Investec was as a fee earning opportunity, and that Investec performed the role that the documents indicated it performed. HMRC contended that the only interest
20 Investec had in the Scheme was the cash fee it was paid for its involvement. The tribunal finds that it was offered no evidence to suggest otherwise. It heard and saw no significant evidence that Investec was asked to exercise any independent discretion with regard to the Scheme or any investment or other expertise. Nor was there evidence from this witness or otherwise that Investec was providing significant
25 investment into the Scheme or was put to any significant risk by it.

(c) Sharon Parr was a director of Walbrook, the nominees used in the Scheme, at the relevant time. She had direct responsibility for relations with DB. She gave evidence about the involvement of the nominees in the conduct of the Scheme. The
30 documents "do reflect what in fact happened." The tribunal finds that the evidence of the witness was fully consistent with the role of Walbrook as a nominee, and accepts her evidence that it acted accordingly.

18 Expert evidence about valuation was given by two witnesses:
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(a) Keith Eamer gave evidence for DB. He had been a director in the share and business valuation department of BDO LLP, chartered accountants. He was instructed to value the shares known as C1 share in DBI as at 6 February 2004, and in particular to value the effect on the market value of those shares by reference to restrictions on
40 those shares in the articles of association of DBI.

(b) David Croft gave evidence for HMRC. He had been involved in different ways in his career with a range of aspects of securities and fund management activities. He was instructed to give his opinion on a number of aspects of the
45 Scheme.

19 There was no other witness evidence offered by HMRC.

20 Aside from the expert evidence, the tribunal was left with the feeling that the witness evidence added little to the documentation beyond an affirmation by each of the three witnesses that the documents represented what happened. At the same time,
5 it was clear, but not surprising, that the recollections of each of the witnesses were limited at this remove from the actual events, and that those recollections had themselves been informed by the documents put in evidence.

21 More specifically, the tribunal notes the limited extent of the evidence offered
10 by the Appellant itself about its own involvement in the Scheme. While Mr Berry's evidence as a participant in the Scheme was useful and derived from personal experience, the tribunal was only able to derive limited assistance from his other evidence. For example, he himself stated in oral evidence that - even with the benefit of having access in preparing his evidence to the papers - "the initial structuring of the
15 transaction I paid very little attention to." It also notes that he made only limited reference to the role of Deloitte in the transaction although emails suggest that he was working closely throughout the key period with Deloitte to ensure that the Scheme was delivered as they envisaged it. See for example emails between Mr Berry and Christine Chen and others at Deloitte on 26 and 27 January 2004.

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Documentary evidence

22 The tribunal had before it considerable documentation about the evolution and execution of the Scheme. It did not ask for, and was not concerned to see, full documentation about individual employees who benefitted from the Scheme, although
25 it saw examples of communications to those involved. It is satisfied that DB had supplied HMRC with the relevant documents.

23 One matter is clear from the documentation. The Scheme was not generated internally by DB. It was a plan put together for DB by Deloitte on the basis of a more
30 general proposal initially put to DB. Deloitte continued throughout to play a central role in designing and delivering the Scheme. This is clear, for example, from the email sent on 7 January 2004 for Tony Butcher, employer solutions group partner for Deloitte London by one of his staff to David Hards, Matthew Press, and John Mooney of DB, with copies to four Deloitte colleagues, including Matthew Crocker. This
35 comments about a critical meeting with counsel about the Scheme the following day being organised by Deloitte. The email also included a draft timetable and action plan for the Scheme. The notes to that draft include the following (symbols as in original):

40 "- each time an action changes in time, delay or advancement, Deloitte will review the whole process to ensure any knock on effect are dealt with effectively. The timetable will be published to all involved every 2/3 days, including an early Monday morning edition focussing on action for the week in strict order.

45 - administration on the timetable will be dealt with by Matthew Crocker"

...

“* Where DB responsibility is indicated, it is assumed Deloitte will offer practical help and support at all stages.”

24 It is not surprising in this context, given the tribunal’s views of the oral
5 evidence presented to it, that the tribunal finds that the evidence is that the documents
produced by DB, for example by way of company documents, represented what
happened stage by stage as the Scheme was put into effect. DB’s case was that the
critical documents both adequately and accurately evidenced the implementation of
10 the Scheme, in that the events took place and the parties involved in the Scheme acted
in accordance with the terms of all agreements. The tribunal finds no strong evidence
pointing otherwise, and accordingly accepts that submission. Some variations, for
example in late signings, are to be expected and did occur, but such events tend to
confirm that what happened did occur rather than the opposite. But the tribunal adds
15 that it also finds that the parties also acted in accordance with the various timetables
and action plans, and continued to revise and update these common schedules of
action.

25 The tribunal finds as follows with regard to the persons involved in the
Scheme:

- 20
- | | |
|-------------|---|
| DB | As appropriate, both Deutsche Bank AG (and its London branch offices) and its United Kingdom resident subsidiary DB Group Service (UK) Ltd. |
| 25 DBI | Dark Blue Investments Ltd. On 27 01 2004 this company was incorporated in, and was then resident in, the Cayman Islands, later becoming UK resident. It was incorporated there by Maple and Calder, with the subscriber share being held there by M&C Corporate Services Ltd, and the registered office being that of |
| 30 | Maple and Calder. Maple and Calder were instructed by Investec. On the day after incorporation two directors of Investec were appointed as directors of DBI. DB appointed a director to the board of DBI on 5 02 2004. |
| 35 Deloitte | The London office of Deloitte and Touche LLP. Deloitte proposed the Scheme to DB and was involved actively in every stage of its operation from design to final delivery. |
| 40 Investec | Investec Bank (UK) Ltd of London. It is a company independent of the Appellant company and DB. |
| 45 Walbrook | Walbrook Nominees (No 6) Ltd, a company incorporated and resident in Guernsey. It is a company independent of the Appellant company and DB. |

26 The tribunal finds that the relevant events in the development and operation of the Scheme are as set out in the chronology set out in the annex to this decision.

PART 3: ANALYSIS

27 There are five critical dates in the chronology:

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- (a) the date on which the employees earned their bonuses
- (b) 2 February 2004, when the shareholders of DBI adopted a new Memorandum and Articles for the company creating new classes of shares
- 10 (c) 6 February 2004, when DB employees were informed of shares held for them in DBI, and when a condition of forfeiture was applied to shares if a DB employee ceased to be a DB employee or gave notice of cessation save in certain cases
- 15 (d) 7 February 2004, when restrictions on the sale of shares held for DB employees took effect
- 20 (e) 2 April 2004, when restrictions applicable to the shares held by DB employees ended

Did employees earn their bonuses before 6 February 2004?

28 The tribunal must find as fact the first of those dates. If that date is a date prior to the establishment of the Scheme, then the Scheme may be irrelevant to the income tax and NI contribution liability for the payments into the Scheme. This is because the sums may then be regarded properly as earnings of the individuals without reference to the Scheme. The relevant law on this point is in section 18 of ITEPA and related provisions. These are set out in the tribunal's decision in the UBS case at [20] to [28]. As the tribunal makes clear findings on this issue that do not involve detailed consideration of any of those provisions, the tribunal does not repeat them.

29 Mr Lasok QC contended that the true chronology of events was such that the employees who in due course received entitlements under the Scheme had in fact received the sums put into the Scheme individually for them before the Scheme started. Accordingly, they had earned the sums, within the proper meaning of employment income in ITEPA (and the proper meaning of earnings for NI purposes) before the sums came within the ambit of the Scheme. That must, he submitted, follow because DB had decided on the sums to be paid to each individual before that individual was notified of entitlement to enter the Scheme. That entitlement depended in part on the amount of bonus available to that individual, so there must have been identified earnings ahead of the transfer of funds to the Scheme.

30 Mr Goy QC resisted this argument, relying both on the oral evidence of Mr Berry and on the documentary evidence produced to the tribunal, including the staff handbook and the documentation issued to DB employees about the Scheme. DB operated on the basis that a bonus was discretionary until awarded. No individual had any advance entitlement in his or her contract of employment to any bonus, and

employees knew this. Entitlement arose only when the bonus was notified or paid to the individual. In this case the first notification was that of share entitlement. Employees had indicated ahead of any knowledge of entitlement whether they wished to be involved in the Scheme. Payment for those who did not wish to be involved or who did not qualify took place separately and after the establishment of the Scheme.

31 The tribunal has little hesitation in finding that employees did not have entitlement to any sum ahead of the transfer of funds to the Scheme. While it agrees that individual sums of bonus entitlement had been identified by DB, it sees no legal basis in the evidence before it on which any individual employee could sue for that sum. It was not paid to the employee when paid into the Scheme, and it was not received by an employee when that happened. The tribunal therefore finds as fact that none of the DB employees received any sums as earnings when the sums allocated in respect of them to the Scheme were identified or when they were paid into the Scheme. If and in so far as any sum formed earnings of an employee it is because of events on or after 6 February 2004, the date on which notification of interests in shares were sent to individual DB employees and the day after DB agreed to subscribe to the relevant shares.

20 *The timetabling of events*

32 The tribunal finds that the other dates are as stated, and must examine what happened on those dates. However, it also makes a general finding that the dates were clearly closely timetabled in a coordinated way involving all concerned. There is clear evidence of this from the extremely detailed and careful timetables for action issued by Deloitte in and from early February 2004 and from emails disclosed by the Appellant. The tribunal, as noted, heard no direct evidence from Deloitte or from any DB witness to suggest that the timetables were intended merely as illustrations and guides. The notes cited from an early version of the timetables suggest that all concerned were to conduct the relevant activities if not on the dates preselected then at least in the coordinated order preselected.

33 Mr Lasok QC drew attention for example to documents about the relative timing of the establishment of DBI and the agreement between Investec and DB. The tribunal finds from the chronology that DBI was established on the instructions of Investec on 27 01 2004, and that Investec appointed two directors to the company on 28 01 2004. Yet the only documented agreement between Investec and DB was the shareholders' agreement concluded on 5 02 2004.

34 In the draft timetable and action plan from 6 01 2004 (referred to above) Deloitte indicate that by 8 01 2004 (that is, immediately after the issue of the action plan and the conference with counsel planned to follow it) the following action is logged: "Third Party selected and agreement reached with them regarding the incorporation of Newco". This is logged to be undertaken by "DB/Deloitte". The timetable then sets out various events related to Newco, including incorporation ("by Jersey lawyers") in the week commencing 22 January 2004. That plan envisaged that the third party would finance the shares necessary to run the Scheme in that week with the shares being transferred into the Scheme after that.

35 The actual chronology shows that the original action plan was varied in
several ways, not least in that DBI was established in the Cayman Islands and not in
Jersey as originally suggested, and that funds for the Scheme came from DB more
5 quickly than originally suggested. (The original payment by Investec to DBI on 2
February was met by a payment of £92 million by DB to Investec on 6 February.)

36 As noted, there appears on the documentation to be no written agreement
between DB and Investec ahead of the incorporation of DBI. It was Mr Goy QC's
10 submission, based on the unequivocal evidence of Mr Berry, that there was no
agreement of any sort between Investec and DB before the shareholder agreement. Mr
Lasok QC contended from the documents that this was deliberate and was intended to
suggest that the incorporation of DBI was not connected to DB. He drew attention to
the following in an email from Deloitte to DB during the planning stage:

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20 "It is important that [Third Party] is not seen as DB's agent. Therefore [Third
Party] will set up [Newco] and only enter into the agreement with DB after
this done. It would be helpful to demonstrate that [Third Party] is under no
legal obligation (eg to refute any Revenue claim that there is a verbal contract
even if there is not a written one) if [third party's] final internal approval is not
considered and, if appropriate, given, until after the initial setting up of
[Newco]."

37 Later plans continued to carry the coordination forward. For example, on 28
25 January 2004 Christine Chen for Deloitte circulated to a number of people both within
DB, Deloitte and their lawyers and elsewhere a draft "closing Agenda" with specific
instructions to return all comments to her so that she would recirculate "only one
document". That draft includes all the essential steps in the Scheme to be undertaken
from 27 January to 7 February "or shortly thereafter". This includes not only actions
30 to be undertaken by DB but those to be undertaken by DBI, Investec, Walboork and
various lawyers. (The document was released to the tribunal without redaction, but the
tribunal has ignored matters for which privilege could be claimed.). The agenda
includes the following items:

35 "27 January
Action: Incorporate shelf company with subscriber shares
Responsibility: Investec and M lawyers

40 Action: Appoint directors to Newco
Document: Board meeting of Newco to appoint 2 Investec directors
Responsibility: Investec and M lawyers

45 Action: Newco to resolve to open bank accounts in the UK and delegate
authority to take appropriate actions: one with Investec and one with DB
Responsibility: Newco and M lawyers

28 January

Action: finalise articles of association
Responsibility: S lawyers (with input from others including DB, but not Investec or Newco)

5 Action: finalise share capital structure
Responsibility: S lawyers and Deloitte

30 January AM

10 Action: Board meeting to acknowledge adoption of finalised articles
and resolution to increase and reorganise capital
Responsibility: Investec and Newco; C lawyers and M lawyers

30 January PM

15 Action: Subscribe to E shares and C1 shares
Responsibility: Investec and C lawyers

5 February

20 Action: Transfer C1 shares to Nominee
Responsibility: Investec and M lawyers

Action: Newco to transfer its funds from Investec account
to DB account
Responsibility: Newco”.

25 The tribunal has used the abbreviations “M lawyers” and similar to indicate the involvement of different companies or firms of lawyers. The agenda names the specific entities. Leaving aside the involvement of lawyers, it is clear that this agenda involves all the main players: DB, DBI, Investec and the nominee.

30 38 The extent of the coordination is reinforced, Mr Lasok QC contended, by continuing correspondence between DB and Deloitte. For example, John Berry outlined on 29 01 2004 what he saw as the course of some of the events in the following week. This suggested that DBI would adopt its new Articles on 2 02 2004 and that DB would apply for shares in DBI the following day. On 30 01 2004
35 Christine Chen of Deloitte responded:

40 “Just to clarify and amend some key dates: DB should not be subscribing for ordinary shares on the 3rd – what is envisaged and necessary to mitigate any tax risk on the agency issue is for DB to subscribe for ordinary shares on the morning of the 5th and then the parties enter into the shareholders’ agreement on the afternoon of the 5th. The gap of time is very important from a tax risk perspective.”

45 This is a revision to the order in the agenda noted in the previous paragraph. The tribunal, in the chronology, finds that the events occurred as Christine Chen clarified and amended (her phrase) and not as John Berry proposed. (The tribunal was given no actual submissions on the timing within 5 February of the two events, but it is

prepared to accept that they occurred in the order suggested and not the reverse order). That illustrates and is consistent with the view that the tribunal takes of the evidence offered by John Berry as to his role in the execution of the Scheme.

5 39 A further example of the coordination taking place, and the role of Mr Berry, is seen in the email exchanges on 3 February 2004 concerning the letter to be sent by Walbrook to the DB employees involved in the Scheme. At 15:29 Christine Chen (Deloitte) sent an email to John Berry (DB) asking him to arrange, for audit trail
10 purposes, that Investec send Walbrook an email following the transfer of the C1 shares from Investec to Walbrook requesting that Walbrook advise the employees of DB involved in the Scheme of risks of the Scheme. This was in reply to comments by Mr Berry on a draft letter to go to the employees. At 15:39 she sent lawyers a revised draft of the letter to be sent by Walbrook to the employees, taking in Mr Berry's
15 amendments. Although the draft was dated 9 02 2004, it is common ground that the letter was sent out by Walbrook dated Saturday 6 February 2004, the day on which the C1 shares were transferred to Walbrook. It is clear from this that both DB and Deloitte were closely involved in specific actions taken by Walbrook and Investec with regard to the Scheme, with Deloitte taking a lead in coordination.

20 40 Another aspect of this forward planning relates to the drafting of the articles of association to be adopted, in due course, by DBI. Detailed exchanges of emails were taking place between DB and its advisers on, for example, 15 and 16 January. At that time the tribunal can see no mention of Investec anywhere in those emails. Indeed, the first mention of Investec in the documents produced to the tribunal appears to be in
25 the Action List circulated by Christine Chen for Deloitte as an attachment to an email on 22 January 2004. This has a column headed "DB Action (including Deloitte) and another column headed "Investec Action". Under the date "19th – 23rd January" this states as an action for Investec: "Finalise principles with DB". The corresponding DB column includes "Finalise Articles of Newco".

30 41 The tribunal finds from this that, applying the civil standard of proof of the balance of probabilities, the order of events as between DB and Investec took place in accordance with coordinated plans (principles?). It can see no other reasonable explanation that reconciles the events that occurred and the planning of which it saw
35 partial evidence. On the basis of the evidence before the tribunal, it must ask why would Investec set up DBI in the way it did unless there was some arrangement in place as to Investec's role in the Scheme. In particular, the share structure adopted can, in the view of the tribunal, be explained only by reference to the Scheme as a whole.

40 42 Mr Berry was pressed by Mr Lasok QC on several occasions on this point. His evidence, as Mr Goy QC reminded the tribunal in closing, was on several occasions that there was no agreement of any sort between Investec and DB before the entering into the Shareholders' Agreement. Mr Beddows gave evidence that there was no
45 certainty as at 2 02 2004 that the Scheme would go ahead. There were discussions and there was a "fallover" agreement that DB would meet costs if failure occurred. Noting that certainty is not the standard of proof against which the tribunal judges

events, the tribunal has difficulty in reconciling that oral evidence, if interpreted broadly to include the actions of all involved and not merely to specific agreements undertaken between DB and Investec directly, with the documents it has seen, including those cited above, as to the events that occurred that week. While it accepts that it has seen no agreement in writing, or written evidence of an agreement, between DB and Investec, it is clear to the tribunal that events took place in a preordained order with a mechanism in place to ensure that the order was as intended and that the reasons for that order was as indicated by Christine Chen. While the tribunal is prepared to accept that there was no direct agreement in place in any formal sense between DB and Investec, clearly some arrangement was in place. The order of events was not coincidental; it was a deliberate order of events.

The restricted securities

43 On 2 February 2004 the shareholder of DBI, at a duly convened meeting, passed a special resolution amending the memorandum and articles of association. Mr Lasok QC pointed out that some of the documents suggested that the change was dated the following day, but the tribunal accepts that the changes were made at least by that day.

44 The changes put in place a new share structure for DBI. The new share capital was one US Dollar and a total of £197,057 divided as follows:

	One share of US Dollar 1.00	
25	Ordinary shares of 35p each	38,042
	C1 redeemable shares of 35p each	91,300
	C2 redeemable shares of 35p each	91,300
30	D shares of 35p each	91,300
	E shares of 35p each	251,078.

35 The one US Dollar share was later cancelled.

45 These amendments put in place the share structure that was the central element of the Scheme, creating a class of shares (the C1 shares) that were intended to be restricted securities for the purposes of Part 7 of ITEPA, but with a specific and time limited restriction. The tribunal accepts that the following structure emerged. The core shareholding was in the ordinary share capital, with the usual rights. E shares had the same rights save that they were redeemable. Those shares were entitled to dividends as were C1 and C2 shares. Dividends were payable to the respective classes on a basis set out in the articles. This took into account any premium at which a share was issued. Because the C1 shares were issued at an extremely large premium, the practical effect was that most of the dividends were payable to those shares. D shares

had no rights to distributions. C1 shares carried voting rights, but C2 and D shares did not.

46 The definition of a restricted security is in section 423(1) of ITEPA. Section
5 422 provides that the securities must be restricted securities at the time of their
acquisition. There are two conditions or, rather, one general condition and a set of
other conditions one of which must also be met:

10 “(a) there is any contract, agreement, arrangement or condition which makes
provision to which any of subsections (2) to (4) applies, and
(b) the market value of the employment-related securities is less than it would
be but for that provision.”

47 Section 422 provides that these conditions must be met at “the time of the
15 acquisition”. Section 421B(1) and (2) provide the relevant definitions for this rule.
Chapter 2 applies to securities:

20 “... acquired by a person where the right ... to acquire the securities or interest
is available by reason of an employment of that person or any other person.

(2) For the purposes of subsection (1)—
(a) securities are, or an interest in securities is, acquired at the time when the
person acquiring the securities or interest becomes beneficially entitled to
those securities or that interest (and not, if different, the time when the
25 securities are, or interest is, conveyed or transferred) ...”

48 It was not in dispute that the employees acquired their interests in the shares in
the Scheme by reason of their employments. The tribunal finds that the day on which
the employees were informed of their interests in the shares was 6 February 2004.
30 That was the day on which Investec transferred the C1 shares to DB, and they were
then transferred on. However, it also finds that Walbrook was told by the Appellant
on 29 January 2004 that it, Walbrook, would be receiving 91,300 C1 shares in DBI to
hold on bare trust for named employees of DB and that this occurred several days
before the meeting at which the new share structure was authorised by the DBI
35 shareholder.

49 Two questions arise about the restrictions: were there restrictions in place at
the time of acquisition by the employees? The tribunal finds that that date is 6
February 2004. If there are restrictions in place, did they affect the market value of the
40 shares?

50 The new Memorandum of DBI, adopted on 2 February 2004, authorised a
change in the share capital. The new Articles of Association, adopted that day,
provided the details. Article 33 provided that no C1 share could be sold or otherwise
45 transferred in the period between 7 February 2004 and 1 April 2004 inclusive unless
the transfer occurred because shares had been forfeited under Article 34.

51 Article 34 applied in the following situations:

5 “If, before 2 April 2004, any individual who holds or who is beneficially entitled to C1 shares which are held on his behalf by a nominee ceases to be employed by any DB company or notice is given to or by that individual of termination of employment for any reason other than termination by the relevant DB company without cause or redundancy, death or disability ...”

10 52 Where a situation within that description occurs, article 34 first provides that:

15 “(1) If immediately prior to that event the C1 shares held by or on behalf of that Terminating Employee, when aggregated with any shares held by any Relevant Holder, would lead to relevant holders holding more than the Relevant Limit as defined by Article 35, then each C1 share held by or on behalf of such Terminating Employee that would result in the Relevant Holders in aggregate holding more than the Relevant Limit shall, with effect from the moment immediately prior to the occurrence of that event, have the same rights for all purposes under these Articles as if it were a D share and shall, on which ever is the later of the occurrence of that event and a notification under Article 34(e), be converted and redesignated as a D share.”

20 It was not in dispute that there was no occasion on which the limit in article 35 was exceeded, and the tribunal is not therefore concerned to examine this further.

25 53 Article 34 also provided:

30 “(2) If on the basis referred to in (1) the Relevant Limit would not be so exceeded, each C1 share held by or on behalf of the Terminating Employee shall be converted into and redesignated as a C2 share and, except where these Articles otherwise provide, such conversion and redesignation shall be deemed to be an issue of the relevant C2 share at the time of such conversion and redesignation.”

35 54 Article 34 went on to provide:

40 “Each Terminating Employee (and any nominee holding shares on behalf of the Terminating Employee) shall be deemed to have irrevocably agreed and to be bound to transfer, or to be bound to instruct any nominee to transfer, for nil consideration all the C2 shares of D shares held by him or on his behalf following such conversion or redesignation to the holders of the Ordinary Shares pro rata as nearly as may be to their holdings of Ordinary Shares or to such of the holders of the Ordinary Shares and in such numbers as the Ordinary Shareholders shall agree.”

45 55 Article 34 finally made provision for any employees whose employment ended but who were not “Terminating Employees”, so making the provision of the article comprehensive of all departing employees. It provided:

5 If, before 2 April 2004, any individual holding C1 shares or for whom C1 shares are held by a nominee ceases to be employed by a DB company in circumstances where that individual was not a Terminating Employee, the C1 shares held by that individual will automatically be redesignated as C2 shares and, except where these articles otherwise provide, such redesignation shall be deemed to be an issue of the relevant C2 shares at the time of such redesignation.”

10 This happened in respect of one departing employee and the C1 shares held by him.

56 In other words, if for any of the reasons stated a DB employee with a beneficial interest in C1 shares either ceased to be a DB employee or gave or was under notice of cessation of employment otherwise than for the reasons indicated, the C1 shares automatically became C2 shares or D shares. If that happened, then the beneficial owner lost the rights of the C1 shares on the conversion.

57 Did this amount to a “contract, agreement, arrangement or condition which makes provision to which any of subsections (2) to (4) applies” for the purposes of section 423 of ITEPA? The full text of the section is set out above.

58 For the Appellants, Mr Goy QC submitted that the evidence established that the C1 shares were subject to restrictions that were real and were understood by the employees concerned to be real. Further, those restrictions has a real and tangible input on the market value of the C1 shares, and the effect could not be ignored as de minimis or too insignificant. These restrictions were within the scope of section 423. In particular, section 423(2) applied. This provided:

30 “(a) ... a transfer, reversion or forfeiture of the employment-related securities, or (if the employment-related securities are an interest in securities) of the interest or the securities, if certain circumstances arise or do not arise,

35 (b) as a result of the transfer, reversion or forfeiture the person by whom the employment-related securities are held will cease to be beneficially entitled to the employment-related securities, and

40 (c) that person will not be entitled on the transfer, reversion or forfeiture to receive in respect of the employment-related securities an amount of at least their market value (determined as if there were no provision for transfer, reversion or forfeiture) at the time of the transfer, reversion or forfeiture.”

59 He relied on the expert evidence of Mr Eamer as to the value of the C1 shares on 6 February 2004 to establish the reduction in value to the C1 shares caused by the restrictions. Although the restriction on sale did not apply on 6 February 2004 to the shares, the other condition did. He also submitted that, in reality, it would not have been possible for a beneficial owner of C1 shares to transfer them on 6 February as the transfer to the employee would not have taken place sufficiently early in the day

for that to be practicable. In any event, any transfer would be subject to the other condition, and he relied on that restriction as meeting the requirements of the section.

5 60 Mr Lasok QC, in argument, withdrew a previous submission that the restrictions imposed by Article 34 fell outside the requirements of section 423 because of the nature of the restrictions. He maintained that it was open to question whether the Article 34 restrictions led to any reduction in value. More generally, he also contended that the shares were not restricted securities on the general ground that the provisions of Part 7 did not apply to tax avoidance schemes.

10 61 The tribunal accepts that the C1 were real shares, and holders received actual dividends. It was possible for an employee to hold them for over two years, and some did so. If they did so, they received dividends from the sums invested in DBI and invested by it. Those shares were securities.

15 62 The tribunal also accepts that the shares were securities subject to a provision within the scope of section 423(1)(a) on the relevant date by reference to Article 34. There was some argument that the restrictions were not genuine restrictions. There was, for example, the suggestion that the restriction was not genuine and that there 20 was no real intent to apply it. The tribunal does not accept that. While the restriction in Article 34 was clearly both limited in time and scope it was nonetheless there. Nor could it be said to be so limited in time and scope together that it could be ignored as of no significance. Unless the tribunal had before it evidence that this was a sham – and it had no such evidence – then the terms of Article 34, when looked at in isolation 25 as a restrictive provision, are not to be ignored.

63 The next issue, also in dispute between the parties, was whether the securities were within section 423(1)(b):

30 “.. the market value of the securities is less than it would be but for that provision”

64 The tribunal had before it the evidence of two expert witnesses on this issue, Mr Eamer for the Appellant and Mr Croft for the Respondents.

35 65 Mr Eamer’s evidence was that the valuation of the shares on the relevant date would be reduced by a sum in the order of 2 to 3 per cent by reason of the restrictions, separately under article 33 and article 34. Under cross-examination he accepted that these were not benchmarked values, but that they reflected what in his view would be 40 a preference of a purchaser to purchase without these restrictions.

66 Mr Croft’s evidence was that the effect on valuation of the restriction was not of significance. Mr Goy QC took issues with some of the statements made by Mr Croft in his witness statement on the grounds that these were statements made outside 45 his competence as an expert witness. The tribunal accepts that submission. There were matters in the report which went beyond the witness’s instructions and involved the expression of views on issues that are for the tribunal to determine, in part, as

5 questions of law. In so far as those statements can be regarded as evidence, the tribunal emphasises that it puts no weight on them. But it does take into account the more specific evidence relating to the valuation of the C1 shares on 6 February 2004. However, it accepts that the evidence of Mr Eamer was presented on a narrower basis of specialism than that of Mr Croft. While it does not accept Mr Goy QC's comment that the tribunal heard from one expert witness alone, it also takes this into account in weighing this evidence.

10 67 Mr Lasok QC submitted that Mr Eamer's evidence of a reduction in value of 2 to 3 per cent in respect of the effects of article 34 was a random figure and that in reality the reduction in value, properly viewed, was not sufficient to render the C1 shares as within the provisions of section 423(1)(b). Mr Goy QC in response pointed out that a small percentage of a large figure could of itself be significant. He also referred the tribunal to the views of Lord Walker about the phrase "market value" in this context in *Gray's Timber* (a decision of the Supreme Court) discussed by the
15 tribunal in the UBS case. At [33] of his decision Lord Walker stated:

20 "Leaving that strand of ... argument on one side for the present, I come to the other strand, which relies on the use of the expression "market value" in chapters of Part 7 other than Chapter 3D, that is Chapter 2 (restricted securities) ... all these chapters describe the relevant restriction, conversion right, or value shifting mechanism in the most general terms.

25 But they also proceed on the footing that that restriction, conversion right, or value shifting mechanism affects the market value of the securities in question ... In all these contexts the restriction, conversion right, or value shifting operation cannot, it seems to me, be dismissed as something collateral or personal to the particular employer and irrelevant to the valuation."

30 68 The tribunal takes from this that it should take a non-technical view of market value for the purposes of Chapter 2, and that it should look at the evidence – in particular the evidence of Mr Eamer – with that approach in mind. On that basis, the tribunal finds that the restrictions did cause a reduction in market value for the purposes of section 423(1)(b) by reference to Article 34 on 6 February 2004 even if
35 no regard is had to article 33. While it might be a small percentage reduction, the tribunal agrees with both Mr Goy QC and on the evidence that the restriction was not only genuine but something that would affect, and therefore must be treated as affecting, the market value of the C1 shares on that date. It was not a negligible effect that could be ignored.

40 69 It follows from this that, leaving aside for the time being the arguments of Mr Lasok QC about the Scheme as a whole, the C1 shares held by Walbrook for the DB employees entitled under the Scheme were restricted securities within the meaning of Chapter 2 of Part 7.

45 *Entitlement to exemption*

70 The relevant legislation concerning the taxation of shares that are within the
definition of restricted securities for the purposes of Chapter 2 of Part 7 of ITEPA are
set out in [36] to [40] of the tribunal’s decision in the UBS case. It does not repeat that
analysis, or the relevant legislation, here save where a specific provision is directly in
5 issue.

71 Section 425 provides exemption from a charge to tax on acquisition of such
shares. The question here is whether the C1 shares give rise to any later charge to
income tax (and therefore to NI contributions) under section 426 and related
10 provisions.

72 Mr Goy QC submitted that the charge under section 426 did not apply to these
shares because of the exemption from that charge that applied under section 429. That
section (case outside charge under section 426) provides:

15 “(1) Section 426 (charge on occurrence of chargeable event) does not apply if—

(a) the employment-related securities are shares (or an interest in shares) in a
company of a class,

20 (b) the provision by virtue of which the employment-related securities are
restricted securities, or a restricted interest in securities, applies to all the
company’s shares of the class,

(c) all the company’s shares of the class (other than the employment-related
securities) are affected by an event similar to that which is a chargeable event in
relation to the employment-related securities, and

25 (d) subsection (3) or (4) is satisfied.

(2) For the purposes of subsection (1)(c) shares are affected by an event similar
to that which is a chargeable event in relation to the employment-related
securities—

30 (a) in the case of a chargeable event within section 427(3)(a) (lifting of
restrictions), if the provision mentioned in subsection (1)(b) ceases to apply to
them,

(b) in the case of a chargeable event within section 427(3)(b) (variation of
restriction), if that provision is varied in relation to them in the same way as in
relation to the employment-related securities, or

35 (c) in the case of a chargeable event within section 427(3)(c) (disposal), if they
are disposed of.

(3) This subsection is satisfied if, immediately before the event that would be a
chargeable event, the company is employee-controlled by virtue of holdings of
shares of the class.

40 (4)

(5) For the purposes of subsection (4) a person is related to an employee if—

(a) the person acquired the shares pursuant to a right or opportunity available by reason of the employee's employment, or

5 (b) the person is connected with a person who so acquired the shares or with the employee and acquired the shares otherwise than by or under a disposal made by way of a bargain at arm's length from the employee or another person who is related to the employee."

73 This drafting is problematic because, in the tribunal's view, it is ambiguous in its reference to "employment related securities". It could be read to mean all the securities issued to all employees receiving sums, or to be limited to those securities
10 issued to an individual employee receiving a sum to which section 426 would attach tax if section 429 did not apply. That is not obvious in the context of a case such as this where the employer, and only the employer, is the appellant.

74 The definition of "employment-rated securities" in section 421B(8) does not
15 assist on this point because it is neutral to the ambiguity:

"employment-related securities" means securities or an interest in securities to which Chapters 2 to 4 apply (ignoring any provision of any of those Chapters which limits the application of the Chapter to a particular description or
20 descriptions of employment-related securities)."

75 However, the tribunal takes the view that it follows from sections 422 and 423, and from the more general observation that Part 7 and Chapter 2 are both concerned with income tax on earnings, that the proper standpoint is that of the
25 individual employee. In that context the reference to "the employment related securities" makes sense as a reference to the securities held by each individual employee. That is disguised in this case because the direct charge is under the PAYE scheme and not directly under Part 7.

76 On Mr Goy QC's analysis, the issue is how section 429 applies to the shares held beneficially by any of the DB employees within the Scheme. His submission is that section 429(1)(a) to (c) are met as is subsection (4). Mr Lasok QC did not dispute that subsections (1)(a) to (c) were met, but contended that the test in subsection (4)
30 was not satisfied.

35 "This subsection is satisfied if, immediately before that event, the majority of the company's shares of the class are not held by or for the benefit of any of the following—

- (a) employees of the company,
- 40 (b) persons who are related to an employee of the company,
- (c) associated companies of the company,
- (d) employees of any associated company of the company, or
- (e) persons who are related to an employee of any such associated company."

77 Mr Goy QC submitted that it was not at all clear what purpose had led to the inclusion of this section, but he argued that its terms were highly prescriptive. And in his submission those prescriptive conditions were all met. The Company for the purposes of subsection (4) is DBI. And on the facts none of the five tests were met.
5 The employees were employees of the DB Group, not DBI, and DBI was not associated with the DB Group. The test for association is set out in section 421H(2) of ITEPA where it is defined in the same terms as section 416 of ICTA. Mr Goy QC took the tribunal to that section and examined it in some detail. He submitted, again on the evidence, that the control of DBI was with Investec, not DB, at all relevant
10 times.

78 Mr Lasok QC contended that the purpose of section 429(4) was to protect events that enured for the general benefit of the company, not specific benefits for employees. The section was to be read purposively with that approach in mind. He
15 challenged the appellants to show that there was a rationale underlying the purposes of section 429 read with section 425 (the exemption on acquisition) to achieve a situation of non-taxation. He also contended on the evidence that DB did or could control DBI at the relevant times, and that the requirements of subsection (4) were not satisfied.

20 79 The tribunal finds little assistance in reading section 425 with section 429. Section 425(2) creates an exemption from income tax if securities are restricted securities save where other chapters of Part 7 apply.

25 80 It also finds little assistance either in the argument of Mr Lasok QC that there are specific economic arrangements within which section 429 should be held to operate or in his challenge to Mr Goy QC to identify the purpose of the section. Section 429 clearly operates to take certain employment-related securities outside the scope of the charge in section 426. And it clearly does so where a set of conditions is
30 met. There is no purposive test in those conditions beyond what can be read, in particular, into subsections (3) and (4).

81 Aside, therefore, from the question whether the section 416 test of control is met in the circumstances of this case, the conditions of section 429 are satisfied and
35 the charge in section 426 does not apply.

82 The opening subsections of section 416 provide:

40 “(1) For the purposes of this Part, except paragraphs 2 and 9(1)(a), (2)(a) and (3)(a) of Schedule 19, a company is to be treated as another’s “associated company” at a given time if, at that time or at any other time within one year previously, one of the two has control of the other, or both are under the control of the same person or persons.

45 (2) For the purposes of this Part, a person shall be taken to have control of a company if he exercises, or is able to exercise or is entitled to acquire, direct or indirect control over the company’s affairs, and in particular, but without

prejudice to the generality of the preceding words, if he possesses or is entitled to acquire—

(a) the greater part of the share capital or issued share capital of the company or of the voting power in the company; or

5 (b) such part of the issued share capital of the company as would, if the whole of the income of the company were in fact distributed among the participators (without regard to any rights which he or any other person has as a loan

10 (c) such rights as would, in the event of the winding-up of the company or in any other circumstances, entitle him to receive the greater part of the assets of the company which would then be available for distribution among the participators.”

83 Mr Lasok QC rested his argument by reference to section 416 on the
15 proposition that DB was associated with DBI at the time, and so the C1 shares were held for the benefit of employees of an associated company. He put the argument in a number of different forms. His first argument was that DB controlled DBI. Further or in the alternative, DB controlled DBI together with Investec. Finally, he argued that the entire shareholding of DBI was completely unreal. The structure should be
20 ignored as a mirror image of the situation ignored by the court in the case of *Arrowtown*.

84 He submitted that the test to be applied by the tribunal was one of fact. In this, he relied on the authority of Lord Hoffman in *R v IRC ex p Newfields Development Ltd* [2001] STC 901 at [10] and [11] as applied by Lightman J in *Gascoignes Group Ltd v HMIT* [2004] STC 844 at [14], commenting on arguments put to him:

30 “(1) ... guidance [on section 416] is to be obtained from the decision of the House of Lords in *Newfields* which is a decision on the sections in point and which underlines the importance of attributed control – control which is to be attributed whether or not actual control exists; and

35 (2) that control of a company (for the purposes of the legislation) can only rest with one person. That is clearly not the case. Control is to be attributed under the Act to the candidates even in situations where control by others as a matter of fact is clear or could likewise be attributed.”

The guidance of Lord Hoffmann in *Newfields* at [10] to which this refers included:

40 “It will be seen that although this definition [in section 416] starts in subsection (2) with a concept of control which reflects its meaning in ordinary speech (“a person shall be taken to have control of a company if he exercises or is able to exercise or is entitled to acquire, direct or indirect control over the company’s affairs”) that fairly simple notion is enormously widened by
45 subsequent subsections.”

85 Mr Lasok QC accepted from other authority the point made in argument by
Mr Goy QC that the control in this sense was control by general meeting, not the
control of the board of directors . He referred to *Steele v EVC International NV* [1996]
STC 785, as giving authority about the extent to which a shareholder agreement could
5 evidence that two companies were acting together to control a company within section
416(3). And he put forward the decision of the Special Commissioner in *Foulser v
MacDougall* [2005] STC (SCD) 374 as a factual example of the application of the test
where control did not rest on the ownership of the shares.

10 86 He applied those arguments to the evidence in this case to argue on each of
the three approaches noted above that DB and DBI were associated.

87 Mr Goy QC resisted these arguments both on the law and on the evidence. It
was important to note that control in this sense was control by the shareholders not the
15 directors. At no time did DB have control of DBI as a shareholder. Nor, indeed, did it
have control through the boardroom as Investec appointed a majority of directors.
Investec controlled DBI and did not do so in association with DB. There was, as noted
above, no agreement until the shareholders' agreement, and that did not cede control.
Investec was not associated with DB through that agreement or otherwise for these
20 purposes.

88 The tribunal finds that DB at no time had control of DBI in the formal sense of
being a controlling shareholder of DBI. Nor does it find the argument that the tribunal
can ignore the E shares, or any other class of shares, is one carrying any weight. On
25 the contrary. The whole arrangement revolved around the complicated share structure
and the precise terms on which the various classes of shares were issued.

89 It is that feature – the carefully engineered share structure of DBI - that, in the
view of the tribunal, is at the heart of this aspect of the argument. It is certainly not to
30 be ignored either selectively or as a whole. To carry out the Scheme, DB and its
advisers had to ensure that DBI had the precise kind of share structure it needed,
together with the various formal agreements between the parties to the Scheme. If the
articles and the agreements went in one direction then, as emails show that DB was
aware, the structure might be open to attack under the *Arrowtown* reasoning (as to
35 which see [83] above). If they went another way, DB would be explicitly in control. If
they went another way again, there would be no restricted securities to pass to the
employees. And other routes would not meet other requirements of Chapter 2 as
interpreted by them. Other routes again might open up VAT problems, accounting
problems, or financial supervision issues. It is clear from the emails that considerable
40 detailed thought was given by DB and its advisors to the precise terms of the relevant
articles of association of DBI and the linked agreements.

90 It is clear to the tribunal that Investec and DBI (initially in the guise of
Newco) were written into the planning and implementation of the Scheme in a
45 detailed, indeed prescriptive, way. Investec was to take certain actions at certain times
and DBI was to take other actions at certain times. Why? Because that was required to
implement the Scheme. The evidence of the planning clearly points to both Investec

and DBI being guided closely about what they had to do and when they had to do it. Was that guidance – the tribunal’s term – enough to constitute control ahead of any formal agreement? The tribunal has in mind the evidence showing that the timing of, and the order in which, events occurred, including the order in which the agreements between DB and both DBI and Investec occurred, was a preordained order.

91 That is the factual situation, the tribunal finds, to which it must apply the test in section 416: “a person shall be taken to have control of a company if he exercises, or is able to exercise or is entitled to acquire, direct or indirect control over the company’s affairs”.

92 The Special Commissioner put the test this way in the closing paragraph of argument, [26], of *Foulser v MacDougall*:

15 “Standing back, the conclusion is that Mr Foulser, both for himself and on behalf of Mrs Foulser, went far beyond just acting as a director negotiating a sale and making a recommendation to the shareholder of the underlying companies. He made all the decisions relating to the sale.”

20 93 That form of wording reflects the facts of that case, which the tribunal does not need to elaborate here. And, of course, this is not binding guidance. But the Special Commissioner had had the caselaw mentioned above cited to him: *Arrowtown, Gascoigne and Newfields*. This tribunal adopts that approach as a practical test on the facts with which to approach the features of this appeal just rehearsed. Standing back, did those go beyond mere negotiation and recommendation? Did DB make all the decisions relating to the Scheme to the extent that it controlled DBI either alone or in cooperation with Investec?

30 94 The tribunal finds that the evidence shows close coordination, but does not, in the section 416 sense, show control.

35 95 The tribunal has indicated in the findings made above its view about the levels of agreement and coordination occurring between those involved in establishing the Scheme. It is clear that Investec knew that to earn the full fee the Scheme had to proceed in a particular way and to a particular timetable. And it is clear that DBI, controlled by Investec, emerged from this process and conducted itself as required by the process.

40 96 The tribunal also observes that the evidence produced to it of the involvement of Investec is limited. It saw notes of the meetings of 15 and 19 January. But it did not see evidence of any email exchanges equivalent to those it saw between DB and Deloitte. For example, the tribunal has set out above evidence of a request by Christine Chen of Deloitte that John Berry of DB ask Investec to ask Walbrook to take certain actions. This suggests ongoing email exchanges. But the tribunal does not consider that it can read into that evidence - or absence of evidence - the necessary degree of compulsion as between DB and DBI that would amount to control for these purposes. It does not show that DB’s actions went “far beyond” those of a commercial

entity dealing with another commercial entity to the extent that in reality DBI, and therefore Investec, was not in control of its own decisions.

97 Accordingly, the tribunal finds that there was no control in the section 416
5 meaning of the phrase and that this aspect of Mr Lasok QC's argument fails.

The Scheme as a whole

98 The central attack by Mr Lasok QC in his argument was on the Scheme as a
whole. It was a "money in, money out" structure with no genuine business content.
10 The tribunal considers it should make its own findings of fact about that aspect of the
Scheme and then consider, in the light of those findings, whether there is any basis in
law for Mr Lasok QC's challenges.

99 The tribunal now turns to this central argument on the basis that it has found in
15 favour of the Appellant on the other arguments.

100 The tribunal does not repeat the case law examined by it in the UBS decision,
and the arguments put to it by Mr Lasok QC in both this case and that, and the
arguments for the taxpayers put to it in both cases. It adopts from the UBS decision
20 the passages cited in, and the tribunal's own comments in [48] to [55] of, that decision
and in particular the references to *Astall* in the Court of Appeal and *Mayer* in the
Chancery Division cited there. And it takes from *Astall* the guidance that it is to
consider the purpose of the legislation and then apply it in the terms set out in that
decision. It adopts from its decision in the UBS case the analysis of the authorities (as
25 set out from [43] in that decision) and its understanding of the proper approach to the
interpretation of Chapter 2 as part of Part 7 of ITEPA (as set out from [51] in that
decision). It adds only the comment that it does not consider this as a case where
individual elements of the Scheme are to be left out of account. It has not accepted
arguments put to it by HMRC to that effect, and its task is to look at the Scheme as a
30 whole.

101 Mr Lasok QC rested his case on the submission that the Scheme, seen in this
way, could not be regarded as within the intent and purpose of Parliament as laid
down in Chapter 2 of Part 7 of the ITEPA. They were not "restricted securities"
35 within that Chapter or the Part read as a whole. They should not, putting it another
way, fall within the "special rules about cases where securities, interests in securities
or securities options are acquired in connection with an employment" set out in that
Part (section 417(1) of ITEPA). The theme of that Part, as recently confirmed by the
Supreme Court in *Grays Timber Products Ltd v HMRC* [2010] UKSC 4, is that of
40 "anti-avoidance and the closing down of perceived tax loopholes" (at [56]).

102 Mr Goy QC rested his case on the formal steps taken at each stage to ensure
that the Scheme met the individual requirements of each provision within that
Chapter. While the tribunal agrees with Mr Goy QC that the securities were restricted
45 securities within the definition laid down in Chapter 2, and that there was no control
asserted between DB and DBI in the section 416 sense, it must nonetheless, in its
view, take into account the nature of the whole arrangement. The Scheme was a

contrived and closely coordinated series of events so that the various individual requirements of Chapter 2 were met but without regard to any other aim or purpose than that of triggering the various exemptions in the Chapter. The outcome was that the employees received, through the Scheme, in untaxed form sums derived from sums designated to them as bonuses that, but for their agreement to participate in the Scheme at a time when the bonuses were not confirmed, would have become earnings if and when the bonuses were confirmed. In the language of *Gray's Timber* the argument for the appellants is that: the Scheme was not using a perceived tax loophole; that Parliament did not close it down; and that the Scheme succeeds at each individual stage and must therefore succeed as a whole. The tribunal cannot read into the language of Chapter 2 any purpose beyond its express language.

103 The tribunal reminds itself of the decisions it cited in the UBS case, and in particular that, having read the statute, it must undertake what was termed the second stage of the process of application in *Astall*:

“The second stage is to consider whether the transaction against the actual facts which occurred fulfils the statutory conditions. This does not, as I see it, entitle the court to treat any transaction as having some nature which in law it did not have but it does entitles the court to assess it by reference to reality and not simply to its form.”

104 The tribunal must also identify the time or times at which it is to identify that reality. The tribunal has in this decision concentrated on the formation and launch of the Scheme. It considers that the crucial period for its decision is the time when the restricted securities were created and the period leading up to that time. That, in its view, follows from the focus of section 421B of ITEPA on the time when the securities are acquired. At the time of acquisition, in February 2004, the restriction was to last for a short period within that tax year. Employees were entitled to cash their shares from the start of the following tax year (in practice from July that year). The tribunal has not therefore examined in detail the course of events after that period beyond the extent necessary to establish whether the specific provisions of Chapter 2 were met. In particular, the fact that employees had an option to retain shares in DBI rather than encash them from April 2004 is not, in the view of the tribunal, relevant to whether the securities were restricted securities.

105 On that basis, the tribunal finds as follows. This is a composite transaction, designed and executed as a whole. It has, the tribunal finds, one significant aim only, that of reducing the burden of income tax on DB employees and at the same time the linked burden of National Insurance contributions on DB (and to a lesser extent its employees). The tribunal finds no other operative purpose in the adoption of the Scheme.

106 The tribunal also finds that this was an “off the shelf” scheme. It did not derive or develop internally within the DB Group as part of its share structure or from others of its executive or general incentive schemes. It does not accept the argument that this was designed with a significant aim of giving employees any involvement in the share

value of the DB Group. To realise the scheme DB, working with those who created the scheme, secured the interposition of the structures discussed in this decision between the allocation of bonuses by DB for payment to certain of its employees and the receipt by those employees of entitlement to those bonuses. The interposition did not reduce any of the funding provided by DB for payment of bonuses, nor did it reduce the gross amount to be allocated to an employee in the form of beneficial interests in shares receivable by an employee otherwise entitled to a bonus. It imposed a condition which on the evidence before the tribunal did not lead to any employee losing entitlement, at the end of the day, to a bonus payment. (The one employee against whom the provisions in Article 34 were exercised was, the tribunal was told, paid a cash sum.) It imposed a condition which lasted a few weeks only, delaying receipt of cash from those who wanted cash by a few weeks from the initial entitlement to an interest in shares. The cash bonuses were payable in February. The first withdrawals from the Scheme took place in July.

107 The designers of the Scheme appear to have based their plans on a close reading of each of the provisions of Chapter 2 of Part 7, taking each provision in the Chapter as a separate issue to be resolved. And the Scheme was designed to secure events such that at each stage the events undertaken met those serial requirements.

108 The tribunal is entitled to stand back and consider the whole evidence. There was an underlying reality to the whole Scheme. That underlying reality showed links that the step-by-step chronology set out at the end of this decision does not show. Events occurred in the order shown in the chronology because of a predetermined order of events, not because that is what happened in a random or uncoordinated way or as the result of a series of separate operators taking separate decisions in their own timeframes. The evidence of the flows of emails between all concerned shows this to be the case in a way that the formal documents do not.

109 The other element to be noted is how the Scheme was financed. The reality in this case was that the appellant and others undertook a series of closely coordinated events that were funded entirely by the appellants so that its funds were transferred to its employees as agreed with them. The flow of funds is set out in the chronology. The tribunal accepts that Investec initially put up the capital for the Class C1 shares (that is, the restricted securities) on 2 02 2004. But on 6 02 2004 DB provided Investec with the funds to meet that investment in full. In the brief intervening period there were a series of agreements in place to ensure that Investec was not at risk. In particular, bearing in mind that Investec controlled DBI in any event, Investec held a charge over the DBI assets (that is, the sums paid to it by Investec) and also controlled DBI's investments. Those agreements did not take place in the abstract. They were part of the careful coordination that was shown throughout the life of the Scheme. Aside from the formal agreements the tribunal has already found that Investec's risks from a failure by DB to complete the Scheme were also covered.

110 Based on that evidence, and standing back, the tribunal has no hesitation in finding as fact that the Scheme was a closely coordinated scheme with a single purpose. That purpose was that of utilising advantages of sections 426 and 429 of

5 ITEPA so that the DB employees paid no income tax on the sums given to them under those exemptions nor any NI contributions to which they might be liable on the sums and that the DB Group itself paid no employer's NI contributions on those sums. It was a Scheme marketed to the appellants for that purpose and undertaken by them for that purpose.

10 111 Further, although the Scheme was undertaken through the medium of independent entities, the tribunal finds as fact that in reality the whole was a coordinated scheme in which all those involved in providing bonus payments to the employees played assigned roles undertaken either to achieve the desired reduction in taxation or to receive a fee for facilitating that aim.

15 112 DBI, the company in which the restricted securities were held, was therefore in reality purely a vehicle for the Scheme. The C1 shares were created solely so that they could be treated as restricted securities within Chapter 2 and not for any other purpose. The capital funding behind the restricted securities was purely derived from within the moneys allocated by DB to providing employees with bonuses for the relevant financial year taken together with the tax burdens that would follow from any actual payment of bonuses. In other words, and the tribunal finds, the Scheme as a whole, and each aspect of it, was created and coordinated purely for tax avoidance purposes.

20 113 That of itself does not prevent the Scheme from having effect, as Arden LJ rightly reminds us at [41]. But it does call in question whether this is within the intention of Parliament in creating in Chapter 2 of Part 7 a voluntary set of rules (see section 425(3) – (5) of ITEPA) for dealing with one form of provision of securities to employees, which otherwise would fall to be taxed as earnings in the hands of the relevant employees. The tribunal has set out both in the UBS decision and above what it considers to be the intention of Parliament in legislating Part 7 of ITEPA as it stood in 2003. The specific provisions directly in issue here are to be read within that context and in the context of Chapter 2 within that Part. On the "actual facts" found in this decision the tribunal does not consider that Parliament intended to provide the double exemption from income tax for DB employees (and the linked exemptions from NI contributions) claimed by the Appellant for those employees in this appeal. The tribunal therefore finds that Mr Lasok QC is correct in arguing that the Scheme is not within Chapter 2 of Part 7 of ITEPA.

35 114 Accordingly, the appeal must fail.

40 **TRIBUNAL JUDGE**
RELEASE DATE: 19 January 2011

ANNEX: CHRONOLOGY OF RELEVANT EVENTS

5 (Note: this is to be read subject to the findings of the tribunal about the order of events.)

	<i>Date</i>	<i>Event</i>
10	? 11 2003	Deloitte sent its proposal for "DB -Tax Effective Compensation" to DB
	28 11 2003	The DB board considered the Deloitte proposal
	16 12 2003	Deloitte paper on "Non associated company planning" sent to DB
15	17 12 2003	Deloitte proposal considered and accepted by DB Compensation Committee
	? 01 2004	DB Compensation Committee decided on the sums to be paid to named employees by way of shares in DB and by way of a bonus payable by way of the Scheme if employees so chose
20	? 01 2004	DB offered employees participation in the Scheme and made presentations to relevant DB employees; employees were also offered guidance notes
25	7 01 2004	Draft timetable and action plan produced for DB by Deloitte. This followed a previous draft paper about implementation sent from Deloitte to DB in the previous month
	26 01 2004	Closing date to participate in the Scheme (to be made by deed of acceptance). About 300 FB employees had completed the necessary deed.
30	27 01 2004	DBI incorporated in the Cayman Islands. 49,999 \$1 shares authorised Investec appointed two directors to DBI on 28 01 2004. DB appointed John Mooney as director of DBI on 5 02 2004, following the amendments to the Articles on 2 02 2004.
35	27 01 2004	Walbrook agreed with DB to act as nominee for the Scheme
	28 01 2004	First draft of closing agenda circulated by Christine Chen of Deloitte
40	29 01 2004	DB informed Walbrook of names of employees for whom shares to be held beneficially under the Scheme. It also informed Walbrook that it would shortly receive 91,300 C1 shares in DBI that were to be held for those employees.
45	29 01 2004	Walbrook declared that it held any C1 shares as a nominee in trust for employees named
50	29 01 2004	Deloitte notified DB that the final funding figure for DBI is to be £91.3M and the details of the DBI share capital after amendment (made on 2 02 2004 as below)

- 30 01 2004 Incentive plan Committee of DB met to consider, among other issues, the draft agreement between DBI and Investec and new articles of association for DBI.
- 5 2 02 2004 Shareholders of DBI increased share capital and amended the memorandum and Article of the company by special resolution. The new share capital was structured as:
- 10 38,042 ordinary shares of 35p
91,300 C1 redeemable shares of 35p each
91,300 C2 redeemable shares of 35p each
91,300 D shares of 35p each
251,078 E shares of 35p each.
- 15 The C1 shares were subject to two time-limited restrictions:
a restriction on transfer from 7 02 2004 to 1 04 2004; and
a restriction requiring C1 shares be converted to C2 or D shares on the occurrence of certain events between issue and 2 04 2004.
- 20 2 02 2004 Meeting of DBI directors at Investec premises. DBI resolved to enter into agreements with Investec noted below.
- 25 2 02 2004 DBI and Investec made the following agreements:
(a) a subscription agreement under which Investec agree to subscribe to the E shares for £87K and the C1 shares for £91.3M;
(b) a portfolio management agreement under which DBI appointed Investec as its investment manager until 31 07 2006;
(c) a security over cash agreement under which a charge was placed over DBI's funds in favour of Investec.
- 30 All three agreements were signed for both parties by the same individual, Kevin Chong
- 35 2 02 2004 Investec subscribed to 251K E shares and 91,300 C1 shares in DBI paying £87K for the E shares and £91.3M for the C shares
- 5 02 2004 DB subscribed to 38K ordinary shares in DBI, the sums being paid into DBI's account with Investec
- 40 5 02 2004 DB made a Shareholders' Agreement with Investec with regard to DBI. Investec agreed to transfer C1 shares to Walbrook for no consideration. DB paid Investec £92M and Investec agreed to make DBI open its bank account with DB, to use DB as its custodian, to transfer all funds to the account or custodianship, and to release DBI from its charge from 6 02 2004. Investec also agreed to purchase DBI shares from Walbrook at specific times subject to agreed procedures.
- 45 6 02 2004 Sums transferred by DB to Investec
- 50 6 02 2004 DBI appointed DB as custodian of its securities under a safeguarding agreement agreed between them that day.
- 6 02 2004 Investec transferred the C1 shares to Walbrook

	6 02 2004	Walbrook informed DB employees of C1 shares held in DBI and of restrictions applying to the shares
5	6 02 2004	Deed of release by Investec releasing DBI's property from the charge held by Investec.
	7 02 2004	Start of period of prohibition of transfers of C1 share in DBI
10	15 02 2004	50 C1 shares redesignated as C2 shares
	2 04 2004	End of period of prohibition in transfers of C1 shares
	13 04 2004	Redemption of DBI C2 shares of an employee who left DB
15	8 07 2004	Investec required DBI to redeem first tranche of shares, at £1,003.73
	8 12 2006	Final sale by Walbrook to Investec
20	31 12 2009	Final date of sale or redemption of shares