TC02088

Appeal number: TC/2001/00879

Income tax – Whether payment made to the Appellant constituted emoluments - When the Appellant had not referred to the receipt in his tax return, whether an assessment could validly be made out of time on the basis of asserted negligence by the Appellant in not seeking tax advice as to whether the receipt constituted income - if the receipt constituted emoluments and the assessment was validly made, whether the penalties charged were excessive - Appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR. COLIN COLLINS **Appellant**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE HOWARD M NOWLAN
MARK BUFFERY FCA AIIT

Sitting in public at 45 Bedford Square in London on 15 – 17 May 2012

Laurent Sykes, counsel, instructed by Crowe Clark Whitehill, on behalf of the Appellant

Jon Davis of HMRC's Appeals & Reviews Local Compliance Office, on behalf of the Respondents

DECISION

Introduction

1. This was an appeal in which the first and the main point at issue was the fairly common question of whether a gratuitous receipt by the Appellant constituted emoluments of the Appellant's employment (or perhaps the "uncommon" question having regard to the $2 million dollar amount of the payment). As with all cases of this nature the facts were likely to be highly relevant to our determination, and unusual. They certainly were.

2. The Appeal also raised the question of whether HMRC had satisfied their burden in showing negligence on the part of the Appellant in making his return (principally by not having sought tax advice as to whether the receipt might be taxable), such that HMRC could sustain the assessment made on the Appellant outside the normal 6-year period, and were that established there was the further issue of whether the penalties imposed had been excessive.

3. The detailed facts are slightly too involved for us to summarise them in this short introduction. It is sufficient to say that two separate grounds on which the Respondents sought to link the receipt to employment-related matters appeared to us to be completely unsustainable. And on the more general question of whether the payment received did still constitute emoluments from an employment, the Appellant satisfied us that this was not so.

4. The Appellant had suffered considerable ill health, in the form of both cancer and heart disease. Whilst this did not remotely influence our decision, this fact, coupled with the feature that the Appellant had suffered from heart palpitations whilst waiting to give his evidence, did induce us to give an immediate oral decision. In this we ignored the penalty issue, but decided the emolument question and the negligence question in favour of the Appellant. We obviously only gave this decision at the end of the hearing having first clarified that we both unhesitatingly reached these two conclusions. We gave short reasons at the time but indicated that this written decision would naturally summarise the facts, the law, and our reasons more fully.

The evidence

5. The principal evidence was given by the Appellant himself and by the man with whom the Appellant had worked on several occasions, generally as the Appellant's Managing Director, namely Mr. Ron Haylock ("Mr. Haylock").

6. Evidence was also given by another man who had worked with the Appellant, namely Mr. Malcolm Wood. Short evidence was given by the Appellant's wife, Mrs. Margaret Collins and by one of his daughters, Emily Collins. Finally, evidence was given by the Appellant's accountant at the time of the disclosure of the $2million receipt to HMRC, namely Costantinos Constantinou, and by the partner and assistant (Mr. Sean Wakeman and Mr. Doug Sinclair) in Crowe Clark Whitehill who had acted for the appellant in relation to discussions with HMRC and this appeal.

7. A witness statement had been furnished by Mrs. Christel DeHaan ("Mrs. DeHaan") the American lady who had paid the $2million to the Appellant. Apparently on the advice of her US tax advisor, Mr. Ed. Marcum ("Mr. Marcum"),

who had been a partner at Ernst & Young at the relevant time, Mrs. DeHaan had declined to give evidence in person or by video link, and had declined to say precisely why she felt unable to supplement her witness statement in any material way.

8. At the instigation of HMRC, the Internal Revenue Service ("IRS") in the United States was asked to ascertain certain information on behalf of HMRC in relation to the background to the making of the $2 million payment. There had therefore been a meeting between an IRS official and Mr. Marcum. Mr. Marcum provided a witness statement, though again did not give evidence in person or by video link. We will refer to this witness statement in due course and quote certain passages. Much of it was dedicated to disputing the record of the meeting that the IRS official had provided and passed on to HMRC.

9. One of the principal reasons why the two accountants from Crowe Clark Whitehill gave evidence was that Mr. Sinclair had travelled to the USA in an effort to obtain more information either from Mrs. DeHaan or from her advisor. This effort had not been particularly successful.

10. We considered that all the witnesses had been entirely trustworthy. In particular both the Appellant and Mr. Haylock were distinguished gentlemen who gave their evidence carefully and on the very few points where they were cross-examined, they entirely satisfied us that there was nothing that they had said in their witness statements or orally that needed to be modified in any way.

11. Before summarising the facts, we should mention that the fact that Mrs. DeHaan was advised not to supplement her witness statement in any way has meant that on certain issues we have had to speculate somewhat. So far as any US tax implications are concerned, therefore, we make it clear that no direct evidence was given, beyond what was said in Mrs. DeHaan's witness statement, that might have any bearing on US tax implications of the relevant payment. Since indeed our well-informed speculation extends to our understanding that payments were made not only to the Appellant, and certainly to Mr. Haylock, but to at least, and probably more than, 32 individuals, there is much about this case that remains unclear to us. Whilst we know virtually nothing about these other payments, we can and must reach the best conclusions that we can as to why the payment was made to this present Appellant. So far as US tax implications are concerned, we make it clear that we know nothing about any US tax point that might be relevant, and more particularly nothing about any of the other payments made. We consider that the evidence, and a small element of well-informed speculation enables us to reach a decision on the primary issue in this case with absolute confidence. But that should not be taken to have much bearing on the wider issues that may be relevant for US purposes.

12. We will now summarise the facts in considerable detail. Thereafter, we will:

- summarise the contentions of the parties in relation to the employment issue;
- give formal findings of fact which we consider vital to our decision;
- summarise the relevant law; and
- give and explain our decision on the employment issue.

Thereafter we will deal in a similar, but shorter, manner with the "negligence" and "penalty" issues. They are of course inherently inter-related. If our decision on the employment issue is correct, the other issues naturally drop away. Beyond that, our view in relation to the employment issue, namely that we consider that the receipt of $2 million dollars was plainly not employment income, does strongly influence

whether we consider it understandable that the Appellant assumed that the receipt was a pure gift, and not something that required him to seek tax advice as to whether it might constitute taxable income.

The facts in detail

13. The Appellant was aged 74 and had retired in the year 2000.

14. The Appellant had in about 1972 worked in the Court Group, a large travel operator. It was there that he had first worked with Mr. Haylock.

15. In the period prior to the summer of 1984 the Appellant had been working as a Marketing Director in American Express' travel division. In the spring of 1984 he was approached by a head-hunter to enquire whether he would be interested in applying for the position of Managing Director of the UK subsidiary of Resort Condominiums International ("RCI Inc"). RCI Inc was a US-based company, the detail of whose business was not described to us, though it clearly involved the doubtless complex issue of enabling holders of "timeshare weeks" of holiday properties with one particular timeshare operator to swap those weeks for different weeks in resorts operated by other operators, at different times of year and in different parts of the world. RCI Inc wished to expand its European operations based in the UK, which was why applicants were being sought for the role of Managing Director.

16. At this time, RCI Inc was owned by a Mr. and Mrs. DeHaan, with the shares split in the ratio 80/20. Mrs. DeHaan had principal responsibility for the international (i.e. non-US) operations, those operations being very modest in comparison with the North American operations essentially run by her husband. It was therefore Mrs. DeHaan who interviewed various applicants for the job of Managing Director of the European business when she was in London, and the three front runners, including the Appellant and Mr. Haylock were then interviewed by numerous senior executives in Indianapolis. Whilst the Appellant knew that his application had not been successful, he later discovered that Mr. Haylock had been offered the position and had taken it. Six months later (therefore in 1985) Mr. Haylock offered the Appellant the position of Marketing Director of RCI's European operations, which the Appellant accepted. We understand that the job involved a great amount of travelling, building up good relations with all the timeshare operators, and it sounds as if this was something for which the Appellant was admirably suited. It also involved (though perhaps more so at the later date that we will refer to shortly) trying to devise a "points" system to evaluate different timeshare entitlements carefully so that fair exchanges could be made of one property for another.

17. In the period between about 1986 and 1989 there was a bitter battle between Mr. and Mrs. DeHaan. It commenced with Mr. DeHaan having a heart attack, whereupon Mrs. DeHaan took temporary control of the group. On his recovery, Mr. DeHaan then sacked his wife, and in due course brought divorce proceedings. In the bitter battle leading up to, and during, the court hearing, senior executives tended to take sides with almost all the senior US executives supporting the case that Mr. DeHaan should acquire total control and buy out his wife's 20% shareholding. Mrs. DeHaan was however supported in a somewhat clandestine manner (bearing in mind that she was at this point not a director and had been ousted from the company) by Mr. Haylock, the Appellant and one Gabriel Oropreza who ran the Mexican and other Latin American operations. Mrs. DeHaan's few supporters risked being sacked by supporting Mrs. DeHaan's then endeavour to acquire control of the company herself, and they met in secret. Both Mr. Haylock and the Appellant were ready to

give evidence on behalf of Mrs. DeHaan in the court divorce proceedings, and the Appellant certainly enlisted the support of other people in the European and non-US business who might support her case. In the event neither Mr.Haylock nor the Appellant were called to give evidence but two South Africans involved in the timeshare industry (who had been recruited for this role in part by the Appellant) did fly to Indianapolis and give evidence in the court hearings.

18. We have not reviewed the decision in the divorce case, but the outcome was as follows. The judge first decided that the shares in RCI Inc were matrimonial property, and that instead of being owned (as formally they were) in the ratio 80/20, they should be treated as owned equally on a 50/50 basis. Mr. DeHaan had offered to buy his wife's shares at what she considered to be a considerable under-valuation, and in response she offered to be either the buyer or the seller at double the price. Mr. DeHaan responded that she would not be able to acquire his shares at that price, to which she responded that she had already arranged the loan finance to do so. The judge then concluded that Mrs. DeHaan was the natural leader of the two, and the outcome of the divorce case was that Mrs. DeHaan acquired her husband's shares, paying effectively of course for 50% of the shares whilst formally taking transfers of 80%. There is some irrelevant confusion in relation to the price paid, in that figures of $90 million and $67.5 million were mentioned. We suspect that the price for 50% was $67.5 million, and that the $90 million might have been the price had it been necessary to buy 80% rather than 50% of the shares. In the light of subsequent events, this slight confusion is not terribly material.

19. It was in 1989 that the divorce battle ended and that Mrs. DeHaan acquired total control and ownership of the group.

20. Whilst relations with Mrs. DeHaan always appeared to remain good, in mid-1994 Mr. Haylock and the Appellant both resigned. The Appellant's resignation appeared to have been prompted essentially by policy differences between the US and the European way of operating. Mr. Haylock was concerned about these same points but had also been particularly disappointed about Mrs. DeHaan's refusal to enable him to acquire any shares in the group. The Appellant left without compensation. Whilst it is of little present significance, Mr. Haylock, as the former Managing Director of the UK subsidiary which ran the business outside the North American and Latin American regions, and naturally therefore a considerable threat to the RCI group if he worked in opposition to the RCI group, received five payments totalling £2.2 million for submitting to a non-compete clause.

21. Following his departure from the RCI Inc group, the Appellant worked for a timeshare customer of the RCI Group, namely Global Resorts.

22. In late 1996 Mrs. DeHaan sold the RCI group to a company called HFS. We were told that the contract was signed in October, and completion effected probably in December. More relevantly the consideration package consisted of immediate cash, shares in HFS and the right to three earn-out payments, the payment of which were dependent on various possible, presently immaterial, increases in EBITDA, gross revenues and client numbers. At the time of the sale, Mrs. DeHaan remained as a Director but we were told that she played no further active part in the business and apparently attended only one Board meeting after the sale. We were also told that whilst the Appellant was told about her sale of the group when he met Mrs. DeHaan at one of the fairly regular timeshare conferences that many in the industry attended, (he was by then working in a successor employment to his initial employment with Global Resorts), he was unaware of the detail of the sale terms and certainly unaware

of even the potential payment of further consideration under the earn-out mechanism to Mrs. DeHaan.

23. At around the time of the sale, all employees received bonuses. We were not told the amounts, and quite naturally neither the Appellant nor Mr. Haylock received the bonuses since they were at that time not employed in any capacity in the group. We were told that the bonuses were treated as ordinary emoluments so far as UK employees were concerned. We were given little detail of these payments or the motivation for them, though mention was made of the possibility that Mrs. DeHaan might have wished, on the occasion of the sale, to procure that the group companies made the payments to the employees to mark her gratitude for the extraordinary success of the group. Since the payments were made by the companies, in the form of ordinary bonuses, and the buyer must have been aware of the proposal to make the payments, we rather imagine (as would be common) that the buyer itself might have had an equal or greater motivation for such payments to be made in order to secure the continued loyalty of the staff, following what was obviously a very significant change of control of the company.

24. After the change of control, and possibly starting with the 1994 departure from the UK subsidiary of Mr. Haylock and the Appellant back in 1994, it emerged that the later management team in the UK were somewhat unsuccessful. Relations with timeshare operators had deteriorated as a result and losses were being incurred. Whilst Mrs. DeHaan had nothing to do with this, one of the senior vice-presidents within the US parent thus sought to, and managed to, re-engage both Mr. Haylock and the Appellant in roughly their former roles at the UK subsidiary of RCI Inc. This occurred in May 1997. They and other members of their team then strove to reverse the decline, and they eventually succeeded in stemming the losses. For his part, the Appellant was engaged partly in reviving visits to timeshare operators, but more particularly in trying to devise a points system that would enable the group to effect an easier and more accurate way of evaluating the relative worth of different timeshare weeks with different operators, at different times of year, and in different locations. We gathered that this fairly long-term project was not a total success. There were different views as to whether the company should simply evolve its own system, or whether it should purchase and modify a bought-in system. There were also differences between the approaches favoured in the US and the UK, and whilst the Appellant doubtless made good contributions to the eventual solution adopted, it took a long time for a satisfactory system to be introduced, and many had eventually contributed to the eventual system chosen.

25. We were never entirely clear of the exact calculation of the sale consideration when Mrs. DeHaan sold the group to HFS. As we have said, it initially consisted of cash, shares in HFS and the earn-out rights. In January 1998 Mrs. DeHaan resigned what appeared only to have been a formal role as a director in the group, and by March 1998 the fact that she had resigned as a director enabled her to sell her shares in HFS, which she did at a very favourable price. At some later time we were told that the share price plummeted. In March 1998 Mrs. DeHaan also became entitled to a large payment under the first of the three earn-out calculations. Again we are not absolutely sure of the figures, but we understand that the cumulative cash that she had thus received, aggregating the very substantial initial cash payment of $550 million, with the amount received under the first earn-out right and finally with the amount received by selling the consideration shares in HFS, amounted to approximately $825 million.

26. A factor that we have not hitherto mentioned, but which both the Appellant and Mr. Haylock stressed, and which Mr. Haylock made particularly clear, was that under the management of Mrs. DeHaan (presumably therefore from 1989 until their departure in 1994 and doubtless the same continued until she sold the group) the group appears to have been run on an extremely efficient and friendly basis. Both witnesses stressed that Mrs. DeHaan was "a remarkable woman". They said that the morale and enthusiasm in the organisation was by far the best that they had experienced in any business and they put this down to the remarkable personality of Mrs. DeHaan. Two features of this were of continuing relevance after she had sold the group. One was that many old colleagues from the group did periodically re-gather either at anniversary celebrations in some part of the world or at industry conferences. The old friendships then remained firm. Secondly Mrs. DeHaan was particularly generous. Her motto had been "To make a difference by caring and sharing". Even prior to the sale of the group she had periodically made generous gifts to one or two people who might have fallen on hard times. One had even been one of her opponents in the battle for control of the group during the divorce proceedings. Much more relevantly, however, we understand that Mrs. DeHaan contributed vast amounts to a charity that she formed called "Cristel House". This charity fostered education for children in numerous parts of the world. We understand that largely through their friendship for Mrs. DeHaan, Mr. Haylock and the Appellant had both supported, and were probably both still supporting and contributing to the projects of the charity, all on account of their respect for the personality of Mrs. DeHaan and their continuing friendship with her.

27. Reverting now to late April 1998, and therefore 18 months after the sale of the group, and roughly one month after Mrs. DeHaan had sold her HFS shares and received her first earn-out payment, there was one of the industry conferences in Las Vegas that was attended by numerous industry people, but including Mrs. DeHaan, Mr. Haylock and the Appellant.

28. As was her custom at these events, Mrs. DeHaan took a suite at one of the hotels, and she invited the Appellant to come up to her suite, and presented him with a letter. In the letter was a personal cheque from Mrs. DeHaan for $2million, together with a letter to the following effect:

> *"Dear Colin*
>
> *Can there be Christmas in April? Yes, why not! Indeed, there is reason: To celebrate the art of caring and sharing. In this context, I would like to recognize in a special way the people whose special contributions helped make RCI such a great company.*
>
> *Saying thank you is in itself meaningful. But…… a form of tangible expression goes much further. It helps make life a little easier. Thank you for your years of service, dedication and commitment and for your contributions in building RCI into the biggest and best exchange company. Enjoy the enclosed check* (US spelling)*, celebrate, and* ***save*** *for your old age!*
>
> *Sincerely,*
>
> *Christel DeHaan."*

29. We ought at this point to mention and then quote one or two matters dealt with in Mrs. DeHaan's witness statement. One point that she made was that since, following the sale, she was no longer actively involved in the business, she was "not in a position to evaluate Mr. Collins' contribution to the company".

30. Since there is only one paragraph in Mrs. DeHaan's witness statement that has any real bearing on why she made the April 1998 payment to the Appellant, we quote it as follows:

> *"9. In March, 1998 I received the first of several earn-out payments from the prior sale of RCI. Soon thereafter I made a payment to Colin Collins along with a payment to a few other select individuals. The payment to Mr. Collins was made via personal check and delivered via the mail along with a personal letter. Mr. Collins had no knowledge that he was to receive any payment. I made this payment to Mr. Collins with no obligation or plan to do so. My intention was to personally recognize and thank those individuals who helped place me in the position I found myself in 1998. The payments made in 1998 differed from the payments made in 1996 as the prior payments were made to all employees and was based on a formula meant to reward RCI employees on a number of criteria. Mr. Collins did not receive a payment from me in 1996 and that fact did not influence my decision to make or not make a payment to him in 1998. The payment in 1998 to Mr. Collins was in recognition of his contribution and dedication to the company and our friendship that existed for many years"*.

31. It will be noted that there is a difference in the recollection, as to whether (as Mr. Collins said) he was given the letter and cheque in the Las Vegas hotel suite, or whether it was mailed to him. Since we assume that Mrs. DeHaan's witness statement was probably written for her, and that she only troubled to correct substantive errors, and since Mr. Collins' account of how the cheque was received was so graphic, we conclude that his account is the correct one. This is of course only a trivial detail.

32. The Appellant said, and we might perhaps immediately say that we entirely accepted this statement, that he was absolutely astonished to receive this cheque. He said that he had had no expectation of receiving anything. He said that he then rang his wife, who was apparently having tea in her kitchen. He told her the staggering news very quickly, and told her not to mention it to others, apparently because he thought that others (notably it seems their daughters) might be making requests for donations from him themselves. The Appellant's wife gave short evidence, as did one of their daughters, confirming that so far as they understood matters, this receipt was a complete bolt from the blue. The Appellant also said to his wife that this gift would "solve their financial problems", a remark that might have come to haunt him by the time when, 14 years later, he was facing a tax appeal for tax, interest and penalties broadly equal in amount to the sterling value of the $ cheque when received.

33. Before proceeding to summarise what the Appellant did with the cheque, we should add the few details that we know in relation to other recipients of payments from Mrs. DeHaan. Since no evidence was given in person by Mrs. DeHaan and there was only a witness statement from her that gave no detail in relation to any other payments, the only vague understanding that we gleaned in relation to the number of payments made by Mrs. DeHaan derived from the meeting notes of the meeting between Mr. Marcum and the IRS official, arranged at the request of HMRC, that we

referred to in paragraph 8 above. From this we gathered that 32, or quite possibly a few more than 32 people, had received payments from Mrs. DeHaan. We naturally have no idea of the amounts received by each, and of who they were. We were certainly told that at least one recipient was no longer employed by the group. In that context of course, Mr. Haylock and the Appellant might have been re-engaged by the group but they had also left group employment back in 1994, more than two years before Mrs. DeHaan sold the group, and they were not re-engaged until well after the sale, and the re-employment by the group under the new ownership was something of which we are satisfied that Mrs. DeHaan was largely unconcerned. The other thing that we were expressly told was that Mr. Haylock confirmed (as is perhaps understandable as he had been the closer confidant of Mrs. DeHaan) that he had been one of the very few people who knew that the Appellant was receiving a payment, and he himself also received a payment. We have no idea whether his payment was of the same magnitude, but imagine that it was.

34. We were told one significant further thing by Mr. Haylock. He apparently asked his lawyers, Babcock and Bower, whether the receipt was taxable. That firm apparently took further advice, presumably from tax counsel, and confirmed that the receipt was a gift, and that it was not taxable. He did not therefore refer to it on any tax return that he may have made.

35. The Appellant did not seek any tax advice in relation to his receipt, and he did not report it on his tax return either. His evidence was that he considered that it was a pure gift, and that it was not taxable.

36. The Appellant's daughters had apparently been given relatively modest amounts by one of their grandparents at some time before the events with which we are now concerned. The Appellant had been told by his bank that if he and they opened Isle of Man bank accounts, the interest income on the deposited cheques would not be taxable. We are not entirely clear whether the Appellant deposited the grandparents' gifts in his account, as nominee for the daughters, or whether each had an account. The distinction is not particularly material. It was the fact that he already had accounts with the Isle of Man subsidiary of NatWest that led him to deposit the $2 million cheque in his account with that bank. He said to us that he refrained from placing the deposit with his own local Market Harborough branch of NatWest because whatever the theory of banking secrecy he feared that rumours would circulate about the substantial receipt. He also said that the Isle of Man interest rate was a good rate. We were not taken to comparable figures, and did wonder whether the rate was only seen to be good because of the wrong comparison with a gross rate on Isle of Man deposits, contrasted with a rate, net of basic rate tax, with an on-shore deposit. Whatever his thinking, the Respondents did not advance any contention of fraud. There was no contention that the $ cheque was deposited in the Isle of Man with a view to concealing the gift from HMRC. For his part, the Appellant contended that he believed, either through misleading statements from his bank of from some other advice, that there was no need to pay tax on interest on non-UK bank deposits, and there was naturally therefore some attraction to depositing the money with a non-UK bank. As a result, for many years, interest was received on the Isle of Man deposits, and ignored in completing tax returns. We were not given any details of any settlements made by the Appellant during this period, but the feature that the sterling equivalent of the original $2 million had fallen by the time HMRC started to enquire into foreign bank accounts held by UK residents clearly indicated that some of the amount originally given to the Appellant had been settled in some way.

37. As a result of applications that HMRC made to the Special Commissioners in around 2006, HMRC commenced the exercise of obtaining details from banks and the foreign subsidiaries of UK banks of information concerning deposits held outside the UK by UK residents on which UK tax ought to have been paid, but had not been paid simply through the expedient of non-disclosure. As a result of this exercise, the Appellant's Isle of Man deposit account or accounts first came to the attention of HMRC, and in May 2007 the Appellant was advised by Mr. Constantinou that he would have to obtain details from the bank of interest received, and would have to pay the tax, interest, and the 10% penalties that were offered by HMRC to those taxpayers who came forward and cooperated with the Offshore Disclosure exercise, and paid their back-tax and interest. Initially the bank only gave the Appellant back bank accounts from the year 2000 which the Appellant said he mistakenly thought had probably been the date when the accounts had been opened, or at least the dates when they had first been used in a significant manner to hold the deposit of the $2 million gift. In his initial disclosure, the Appellant did tick the relevant box that indicated that the source of the monies on which undeclared deposit income had been earned was "Gift".

38. The Isle of Man bank subsequently either found, or at least first forwarded to the Appellant, further bank accounts going back to the date in mid-1998 when the $2 million had been received and first credited to the accounts, and this further information was provided to HMRC. Again in the form sent to HMRC, the source of the funds on deposit was again described as gift, by the insertion of a tick in the relevant box. In due course the Appellant reached a settlement with HMRC in relation to the undeclared interest. In this settlement he duly paid the tax, interest and the 10% penalty applicable to those who met HMRC's criteria for suffering only that modest amount of penalty.

39. This present appeal is not directly related to the *bona fides* of the Appellant in not reporting income on the foreign bank accounts, but we will make some tentative observations in relation to that issue below.

40. The declaration that the funds on deposit had initially been the subject of a gift led HMRC to commence enquiries into the nature of the gift. In due course HMRC concluded that there was a case for their contentions first that the $2 million receipt had been emoluments of the Appellant's employment and secondly that in not having sought tax advice as to whether this amount should have been declared or at least referred to in his tax return, the Appellant had shown negligence, such that HMRC could make "out of time" assessments under section 36 Taxes Management Act, 1970. After an adjustment for the wrong use of exchange rates, the cumulative tax, interest (to 31 December 2011) and penalty imposed (the penalty being at 40% of the tax) amounted to £1,011,857.

41. We will now deal with the respective parties' contentions, our findings of fact, the law and our decision in relation to the "emoluments" issue on the supposition that there was negligence, such that the assessments were validly made.

The contentions on behalf of the Appellant

42. The contentions on behalf of the Appellant, both as regards the summary of the facts that we might consider to be the realistic findings of fact, and the law are broadly in line with our findings and our decision so that we will not list them at this point. There is only one contention that we should mention.

43. There was considerable discussion by both parties about the fact that Mrs. DeHaan had not given evidence in person, and therefore what weight should be given to the content of her witness statement. A further consequence was that she could not be questioned about the precise terms of the letter that she gave the Appellant with the $2million cheque on 27 April 1998.

44. It was not known during the hearing whether there was some US tax charge on the donor, were the analysis to be that Mrs. DeHaan had simply made a gift of the $2 million to the Appellant. It was certainly supposed, however, that there was some sensitivity in this regard, and it was suggested on behalf of the Appellant that this was why Mrs. DeHaan was being advised not to give evidence in person or by video link. Whilst we confirm that we did not seek expert evidence in relation to the relevant US tax position, and we naturally heard no evidence derived in any way from Mrs. DeHaan (other than what she said in her witness statement), we did conclude that the terms in which matters had been expressed (both in the letter and the witness statement) tended to confirm that there was some sensitivity to the exact manner in which the payment was made. It also seemed that the representative for the Respondents virtually accepted himself that this case had been rendered more confused by this sensitivity. Our attitude to this sensitivity, therefore, is that we should not ignore any of the terms of the letter or the witness statement, but at the same time we should seek to discern the credible motivation for the payment of the $2 million by looking also at the undisputed facts, rather than just the terms expressed by Mrs. DeHaan.

The contentions on behalf of the Respondents

45. It was contended on behalf of the Respondents that the Appellant was chargeable to income tax under section 19 Taxes Act, 1988 on the basis that the $2 million receipt constituted “emoluments from his employment”.

46. We should record that both parties were agreed that there was no possibility of the receipt being charged under section 148 Taxes Act, 1988, the section dealing with termination payments and payments on the change in nature or scope of an employment. This was because the payment had nothing to do with the resignation of the Appellant in 1994, and certainly nothing to do with the employment that re-commenced in mid-1997 because that employment did not terminate until the year 2000.

47. The Respondents’ section 19 contentions were broadly as follows.

48. There were two specific contentions that it was claimed directly linked the payment to employment. The first was that because the Appellant had missed the chance of receiving the bonus payment paid around late 1996 to numerous employees on the occasion of the sale of RCI Inc to HFS, the $2 million payment was designed to pay the Appellant what he might have received in that “bonus round” had he been employed at that point. The second specific contention, allegedly linking the payment to the performance of duties, was that the $2 million payment was made in order to encourage the Appellant to greater efforts in turning round the fortunes of the UK subsidiary, and thereby to enhance the EBITDA calculations that were relevant to the calculation of the earn-out payments to be made to Mrs. DeHaan. This contention was largely based on the IRS meeting note of the meeting arranged, at HMRC’s request. We have already referred to the way in which Mr. Marcum has disputed the tenor of the meeting note.

49. The contention in relation to some inter-linking between the making of the payments to the Appellant and others in April 1998 and the earn-out calculations was also touched on when reference was made to a note of a phone conversation on 31 January 2012 between Mr. Wakeman and Mr. Sinclair of Crowe Clark Whitehill and Mr. Marcum. During this phone call, to quote the note of the phone conversation, Mr. Marcum had "mentioned that when the payments had been made, they had sought to have them included by HFS as payments on a Form W2. HFS refused as these were not their payments". We will refer in due course to this remark, since if there was any basis for saying that the payments might have been paid, or booked, by HFS, this could have a bearing on their nature.

50. Leaving aside the two specific bases on which the Respondents had sought to link the payments to employment (i.e. those mentioned in paragraph 48), the Respondents' more general contention was that even if the payment was gratuitous, it still related to the fact that the Appellant was, or had been, an employee, such that it "derived from the employment". There was no case for saying that there was some different, non-employment, occasioning cause for the payment to be made. The reported cases do, of course, demonstrate that there can be other circumstances (not involving the existence of some "non-employment occasioning cause") where it has been concluded that particular receipts loosely connected with employment were not "emoluments derived from the employment". The Respondents' contention as regards this, however, was that they could take virtually each one of the various factors that the Appellant said distanced the present payments from "emoluments from employment" in isolation, and they could find a reported case where either that factor, or some wording in a judgment relevant to that factor, indicated that the particular factor itself was not necessarily inconsistent with the conclusion that a payment constituted emoluments from an employment.

51. We might perhaps anticipate the basis of our decision by saying that, whilst we accept the point just recorded, the critical question for us is whether we reach a quite different conclusion when we add up the very considerable number of what we might call "contra-indications", and we look at the total picture that then emerges and we also consider why Mrs. DeHaan made the payment, and for what reasons therefore the Appellant received the payment. The answer, as we have said in the Introduction, is that we do then reach a very different conclusion from that advanced by the Respondents.

Our findings of fact

52. This is a case where we consider that our findings of fact will be particularly material. This is because cases of this nature are in any event fact sensitive. Secondly there is the doubt occasioned by the absence of evidence having been given in person by Mrs. DeHaan, and the doubt and sensitivity occasioned by possible US tax considerations. In view of this slight gap in the evidence, we will explain fully the various findings of fact that we now make.

A substitute payment for the missed 1996 bonus

53. We first find there to be no case whatsoever for the contention that the $2 million payment was designed to recompense the Appellant for not having shared in the bonus payments made by RCI Inc, and presumably by its UK subsidiary, in 1996 on the occasion of the change of control. Since the Appellant was not employed in the group in 1996, it is impossible to say what level of payment he might have received in 1996, in order to consider whether the $2 million payment was in whole or

even in part designed to compensate for the obvious failure by the Appellant to share in the bonuses then paid to employees. We are however quite clear that the 1996 bonuses paid to others were relatively modest, and that the $2 million payment dwarfed the bonus payments. Insofar as the bonus payments might have also appealed to HFS, the buyer, as payments designed to secure the continuing loyalty of key staff on the occasion of the significant change of control, it is perfectly obvious that there would have been no occasion to make such a payment to someone who was not employed at the time, and extraordinarily strange for the payment only to be made in April 1998 and not mid-1997 when the Appellant re-joined the group, if this claimed linkage was in fact of any relevance. Had the payment had anything to do with the 1996 bonus payments, one might have expected the Appellant to have received some form of "golden hello" payment on re-joining the group.

54. Another obvious consideration is that we believe that at least 30 people received payments from Mrs. DeHaan in or around the date April 1998. We rather suspect that the number of payments might have exceeded 30, since one or two remarks indicate this. Are we meant to suppose that all 30 odd recipients were being compensated for not having shared in the 1996 bonus payments, or was the motivation for the payment to all the others something distinct, whilst the payment to the Appellant alone was somehow linked to the non-receipt of the bonus payment?

55. In short, we dismiss this suggested linkage without hesitation

A payment to boost the earn-out payments likely to be payable to Mrs. DeHaan.

56. The Respondents' stronger contention was that Mrs. DeHaan was still conversant with group affairs even after the sale. She therefore knew that the Appellant had been re-engaged by the UK subsidiary in mid-1997, she considered him key to the revival of the fortunes of the group, and thus to the EBITDA and gross revenue and other calculations relevant to her earn-out receipts, so that the $2 million payment was made to spur the Appellant on to yet greater efforts in turning around the fortunes of the UK subsidiary, and the group as a whole.

57. We consider this contention quite as misplaced as the one in relation to the linkage with the missed 1996 bonus payments.

58. We do not directly blame the Respondents for advancing what we consider to be a very far-fetched contention because in fairness certain passages of the IRS meeting note with Mr. Marcum suggested precisely this linkage. It is highly significant, however, that Mr. Marcum claims in his witness statement that the IRS official jumped to unwarranted conclusions, and that on the basis of what Mr. Marcum had said to that official, there was no such connection as was claimed.

59. We quote the following paragraphs from Mr. Marcum's witness statement:

> *"17. The IRS memo concludes that she (Ms. DeHaan) wanted to reward the employees that she considered helped to meet the goals" and "Mrs DeHaan made the payments because of the employee/employer relationship she had with these individuals. That was the only reason for the payments". This was not discussed at my meeting with the IRS and in fact the 1998 earn-out payment to Ms. DeHaan was based on 1997 results of "successor" RCI.*
>
> *18. It would appear from the heading of "Interview Questions" on the separate page which accompanied the notes of IRS meeting which Mr. Sinclair*

forwarded to me, that direct specific questions were asked by the IRS Agent. This was not the case and it would appear that a number of incorrect conclusions may have been reached by the IRS. I can confirm that monies were paid to Mr. Collins on a non-contractual voluntary basis by Mrs. DeHaan. Mr. Collins left RCI in 1994 and returned at the request of the new owners in May 1997.

The IRS memo states that the money paid to Mr. Collins "was paid because of his employment at RCI Europe and helping the company achieve the goals set forth in the contract for the sale of the company and the subsequent payments Ms. DeHaan would receive after the sale, if the company met predetermined goals." This is a conclusion reached by the IRS but is not an affirmative statement made by me during our meeting.

19. I do not believe that the notes accurately reflect what was discussed at the meeting.

20. In summary, I am firmly of the opinion that the payment by Ms. DeHaan to Mr. Collins was entirely voluntary and non-contractual."

60. Where there is a conflict in evidence, particularly one where the IRS agent provided no witness statement and Mr. Marcum was not available in person to be cross-examined on his witness statement, it falls to us to reach a conclusion on the facts by looking at what both parties said, but predominantly by considering the actual facts in a common sense manner.

61. The reasons why we conclude, as a finding of fact, that there was not the slightest intention on the part of Mrs. DeHaan to spur the Appellant on to greater efforts in improving the EBITDA calculations by the making of the payment to him in April 1998 are as follows:

- Mr. Haylock told us that the UK and European figures were a "drop in the ocean" in comparison with the US figures, so that any reduction in UK losses would have only a very marginal effect on group figures.
- We were specifically told that one, or rather effectively at least one, of the recipients of the April 1998 payments was no longer employed in the group in any capacity at the time the payment was made.
- Mrs. DeHaan attended only one Board meeting following the 1996 sale, and we are far from convinced (partly because she mentioned this in her witness statement) that she knew what type of role the Appellant might have been playing, following his return to the group in May 1997, and whether that role (however undertaken) could have much bearing on the EBITDA figures.
- The Appellant was only employed by the UK subsidiary for 7 months of the year whose figures were relevant to the earn-out receipt that Mrs. DeHaan received in March 1998.
- Mr. Haylock indicated that if (as we doubt) Mrs. DeHaan supposed that the Appellant was performing the type of role within the UK subsidiary that might enhance EBITDA calculations significantly if undertaken with extraordinary energy, then she was wrong. The Appellant's role was largely dedicated to the research on a points system which was a long-term project; its effect on earnings would be long deferred, and in the short term the efforts were not particularly successful anyway.
- The Appellant was unaware of the earn-out entitlement on the part of Mrs. DeHaan until well after the relevant period, so that if the payment was meant

to spur him on to greater efforts, he was unaware why that was so. In any event we are clear that the Appellant was conscientious and we doubt whether he would have worked in any different manner, had he been aware of Mrs. DeHaan's claimed motivation.

- Finally, and most obviously, bearing in mind that the aggregate payments made by Mrs. DeHaan might have been of roughly the order of $60 million, it would seem strange for a person whose business acumen Mr. Haylock and the Appellant both praised most highly to have been "paying 10 in the hope of enhancing a receipt of 1 to 2". That level of enhancement of the earn-out payments, contrasted with the amount of the payment made seems to us to put the point fairly.

We therefore reject any suggestion that the payment made to the Appellant had anything whatsoever to do with EBITDA calculations, or the role that the Appellant was playing in 1998 and 1999.

62. Before turning to further material findings of fact, we should mention that we are very puzzled by the remark that we quoted in paragraph 46 above. This was the remark that Mrs. DeHaan's accountant had tried to book the payments made in April 1998 through HFS in some way. We cannot read this to mean that there was any conception that HFS might actually pay the amounts, because the prospect of the buyer being asked to pay very large payments that the seller wished to bestow on people, all on top of anyway having to make the earn-out payments seems far fetched. Were the buyer, worse still, to have been aware of the claimed motivation for the payments, namely spurring on employees to enhance EBITDA etc, and thereby to further increase the earn-out payments, the suggestion would become even more extraordinary, apart from the fact that if the company paid out legitimate expenses of the magnitude involved, this would reduce the profit numbers very considerably. If, on the other hand, the request was merely that HFS should somehow book the payments on some form as if it had made the payments when it would not have done so, this is equally curious though for different reasons. It is hardly surprising that HFS declined the request. These points have little bearing on the present issue, though they do seem to reveal some possible US sensitivities in relation to the payments, and they lead us, more than ever, to conclude that we must reach our conclusions principally by reference to the hard facts.

The $2 million payment should be treated as having been paid to an ex-employee, the resumed 1997 employment being altogether irrelevant

63. Our next finding of fact is that the payment to the Appellant had nothing whatsoever to do with the replacement employment that he took in May 1997. We are convinced that once she had sold her HFS shares and received the March 1998 earn-out payment, such that much of the eventual cash resulting from the sale was "in hand", Mrs. DeHaan chose to make generous gratuitous payments to various people. It seems to us that four factors are likely to have influenced Mrs. DeHaan to make the payments. None of them are remotely related to the resumed employment of Mr. Collins by the group under its new owners.

64. Whilst UK case law in relation to the emoluments question makes it clear that we should look at the nature of the payment from the perspective of the recipient, rather than the payer, we nevertheless consider that Mrs. DeHaan must have been significantly influenced by the feature that she had made a vast profit on selling RCI Inc, and that whilst she was doubtless primarily responsible for the success of the company and the enormous profit made, she was not the only contributor. We think

it only reasonable and realistic to conclude that, having (at a guess) made a profit of $600 million after interest and capital gains tax from a position in 1989 where she might have lost her stake in the company for a minute fraction of that figure, all achieved in 7 years, it was only right to recognise the contributions of others. If each of 30 people received $2 million, making total payments of $60 million, that might seem to have been extraordinarily generous. Nevertheless it was only 10% of our guess at the net profit after interest and tax, and to someone who was famously generous, it is far from surprising that she felt some moral responsibility to benefit others and to enable them to share in her good fortune to that sort of degree.

65. The point just made is rather supported by the fact that there appears to have been genuine respect and friendship between the senior employees in the RCI group, and in her charitable endeavours, and in helping other needy people, it is obvious that Mrs. DeHaan was a very generous and caring person. We certainly do not say that the payment was in any way made to foster support for her charitable activities, but it is nevertheless the case that the combination of her personality, the respect that her former work-colleagues retain for her, and perhaps the recollection of the generous payments that she made in 1998 have held the former colleagues together in an unusual manner. And those various considerations have resulted in the only two about whom we know anything remaining seriously keen to do whatever they can to support her massive charitable projects.

66. It is true that if Mrs. DeHaan was considering why she was grateful for the endeavours of the Appellant, she would have referred (as indeed she did in the letter quoted in paragraph 28 above) effectively to his work in building up the fortunes of the group. We have, however, no doubt that whether she expressed it or not, she must have been conscious that she owed a great debt to those who encouraged and supported her in the divorce battle, and equally we are clear that there were ties of friendship between Mrs. DeHaan and both the Appellant and Mr. Harlock.

67. The principal reason for our having considered Mrs. DeHaan's likely mindset when making the payments in April 1998 is that all the points mentioned in paragraphs 64 to 66 seem to us to support the point made in paragraph 63 above, namely that the payment to the Appellant had nothing whatsoever to do with the Appellant's renewed appointment with the group under the control of HFS. Without suggesting that this point then has any decisive relevance to the outcome of this case, we will deal with the tax treatment of the Appellant's receipt as if at the time of the receipt he had ceased to be an employee approximately 4 years before receiving the payment. We consider the later employment, under the HFS regime, to be of no relevance whatsoever.

Whether the greater motivation for the making of the payment was recognition of past services, support during the divorce or pure friendship

68. We should record that it is impossible for us to reach a finding of fact that the Appellant received the payment more for the support he gave during the divorce battle than for his more specific employee services, or indeed *vice versa.* Mr. Haylock said that he considered it impossible to say whether either one or the other was predominant. The Appellant's counsel did not ask us to attribute the payment to, or predominantly to, the support in the divorce action. Reverting now to the findings reached in paragraphs 64 to 66, we consider it likely that Mrs. DeHaan was influenced by all of the following factors:

- a desire to share her good fortune with others who deserved it;

- her famed generosity and the friendship with former work colleagues;
- a recognition of the contribution that the work done by others had contributed to the success of the company; and
- a recognition that, but for the outcome of the divorce proceedings, fostered perhaps by those few who supported her, none of what she had achieved would have been possible.

69. Whilst it is pure speculation on our part, and we have no idea of the identity of any of the other recipients of payments, or why they might have received payments, it seems to us to be entirely possible that Mrs. DeHaan might have made a payment to someone (for instance her divorce lawyer, accountant, or investment advisor) involved with her divorce action, should she have felt particularly grateful to such an individual. We only mention this pure speculation because it seems to us to illustrate the mix of motives that was likely to have influenced Mrs. DeHaan when she made the payments.

The relevant law

70. We have read all of the cases that were referred to us during the hearing. There have been many summaries of the relevant case law, which impacts on when payments made to employees and past employees should be treated as "emoluments from the employment", and when they should not. A helpful recent summary is that given by Judge Brannan in the recent Tribunal case of *Kieran Anthony Rogers v. HMRC* [2011] UKFTT 167 (TC). It would be superfluous for us to repeat that summary.

71. The simplest way to demonstrate that a receipt is not "emoluments derived from employment" is of course to point to some other occasioning cause that has nothing to do with the employment. In this context, it is not fatal to such an approach to recognise that the receipt would still not have been received but for the employment status, provided that the real driving force for the making, and the receipt, of the payment is that distinct factor. Thus if a son works in the family firm, and the father gives the son shares in the company, or if the lord of the manor is particularly fond of one of the household servants, and makes some gift for that reason, the receipts of this nature may very well not be emoluments.

72. When the type of factor mentioned in paragraph 71 is absent, the cases demonstrate that there can still be circumstances where receipts by an employee or past employee should still not be treated as emoluments. Before considering the circumstances where such a conclusion is realistic, it is worth saying that the present case is not that far removed from the type of case referred to in paragraph 71. After all, alongside the facts that the Appellant had ceased to work (in any sense material to this case) four years prior to receiving the payment, and that the donor had sold the company 18 months before making the payment (such that the link with employment was becoming somewhat weak), the features that there was continuing friendship between Mrs. DeHaan and the Appellant, that Mrs. DeHaan must have attributed some of her gratitude to the support given by the Appellant during the crucial divorce battle, and that she felt it appropriate to share her good fortune in a relatively modest way with various others are all factors that are occasioning causes distinct from employment. We do not say that this case is resolved on that basis, but these points must be weighed in the balance.

73. Reverting to the legal point that there is still very good authority for the proposition that receipts by employees or ex-employees will not always be

"emoluments derived from the employment" even where there is no quite distinct alternative explanation for the making of the payments, there are numerous cases that support this point. Many refer to the feature of there being a "testimonial" to an employee, or more usually a retired employee. Others concentrate on the impossibility of attributing a payment to the services in any period or periods. Others simply note the unreality of treating a very substantial payment, probably a gratuitous payment, as realistically being any form of top-up to what was anyway "full" salary. And naturally the cases concentrate on the fact that the various facts likely to break the link with employment are the features that the recipient has retired, the payment was gratuitous and unexpected, the payment was disproportionate to salary and the payment was made by people other than the employer who wished to show their gratitude to the recipient.

74. The case of *Reed v. Seymour* 11 TC 625, the case where the famous cricketer received a benefit match payment of approximately 10 times his annual salary and escaped Schedule E tax on it, is a particularly instructive starting point because the fundamental reason why Lord Atkinson dissented from the majority decision to allow Mr. Seymour's appeal was that "no evidence was given to show that Seymour was possessed of anything beyond his skill in cricketing or the discharge of his professional duties to give him a claim to the benefit of a benefit match, but that skill he was hired to exercise and display in the performance of the duties of his post, and the money he thus secured accrued to him by reason of that, not as far as appears by reason of anything else." Whilst that was manifestly the case, James Seymour still won his appeal. The payment was in the "testimonial" category, regardless of the fact that the testimonial was entirely related to the work that James Seymour was employed to do. We will refer again to this case below.

75. The case of *CIR v. Morris* [1968] SLT 213 (the testimonial payment to Mr. Morris and 15 other individuals employed by the Atomic Energy Authority and seconded to the South of Scotland Electricity Board to rescue the troubled construction project of the Board's nuclear power plant) is a much more recent example of a case where the testimonial payments can have been paid for nothing other than gratitude for the work that the 16 men had done, and for which they were paid and employed by the AEA. None were asserted to have been exceptionally affable or to have had any other worthy attributes.

76. We consider that whether we should express the "emoluments from employment" test as one where we should contrast whether the receipts derive from employment, or some other occasioning cause, or whether we should express it along the lines of just considering whether or not the receipts are "emoluments from the employment", there are on either basis cases where receipts by an employee or ex-employee can fall outside the net, notwithstanding the absence of the distinct non-employment occasioning cause. In *Cowan v. Seymour* 7 TC 372 (the gratuitous payment to the ex-secretary and liquidator by shareholders), the receipt was said "not to be a payment for services rendered in the true sense", and all the cases where there was said to be a testimonial, which was thus not a receipt of emoluments, are examples of this point.

77. We will now list the pointers that lead us to conclude that this is a clear case where the receipt did not constitute "emoluments for the past employment". Virtually all of the points that we now list, even when taken singly, have been taken to be an indication (albeit not conclusive on their own) that a receipt was not a receipt of emoluments, but when taken collectively the case becomes compelling.

- The receipt was not only gratuitous; it was genuinely totally unexpected and in our judgment was paid by Mrs. DeHaan without the slightest expectation that the Appellant would do anything at all that would benefit her in any way. From the Appellant's standpoint, we accept that the payment was a total "bolt from the blue". So far as UK law it concerned, therefore, it was a gift in every sense of the word. It is instructive to compare the facts in this case with those in *Reed v. Seymour* and those in *Bridges v. Bearsley* 37 TC 289 (CA), where the Hornby sons honoured their father's unfulfilled intimation that the Appellants would be given shares in Meccano Limited in his will. The payment in *Reed v. Seymour* may have been gratuitous in a strict sense but benefit matches were relatively common, and James Seymour must have considered that he had a very good chance of benefiting from a benefit match. In the Hornby case, the case was admittedly sidetracked by the side issue occasioned by the appellants' solicitor's endeavour to make the sons' promise binding by building in some sort of condition to the receipt about remaining employed, intended to provide consideration and make the sons' later promise enforceable. It was that feature that led one of the Court of Appeal judges to dissent. Leaving that aside, however, the reality is still that the various appellants had been working for a long time with the benefit of negotiations with the father that he would leave them shares in his will, and it was clearly their expectation that this would be so. And they had been serving as directors with those expectations and firm beliefs in mind. Indeed, the sons immediately accepted that they had a moral duty to respect their late father's promise, and meet the expectations of the appellants, which they did. In contrast in this case, the Appellant resigned in 1994 with no expectations of receiving anything. He was one of the very few recipients of a gratuitous payment to have been bowled over in surprise, and able truly to say that the payment was unexpected in every sense.
- The payment was wholly disproportionate to the amount of the Appellant's past salary (and indeed, were this relevant - which it is not, to his post-1997 salary as well), and was not in the remotest sense a supplement to inadequate salary, or designed (in the words of *Blakiston v. Cooper* 5 TC 347) "to increase the scanty stipends of ill-paid vicars". The Appellant's base salary had been in the region of £115,000 per annum, rising with benefits perhaps to £150,000, that being a level that the Appellant confirmed he considered to be full pay. The $2 million was in another league.
- In contrast to the facts in several of the reported cases, it is obvious that when there was not the slightest expectation of receiving the one vast payment, there was certainly no expectation that the payments would be regular. Regularity and expectation naturally diminish the reality of the gratuitous nature of payments, any such feature here being wholly absent.
- The payment was not only not made by the employer, but manifestly could not have been paid by the employer since the occasioning cause for the making of the payment derived from the enormous profit made on the sale of the shares of RCI Inc, and nothing that could possibly induce the employer to pay, or to have paid, more emoluments.
- The payment (once we disregard the 1997 re-employment which we consider to be completely irrelevant) was not made to an employee, or remotely in connection with termination. It was paid approximately 4 years after the Appellant's resignation. This delay was certainly not cosmetic. It derived entirely from the feature that was the occasioning cause for the payment, namely that it was in March 1998 that Mrs. DeHaan had marshalled the vast majority of the eventual cash proceeds to be derived from the sale of RCI Inc. It was an immediate recognition by a generous person that for a host of

reasons she should immediately mark and recognise the various contributions by others to the profit that she made. The notion that it was a "4 years late" top up to salary that should be paid by someone who had sold the shares of the employing company 18 months earlier has no remote reality.

- Finally the feature that the payment was indeed made by a person distinct from the employer is a further factor that distances the receipt from emoluments from employment. When the donor had sold the shares in the company, and the recipient had not been working for the company for four years, one is immediately driven to ascertain the real reason for the payment, which we regard as having nothing to do with paying some late salary on a gratuitous basis.

78. When we recall the reality that we recorded in paragraph 64, when we couple this with the features mentioned in paragraph 68 that indicate that this case is close to those where the receipt derived from some cause altogether remote from employment, and when we finally consider all the points just made in paragraph 77, we say without hesitation that the Appellant's receipt on 17 April 1998 was a pure gift, and cannot be said on any basis to have constituted emoluments of his past, or indeed of any, employment.

79. On that ground this appeal is allowed.

The "negligence" issue

80. This issue is of course irrelevant unless our decision in paragraphs 78 and 79 is overturned on appeal, but we will of course deal with it, albeit relatively shortly.

81. We accept the points made to us in argument by the Appellant's counsel, namely that for an assessment to be made outside the normal time limits, and thus pursuant to section 36 Taxes Management Act, 1970, the taxpayer must be shown to have been responsible for "negligence", in a case such as this where no fraud is even asserted, and secondly it must be shown that the negligence has occasioned the loss of tax.

82. In relation to those two separate points, the Appellant's counsel contended that the Appellant had not been guilty of negligence by not seeking tax advice as to whether the particular receipt was taxable. It was entirely natural to treat it as a gift, and he therefore demonstrated no absence of care or ordinary caution such as to be responsible for negligence.

83. The Appellant's counsel made the separate point in relation to the second limb of the section 36 test, just referred to in paragraph 81 above, that it could not be said, even if he was wrong on the first point and the Appellant was treated as having been guilty of negligence by not seeking tax advice, that that negligence occasioned the tax loss. For when later asked for the relevant tax advice, Mr. Constantinou, and in due course Crowe Clark Whitehill as well, advised that the receipt was indeed a non-taxable gift. Accordingly had the Appellant asked for tax advice at the time, the result would still have been that the receipt would not have been declared, and on the present assumption that tax should have been charged, that tax would still have been lost. Accordingly the negligence, as such, would not have occasioned the loss, because the loss would still have arisen even if the advice had been sought.

84. During the hearing it also emerged that not only had Mr. Haylock received a fairly similar gratuitous payment, but he had sought advice as to whether it was

taxable from Bower and Babcock, who in turn had sought advice from counsel. The advice was that the receipt was a non-taxable gift.

85. It was contended on behalf of the Respondents that the failure to seek advice was a negligent omission. It was also suggested that the feature of crediting the receipt to a foreign bank account and then not declaring the interest on the foreign account were further examples of negligence.

Our decision on the "negligence" point

86. We are initially influenced, rather naturally, by the fact that we consider that this seems to us to be a clear case where the receipt was a pure gift and not a receipt of emoluments. That, however, for both of us is the result of being reasonably familiar with the relevant area of tax law. The more material question is whether we consider that an ordinary honest taxpayer would have considered it necessary to seek tax advice before concluding that it was appropriate not to refer to the gift on the tax return.

87. We think it relevant to remember the context in which this receipt arose. The Appellant was not remotely expert in financial matters, something we deduce from the marketing roles that he had undertaken during his career and his ignorance about the appropriate treatment of foreign bank interest beneficially received by a UK resident taxpayer. Furthermore, we rather imagine that everything that the Appellant had received as an employee, including all benefits, would have been taxed automatically at source under the PAYE machinery and similarly under the National Insurance regulations, so that he would never in his entire career have had to consider the tax treatment of anything geared to employment income.

88. We then consider it entirely understandable that when you receive a completely unexpected $2 million cheque in an envelope, handed to you in a Las Vegas hotel bedroom by somebody who used to own the firm from which (so far as she was concerned) you had resigned 4 years before, it takes quite a stretch of imagination to conceive that the receipt might rank as taxable salary.

89. We accept that Mr. Haylock may have been more prudent in that he did seek tax advice. This may have been explained by a fact that we have not hitherto mentioned which was that the UK subsidiary that paid the £2.2 million non compete payment (or rather the five instalments of the £2.2 million) was involved in some tax appeal in relation to those payments. This did not directly involve Mr. Haylock, but it is possible that in the course of that case, he may have become familiar with more tax points that the Appellant would have been aware of. Perhaps more relevantly, he might have had natural contacts with a firm of lawyers who gave tax advice. We accept that the Appellant obviously engaged the services of Mr. Constantinou, presumably to deal with the detail of tax returns, but we still consider it natural that the receipt of the cheque in the hotel bedroom in all the relevant circumstances was something that, without taint of negligence, the Appellant could understandably assume to be a pure gift.

90. We also accept the second of the Appellant's counsel's points in relation to section 36. Whilst the feature that Mr. Haylock sought tax advice himself was a slightly troubling feature in relation to the first negligence issue, the fact that seemingly thorough advice was given to Mr. Haylock in relation to facts that we assume were virtually identical, to the effect that the gift was not taxable, is significant to the "causation" issue. It is further support for the proposition that even

if the Appellant had sought advice, the outcome would have been the same and the gift would not have been returned as income, and the tax still lost. It would indeed be odd now if the right analysis was that the gift was taxable for HMRC to concede, as they appeared to do, that no assessment could be made out of time on Mr. Haylock, since there had been no negligence, whereas an assessment could be sustained on the Appellant, notwithstanding that his alleged negligence did not occasion the loss.

91. We refer now to the alternative basis on which the Respondents suggested that the Appellant had been guilty of negligence, which was all related in some way to the crediting of the monies to foreign bank accounts, and the failure to declare the interest on those accounts for tax purposes.

92. We entirely follow that if a taxpayer wished to avoid tax on a particular receipt, that he considered was properly taxable, or that might well be taxable, it would be quite natural to seek to conceal the receipt by crediting monies received to a foreign bank account, and then the interest (perhaps on a large sum) would similarly have to be concealed, and not declared. Those steps are all fraudulent however. We fail to see in what sense the crediting of the proceeds of the Appellant's $2 million cheque to an Isle of Man account could be classed as negligence. It seems to us that it is either fraud, or else the Appellant's explanation is accepted and it is not fraudulent. HMRC made it quite plain that no contention of fraud was being advanced. All that was asserted was that there had been negligence in relation to the receipt of the $2 million and since we refuse to consider any claim that implies fraud when specifically none has been alleged, and can see no relevance to negligence in the crediting of this cheque to the foreign bank account, we now ignore this particular contention.

93. We should record the Appellant's contention, which (in the light of our remarks in the previous paragraph) is principally of relevance only to the now immaterial matter of the non-declaration of interest on foreign bank accounts. The Appellant said that he believed that he had been advised by his bank or some other advisor that such interest was not taxable. We find it strange that anyone might have thought this, though since banks doubtless periodically made the point that foreign bank interest would at least not be paid subject to initial deduction of UK tax, we can imagine that some low-level bank officials might very well have misled customers into thinking that the absence of withholding tax meant that there was no tax at all on such accounts, and even where correct statements were made, we can understand that customers may have misunderstood the position. We believe that some publicity attached to the feature that banks had probably misled some customers.

94. It is immaterial for us to make any formal finding in relation to this matter, first because no tax is presently in dispute in relation to the interest, all of it now having been paid, and again fraud has not been alleged. We might remark however that the Appellant did appear to be a straight-forward gentleman, and it struck us that his account of admitted ignorance might well have been true.

95. Our decision on the "negligence" issue is that negligence has not been demonstrated, as HMRC is required to do, and that no out of time assessments were valid. Our two grounds for this decision are that it was entirely natural for this taxpayer to assume that the hotel room gift was not taxable, and that it need not be declared. We consider that whilst some might have checked this with an advisor, and Mr. Haylock did, failure to do that was not negligent. Secondly, since the advice that he actually later received, and the advice given to Mr. Haylock both confirmed that the gift was not taxable, and need not be declared, the tax would still have been lost to HMRC even if tax advice had been obtained. Accordingly any

negligence in not seeking that advice did not occasion the loss of tax under the second test in section 36.

The Penalty issue

96. We are tempted to ignore the penalty issue. This is for the reason that it is only relevant if our decisions on the substantive matter and the negligence matter are both over-turned on appeal, and if they are (meaning of course that the Upper Tribunal or a higher court will have regarded this case in a somewhat different light than we have done) the Upper Tribunal or the higher court would be in a better position to assess the penalty.

97. In order, however, to give some decision in relation to the penalty issue, and a decision that can be appealed, if necessary and if relevant, we consider that the abatement of the penalties for the three issues of "disclosure", "co-operation" and "seriousness" should respectively be 15%, 35% and 35%, leading to an overall penalty of 15%.

98. We consider that HMRC's low initial reduction of 10% for "disclosure" (out of a maximum 30% discount for disclosure on HMRC's normal basis of calculating penalties) was marginally unreasonable in that the initial disclosure had in any event referred to the source of funds as a gift. That enabled HMRC to enquire into the nature of the gift. The initial disclosure revealed, however, only the bank accounts from 2000. The Appellant defended this, and the implicit feature that the earlier accounts were not disclosed by referring to the fact that it was through errors on the part of the bank that he received initially only the bank accounts back to the year 2000. And he said that he thought that the account must have been opened in 2000, not 1998. Whilst we can imagine that it is easy to forget the date, 12 to 14 years earlier when an account was opened, we feel that the Appellant must have realised that earlier accounts were missing because the balance on the account in the first bank statement was of a far lower amount than he must have known would initially have been credited to the account, on receipt of the gift. And failure to disclose this did result in the non-disclosure of the significant size of the gift. We accordingly allow only a marginally greater discount, of 15% for disclosure than that granted initially by HMRC.

99. We consider the Appellant's co-operation to have been good, in part because he has simultaneously been battling with serious ill-health. We thus raise the discount for co-operation from 30% to 35%.

100. In relation to "seriousness", on the basis of the two decisions that we have reached, it is entirely natural that we consider any error that there may have been was an innocent and understandable error. In view of our two decisions that the Appellant was actually right anyway, and not guilty of any negligence, this conclusion in relation to "seriousness" is somewhat inevitable. We increase HMRC's discount of 20% (out of a maximum of 40%) to 35%.

Costs

101. This case had been categorised as Complex but we understand that the Appellant had opted out of the costs regime, and we accordingly make no order in relation to costs.

Right of Appeal

102. This document contains full findings of fact and the reasons for our decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) Tax Chamber Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

HOWARD M. NOWLAN
TRIBUNAL JUDGE

RELEASE DATE: 19 June 2012

Amended pursuant to rule 37 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 on 9 July 2012.