



[2013] UKUT 0225 (TCC)  
Appeal number: FTC/01/2012

*INCOME TAX – claim for loss on disposal of loan stock – whether loan stock a “relevant discounted security” – FA 1996, Sch 13, para 3 – whether additional payment on redemption of loan stock was interest – yes – appeal dismissed*

**UPPER TRIBUNAL  
TAX AND CHANCERY CHAMBER**

**NICHOLAS PIKE**

**Appellant**

**- and -**

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

**Respondents**

**TRIBUNAL: MR JUSTICE NORRIS  
JUDGE ROGER BERNER**

**Sitting in public at The Rolls Building, Fetter Lane, London EC4 on 27 February  
2013**

**Scott Redpath, instructed by SP Consultants Ltd, for the Appellant**

**Michael Gibbon QC, instructed by the General Counsel and Solicitor to HM  
Revenue and Customs, for the Respondents**

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## DECISION

1. In his self assessment tax return for the year ended 5 April 2000 Nicholas Pike  
5 claimed relief against his income in the sum of £3,463,563, deriving from a loss incurred on relevant discounted securities. That claim arose in this way.

2. On 28 March 2000 Mr Pike (who had recently retired as a Senior Executive of the Dell Computer Corporation) acquired an “off the shelf” company which he renamed Aim Internet Investments Limited (“the Company”). He took 999 shares in  
10 the Company and his wife took the remaining share. He became its sole director.

3. Three days later (on 31 March 2000) Mr Pike caused the Company to issue £6,000,000 nominal of Loan Stock 2013, all of which he took at par.

4. The Loan Stock Certificate issued to Mr Pike provided that:

15 “The Company shall, subject to the terms of this Loan Stock, pay to the Stockholder on the 15 July 2013 (“Repayment Date”) the Redemption Proceeds as defined in Condition 2”.

5. Condition 2 was headed “Redemption” and was in these terms:

20 “2.1 in these Conditions “the Redemption Proceeds” means, in respect of any repayment or redemption of the Principal Amount in full or in part pursuant to the Certificate, a sum being the aggregate of: (i) the Principal Amount to be repaid or redeemed; and (ii) an amount equal to 7.25% per annum of the Principal Amount to repaid or redeemed, accruing on a daily basis from and including the date of the Certificate up to and including the date of repayment or redemption.”

25 The remaining provisions of Condition 2 provided for partial and for early redemption.

6. Five days later (on 5 April 2000) Mr Pike declared the trusts of The Nicholas Pike Settlement 2000 in relation to the £6,000,000 Loan Stock (which constituted the trust fund of that settlement).

30 7. In his self assessment return Mr Pike noted that because the Company was connected to him the gain or loss on the transfer of the Loan Stock into The Nicholas Pike Settlement 2000 was calculated by reference to its market value at the time of the transfer to the trust. He added this explanation:-

35 “I have therefore calculated the market value of the Loan Stock at the date of transfer. It is redeemable on 15 July [2013] in an amount of £6,000,000 plus a premium of 7.25% for each year that the Loan Stock is outstanding. This gives redemption proceeds of £11,780,984. The current value of this covenant to pay the Loan Stockholder this amount on the repayment date is determined by the interest rate that would be  
40 required by an unconnected person. If the return were virtually risk free a return of 7.25% or so would be reasonable. However the

5 investment in [the Company] Loan Stock is very risky. The underlying assets may be invested in risky investments with no fixed rate of return. The operating policy of the company could be changed to the detriment of the Loan Stockholders without even consulting them. A 5% per annum risk premium has been added to the base rate giving 12.25%. Valuing the ultimate proceeds at the rate of 12.25% gives a current market value of £2,536,437.00. The Loan Stock cost me £6,000,000.00 and so I have entered a loss of £3,463,563 in Box 15.11 [of my self assessment return].”

10 8. Under the provisions of paragraph 2 of Schedule 13 to the Finance Act 1996 Mr Pike would be entitled to relief from income tax on an amount of his income for that year equal to the amount of that loss if the loss was sustained “from the discount on a relevant discounted security”.

15 9. A “relevant discounted security” is defined in paragraph 3 of Schedule 13 to the Finance Act 1996 in these terms (so far as material):-

“3-(1) ... in this Schedule “relevant discounted security” means any security which (whenever issued) is such that, taking the security as at the time of its issue, the amount payable on redemption –

(a) on maturity; or

20 (b) in the case of a security of which there may be a redemption before maturity, on at least one of the occasions on which it may be redeemed,

is or would be an amount involving a deep gain ...

25 (3) For the purposes of this Schedule the amount payable on redemption of a security involves a deep gain if -

(a) the issue price is less than the amount so payable; and

(b) the amount by which it is less represents more than the relevant percentage of the amount so payable.

30 (4) In this paragraph “the relevant percentage”, in relation to the amount payable on redemption of a security, means-

(a) the percentage figure equal, in a case where the period between the date of issue and the date of redemption is less than 30 years, to one half of the number of years between those dates ...

35 (6) For the purposes of this paragraph the amount payable on redemption shall not be taken to include any amount payable on that occasion by way of interest.”

40 10. Under the Loan Stock 2013 instrument the amount payable on redemption was “the Principal Amount ... and ... an amount equal to 7.25% per annum of the Principal Amount ... accruing on a daily basis from [31 March 2000] up to ... the date of ... redemption ...”. If the additional 7.25% accruing on a daily basis was an amount payable by way of interest then the Loan Stock was not a relevant discounted security (and the loss on the transfer of it into The Nicholas Pike Settlement 2000 could not be used as a relief against income tax). HMRC refused relief. The First-tier

Tribunal (Judge Mosedale and Mr Thomas) rejected Mr Pike’s appeal against that determination and held that in fact the sum paid in addition to the Principal Amount was an amount payable by way of interest: see [2011] UK FTT 289 (TC). The question on this appeal is whether they erred in law in reaching that conclusion.

5 11. In support of Mr Pike’s appeal Mr Scott Redpath of Counsel submitted:

(a) Although the characterisation of the additional payment is not simply a matter of labelling the Loan Stock instrument in fact makes no provision for interest at all but only “a premium”;

10 (b) In truth and in substance the additional sum paid by way of return was not “interest” but a “redemption premium”;

(c) That whilst the redemption premium may have been the economic equivalent of interest of 7.25% per annum it was not in law or in fact interest because nothing was payable until the Principal Amount was redeemed;

15 (d) The justification for that feature of the Loan Instrument is explained in paragraphs 9 and 10 of Mr Pike’s witness statement in support of the appeal to the First-tier Tribunal in this way:

20 “It was intended that [the Company’s] investments would be concentrated in the internet and technology sectors as I considered at this time that these sectors offered enormous growth potential and opportunity for spectacular returns, in the form of capital gains over the medium to long term.... The nature of these investments and direct business participations that the company was then contemplating meant that the company would be unlikely to enjoy a significant income flow. It was therefore considered inappropriate to pay interest on the Loan Stock as the company would not have the cash flow to pay such interest”.

30 12. As to whether the amount payable on redemption in addition to the return of the amount originally loaned was an amount payable by way of interest, we entirely agree that the issue is not to be determined by the application of labels. The question is: what is the true nature of the arrangement into which the Company and Mr Pike have entered having regard to the language in which they have described that arrangement? Does the amount payable on redemption include an amount payable on that occasion by way of interest?

35 13. To answer that question we must understand what “interest” is. There is no definition of “interest” in Sch 13 itself. We do not consider that “interest” for Sch 13 purposes can have, as Mr Redpath submitted it did, any special meaning. Interest is a term that has a well-established meaning that must, in our judgment, apply for this purpose. There is statutory guidance for the purposes of the Tax Acts to be found in section 832 ICTA 1990. But, as Megarry J said (in Re: Euro Hotel (Belgravia) Ltd [1975] 3 All ER 1075 at p 1081b) of its predecessor:-

“One turns to the definition section with avidity but one reads it with disappointment. By section 526(5) [now section 832(1)] “...except

insofar as the context otherwise requires... “interest” means both annual or yearly interest and interest other than annual or yearly interest”. “Interest” in short means “interest”...”

14. It is however possible to identify certain characteristics of an amount payable by way of interest from observations in the decided cases. On this Mr Redpath and Mr Gibbon QC were essentially agreed.

15. First, interest is calculated by reference to an underlying debt. As Megarry J put it in Euro Hotel (*supra*) at p 1084 b-f:-

10 “It seems to me that running through the cases there is the concept that as a general rule two requirements must be satisfied for payment to amount to interest, and *a fortiori* to amount to “interest of money”. First, there must be a sum of money by reference to which the payment which is said to be interest is to be ascertained. ... Second, those sums of money must be sums that are due to the person entitled to the  
15 alleged interest ... I do not, of course, say that in every case these two requirements are exhaustive, or that they are inescapable. Thus I do not see why payments should not be “interest of money” if A lends money to B and stipulates that the interest should be paid not to him but to X: yet for the ordinary case I think they suffice”.

20 16. Second, the payment that is made by reference to that debt is a payment made according to time. The general idea is that it is compensation for the use of the money. Sometimes it is said to represent the profit the creditor would have made if he had himself had the use of the money, or the loss he has suffered because he has not had that use. Sometimes it is said to be the creditor’s share of the profit which the  
25 borrower or debtor is presumed to make from the use of the money (see Euro Hotel (*supra*) at 1084 c-d and Schulze v SW Bensted (1916) 7 TC 30 at 33). Perhaps the simplest formulation is to be found in Bennett v Ogston (1930) 15 TC 374 where at p 379 Rowlatt J said:-

30 “I think when you are dealing with what is interest and nothing but interest you cannot say it is in the nature of business, because it is payment by time for the use of money”.

17. Third, the sum payable accrues from day to day, or at other periodic intervals. In Willingale v International Commercial Bank Ltd [1978] AC 834 the House of  
35 Lords was concerned to consider the nature of the profit made on the purchase of medium term bills purchased at a discount and either held until maturity or sold prior to maturity. In its accounts the bank included a time based proportion of the profit that would be made on each bill held until maturity (called “accrued discount”): and the issue was whether this “accrued discount” fell to be included in the bank’s profits for the purposes of assessing corporation tax. Lord Salmon (who was part of the majority)  
40 pointed out (at p 842 D-E) that:

45 “Although there may be some superficial similarity between (a) lending £10,000 for five years at a rate of interest of X% per annum on the terms that none of the interest amounting in all to £5,000 shall be payable until the principal becomes repayable and (b) buying a foreign bill of exchange with a face value equivalent to £15,000 for a price

equivalent to £10,000, the two transactions are ... essentially different from each other in character”.

He had earlier explained (at p 841 G-H) what that difference in character was:-

5 “The difference between the price at which the bank buys the bill, and the bill’s face value is something referred to as “a discount”. A discount however is different from interest: it is not earned nor does it accrue from day to day.”

Lord Fraser of Tullybelton (also a member of the majority) pointed to the same difference saying (at p 845 B-C):-

10 “In my opinion there is an essential difference between interest and discount, so much so that to speak of “earning” discount, seems to me wrong. Interest accrues from day to day, or at other fixed intervals, but discount does not. Two consequences follow. Firstly, when periodical interest is received (or is due to be received) the profit or gain on the  
15 loan is realised from time to time. But when a bill is discounted nothing is realised until the bill matures or is sold, and the whole profit is postponed or rolled up until one of these events occurs.”

18. Fourth, whilst interest accrues from day to day, or at other fixed intervals, it does not have to be paid at any intervals. As the speech of Lord Salmon cited above  
20 contemplates, it is possible for interest not to become payable until the principal becomes repayable. That, indeed, was the specific issue addressed in Davies v Premier Investment Co Ltd [1945] 2 All ER 681. A gold mining company issued 6-year notes to fund its development programme. The notes were issued at par and carried no interest, but were repayable on a fixed date together with a premium of  
25 30%. There was provision for earlier redemption in which event (in lieu of the premium of 30%) the premium was to be calculated at the rate of 2 ½% percent for every period of six months (or 5% per annum). The Court held that if the premiums were intended to be an accretion of capital then it was to be supposed that the premium would remain the same whether the loan was repaid on the redemption date  
30 or at any earlier date. But so far from that being the case the loan notes provided that they would carry a return of 5% per annum: and although described as a “premium” the return was to be regarded as interest.

19. Fifth, the decision in Davies also illustrates that what the return is called is not  
35 determinative of its nature: and that point was also made in Re: Euro Hotel (*supra*) at p 1083 e-f where Megarry J is reported as saying:-

40 “It has, quite rightly, not been suggested that the language used by parties to an instrument in describing payments to be made under it can bind the Inland Revenue or affect the alteration of a statute. The question must always be one of the true nature of the payment. The language, of course, is important, for the words used may mould or affect the nature of the obligation; but one must always return to a consideration of what, given that language, the payments made under the obligation truly are: are they “interest of money” within the meaning of the statute?”

20. Sixth, the mere fact that the payment by way of interest may be aggregated with a payment of a different nature does not “denature” the payment that is interest. This point was made in Chevron Petroleum UK Ltd v BP Petroleum Development Ltd [1981] STC 689 at p 694 g-j where Megarry VC is reported as saying:-

5 “If in its nature a sum is “interest of money” I think it retains that nature even if the parties to a contract provide for it to be wrapped up with some other sum and the whole paid in the form of single indivisible sum. The wrappings may conceal the nature of the contents, but they do not alter them ... If the true nature of a sum of money is  
10 that it is “interest of money” that sum will not be denatured, or transmuted into something different, simply by being incorporated into some larger sum before being made payable under the terms of the contract”.

21. Having described certain positive characteristics it is useful to contrast  
15 “interest” with other forms of return. We have already referred (paragraph [17] above) to the observations of Lord Salmon and Lord Fraser in Willingale: Lord Greene MR undertook a more extended consideration in Lomax v Peter Dixon & Sons Ltd [1943] 1 KB 671, where he considered both discounts and premiums, and considered what was the nature of the return they offered.

20 22. As part of that consideration he referred to the Scottish case of Inland Revenue v Thomas Nelson & Sons Ltd [1938] SC 816 in which the underlying loan instrument was a 10-year loan note with provision for earlier redemption. Lord Greene said:-

25 “The agreement provided (and this is the important matter) that on payment of the principal sums or any part thereof there should be paid a premium varying with the date on which such principal sums or any part there of should become payable. From this it appears that the amount to be paid by way of premium must have been calculated by reference, not to any element of capital risk, but to the period of the loan, whatever it might turn out to be, a circumstance which prima  
30 facie, at any rate, stamped the premium with a revenue character”.

The distinction he was there drawing was between a risk-based return (a reward for speculation or compensation for risking capital) and a purely time-based return.

23. Lord Greene then observed that there could be no general rule that any sum  
35 which a lender had received over and above the amount which he lent ought to be treated as income: and each case must depend on its own facts, with evidence outside the contract itself being admissible to explain “the quality which ought to be attributed to the sum in question”: see [1943] KB 671 at p 677. This consideration of the broad contractual context was necessary because (as Lord Greene had explained at p 675)

40 “In many cases ... mere interpretation of the contract leads nowhere. If A lends B £100 on terms that B will pay him £110 at the expiration of 2 years, interpretation of the contract tells you that B’s obligation is to make this payment. It tells us nothing more. The contract does not explain the nature of the £10...”



27. We first note that the terms of the Loan Notes do not expressly provide for interest to be paid. A conclusion that the true nature of the return described as “a premium” was “interest” would nonetheless be entirely consistent with the observations of the Court in Lomax and in line with the actual decision in Davies:  
5 though of course every case must turn on its own facts.

28. Second, the description of the return as “a premium” is plainly not determinative. The First-tier Tribunal had to identify the true nature of the return from all the circumstances of the case (of which the label that the Company and Mr Pike applied was only one).

10 29. Third, the return described as “a premium” bore all the characteristics of a payment of interest. It was paid by reference to an underlying debt, at a stipulated rate, and calculated by reference to time elapsed: and it accrued daily, as Condition 2.1 of the Loan Stock Certificate expressly provided.

15 30. Fourth, the mere fact that the return was only paid when the loan itself was repaid is neutral. It might indicate a premium: or it might indicate deferred interest. But it accrued daily: just like interest and generally unlike premiums (or discounts), the true value of which can only be determined at particular points in time. The fact that Mr Pike, as the creditor, was only entitled to the additional payment on redemption does not, contrary to what Mr Redpath sought to argue, prevent the return  
20 from accruing on a daily basis.

31. Fifth, the additional payment which is argued to represent a “premium” and not interest was in this case purely time-based, and not risk-based. This was explained in Mr Pike’s self assessment return. He told HMRC that if the investment return were virtually risk free then an interest rate of 7.25% would be reasonable. But if the rate  
25 of return were to take account of the riskiness of the investment then it would have to be 12.25%. It was precisely because the additional payment (of 7.25% of the Principal Amount) represented a normal rate of return (and did not reflect the defect in the security) that the value of the security on acquisition was less than its issue price and that Mr Pike suffered such a massive loss in three days.

30 32. Sixth, the commercial context does not suggest that the First-tier Tribunal made a legal error in characterising the true nature of the return. Mr Pike’s subjective intention as sole director of the Company in causing the Company to issue the Loan Notes to himself on those terms is not legally relevant. But insofar as anticipated cash flows form part of the factual context which falls to be taken into account in  
35 ascertaining the true nature of the additional payment then the evidence is neutral. It tells the Tribunal that any payment had to be made at the end of the loan: but it does not help in establishing that the payment was a premium of a capital nature rather than rolled up interest.

33. Every case turns on its own facts. It seems to us plain that in this case the  
40 additional payment was in law capable of being “interest”: and equally plain that the First-tier Tribunal made no error of law in characterising it as such and was plainly entitled to reach the conclusion it did. We would dismiss this appeal.

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**MR JUSTICE NORRIS  
JUDGE ROGER BERNER**

**RELEASE DATE: 10 MAY 2013**

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