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PRESS SUMMARY

UBS AG (Respondent) v Commissioners for Her Majesty’s Revenue and Customs (Appellant); DB Group Services (UK) Ltd (Respondent) v Commissioners for Her Majesty’s Revenue and Customs (Appellant) [2016] UKSC 13

On appeal from: [2014] EWCA Civ 452

JUSTICES: Lord Neuberger (President), Lord Mance, Lord Reed, Lord Carnwath, Lord Hodge

BACKGROUND TO THE APPEALS

The appeals, brought by the Commissioners for Her Majesty’s Revenue and Customs (“HMRC”), are concerned with schemes which were designed to avoid the payment of income tax on bankers’ bonuses, by taking advantage of exemptions under Chapter 2 of Part 7 of the Income Tax (Earnings and Pensions) Act 2003, as amended by Schedule 22 to the Finance Act 2003 (“ITEPA”). In particular, under section 425(2) of ITEPA, an exemption is conferred on the award to employees of “restricted securities”, defined by section 423 as shares which are subject to provision for their forfeiture if some contingency occurs. Under the schemes, the banks decided to award discretionary bonuses to their employees, but rather than paying the bonuses to them directly, the banks instead used the amount of the bonuses to pay for redeemable shares in offshore companies set up for the purposes of the schemes. The shares were then awarded to the employees in place of the bonuses. Conditions were attached to the shares making them subject to forfeiture if a contingency occurred, so as to qualify for the exemption. In the UBS case, the contingency was a specified rise in the FTSE 100 within the next three weeks. The contingency was unlikely to occur, and it was also hedged against so that the employees would lose out slightly, but not significantly, if it did occur. In the DB case, the contingency was the employee’s being dismissed for misconduct or voluntarily resigning within the next six weeks. Once the exemptions had accrued, the shares were redeemable by the employees for cash.

HMRC decided that tax should be assessed as if the employees had been paid in cash the amount of the bonuses allocated to them. UBS and DB’s appeals to the First Tier Tribunal were dismissed. The Upper Tribunal heard the cases together and allowed UBS’s appeal. DB’s appeal was dismissed on the basis that the scheme failed to comply with a technical requirement for exemption. The Court of Appeal dismissed HMRC’s appeal in the UBS case, and allowed DB’s appeal.

JUDGMENT

The Supreme Court unanimously allows HMRC’s appeals. Lord Reed gives the lead judgment, with which the other Justices agree.

REASONS FOR THE JUDGMENT

Lord Reed explains that the case of *W T Ramsay Ltd v Inland Revenue Comrs* [1982] AC 300 extended the purposive approach to statutory construction, which was orthodox in other areas of the law, to tax cases. It also established that the analysis of the facts depends on that purposive construction of the statute [61-62]. Taxing statutes generally draw their life-blood from real world transactions with real world economic effects. Where an enactment is of that character, and a transaction, or an element of a composite transaction, has no purpose other than tax avoidance, it can usually be said that to allow tax

treatment to be governed by transactions which have no real world purpose of any kind is inconsistent with that fundamental characteristic. Where schemes involve intermediate transactions inserted for the sole purpose of tax avoidance, it is quite likely that a purposive interpretation will result in such steps being disregarded for fiscal purposes [64].

In the present appeals, Lord Reed begins by asking whether a purposive interpretation of the legislation is possible. The context of Chapter 2, and the background to its enactment, provide some indication of Parliament's intention. The purposes of Part 7 were broadly identified in *Grays Timber Products Ltd v Revenue and Customs Comrs* [2010] UKSC 4 as being: (i) to promote employee share ownership by encouraging share incentive schemes; (ii) since such schemes require benefits to be contingent on future performance, creating a problem if tax is charged on the acquisition of the shares, to wait and see in such cases until the contingency has fallen away; and (iii) to counteract consequent opportunities for tax avoidance [74]. The background to the enactment of Chapter 2 indicates that it was intended to address practical problems, and to forestall opportunities for tax avoidance [75].

It is difficult to accept that Parliament intended to encourage, by exemption from taxation, the award of shares to employees, when the award of such shares has no purpose other than the obtaining of the exemption itself [77]. The section 425(2) exemption, in respect of the acquisition of securities which are "restricted securities" by virtue of section 423(2), was designed to address practical problems arising from valuing a benefit which was, for business or commercial reasons, subject to a restrictive condition involving a contingency. Nothing suggests that Parliament intended that section 423(2) should also apply to restrictive conditions that have no business or commercial purpose, but are deliberately contrived solely to take advantage of the exemption [78]. This is not undermined by the section 429 exemption, which is confined to two specific situations falling within the broader section 425 exemption, whose purposes are consistent with the general approach to Chapter 2 [80]. The fact that Parliament has expressly dealt with tax avoidance in Chapters 3A to 3D does not support the inference that Parliament's intentions in relation to anti-avoidance had been exhaustively expressed [82]. Lord Reed concludes that the reference in section 423(1) to "any contract, arrangement or condition which makes provision to which any of subsections (2) to (4) applies" is to be construed as being limited to provision having a business or commercial purpose, and as not applying to commercially irrelevant conditions whose only purpose is the obtaining of the exemption [85].

In the UBS case, Lord Reed finds that the condition was completely arbitrary, and had no business or commercial rationale. Further, the economic effect of the restrictive condition was nullified by the hedging arrangements, except to an insignificant and pre-determined extent. Accordingly, the condition should be disregarded, with the consequence that the shares are not "restricted securities" within the meaning of section 423 [86-7]. The condition in the DB case operated only for a very short period, during which the possibility that it might be triggered lay largely within the control of the employee who would be adversely affected. It had no business or commercial purpose, and thus fell outside section 423 [88].

Having found that the exemption does not apply, Lord Reed holds that the proper basis for taxation of the bonuses is as shares, and not as cash. The shares did not simply function as a cash delivery mechanism: the amount of cash for which the shares might be redeemed was neither fixed nor ascertainable when the shares were acquired [92]. The value of the shares has to be assessed as at the date of their acquisition, and the restrictive conditions must be taken into account, as ordinary taxation principles require the tax to be based on the shares' true value [94-5].

References in square brackets are to paragraphs in the judgment

NOTE

This summary is provided to assist in understanding the Court's decision. It does not form part of the reasons for the decision. The full judgment of the Court is the only authoritative document. Judgments are public documents and are available at: www.supremecourt.uk/decided-cases/index.html