[2017] UKFTT 589 (TC)

TC06031

Appeal number: TC/2012/04959
TC/2012/07259

Income Tax – EBT Scheme – discretionary power of appointment - allocation of amounts to sub-trust in respect of directors and families – no appointment of sums by trustees to directors – directors received benefits mainly in form of interest free loans made by trustees: Whether sums contributed to EBT / Sub-trust / payment of loan amounted to earnings subject to PAYE / NICs
Issues: Whether contribution to EBT was redirection of earnings? – No- Whether despite no allegation of Snook sham being made discretionary trust was really a bare trust applying case law approach of Autoclenz v Belcher and Antoniades v Villiers? – No – Whether payment of earnings applying Ramsay approach - yes – appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

(1) OCO LIMITED **Appellants**
(2) TOUGHGLAZE (UK) LIMITED

- and -

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

TRIBUNAL: JUDGE SWAMI RAGHAVAN

Sitting in public at the Royal Courts of Justice on 5-8 and 12-14 December 2016

Michael Jones counsel, instructed by RPC for the Appellants

Philip Jones QC, Richard Vallat, and Charles Bradley, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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Introduction

1. The appellants used schemes designed to provide benefits to key employees without incurring PAYE or National Insurance Contributions (NICs) liabilities. The scheme involved setting up an employee benefit trust (EBT), and the subsequent creation of sub-funds for the benefit of particular employees and their families. Benefits were provided to the employees and their families mainly by the trustees advancing interest free loans to the employees.

2. The appeals are against Regulation 80 determinations in respect of underpaid PAYE, and s8 decisions (under the relevant NICs legislation), which HMRC argue arise on the payments the EBT made to the sub-trusts. There are also appeals against closure notices and related amendments to corporation tax self-assessment returns denying a deduction in respect of EBT contributions.

3. In outline the scheme worked as follows:

> (1) In each case the appellant wished to establish a flexible means of providing benefits to key employees and their families in a tax efficient manner.
>
> (2) Each appellant therefore declared a trust over funds set aside for the benefit of certain key employees. In OCO's case it did this in the years ending 30 June 2005 and 30 June 2006. In Toughglaze's case it did this in the years ending 31 May 2004, 31 May 2005 and 31 May 2006.
>
> (3) Subsequently, a professional trustee company was appointed to act with the appellant as trustee. The appellants later resigned as trustees, with the result that the professional trust company became the sole trustee of the EBT.
>
> (4) Following the establishment of the EBT, the trustees created sub-funds for the benefit of the key employees and their families. Benefits were thereafter provided to employees and their families in a variety of different ways, principally by the trustees advancing loans to beneficiaries.

Rule 18 – Conclusion on issue which binds related cases

4. The appeals are lead appeals for the purpose of a Rule 18 direction that was originally made on 27 February 2013 and further amended on 28 January 2016. Some several hundred or so appeals where the same scheme devised by Premier Strategies Limited ("PSL") (disclosed under DOTAS number 93756767) was used by other taxpayers stand behind the lead cases as related cases. The Rule 18 issues and the determinations the tribunal has made on them in so far as relevant to the circumstances of the lead appeals are set out in the appendix to this decision. As regards the NICs issue there has been some simplification in the way the case was put before the tribunal given changes in case-law that occurred since. These changes do not materially alter the result for the related parties. The effect of the Rule 18 direction that was made is that, subject to applying to being unbound, the parties in the related cases stood behind the lead cases are bound by the tribunal's determination in respect of the issues.

5. The key point for the related appellants to note is that the tribunal has determined the issue of whether the sums appointed to the sub-funds were, "earnings" in respect of which the appellant was under an obligation to account for income tax through the PAYE system and the issue of whether such sums were liable to NICs in HMRC's favour.

6. Given that result (that the relevant sums were earnings subject to PAYE and NICs) it was not necessary to the tribunal to make any determination on the issue raised relating to deductions of corporation tax. The tribunal understands HMRC's position in relation to the lead appeals to be that, where HMRC have been successful in establishing the relevant sums were earnings subject to PAYE and the issue of whether such sums were liable to NICs, as they have been here, then HMRC do not intend to dispute the employer appellant's ability to deduct the earnings amounts for corporation tax purposes.

The Issues in Detail:

7. As regards Income tax/PAYE / NICs the issues were as follows:

> (1) Were the sums to which these appeals relate (the Sums) "earnings" in respect of which the appellant was under an obligation to account for income tax through the PAYE system at any of the points below, or otherwise:
>
> (a) The declaration of trust made by the appellant over the Sums;
>
> (b) The appointment of the Sums to a sub-trust;
>
> (c) The lending of the Sums by the trustees of that sub-trust to individual employees?

8. As regards the income tax and NICs issue the appellant's position was that at no point had the appellants received earnings:- before the declaration of trust the appellants' did not receive and were not entitled to any sum. Once the trust had been declared appointments were discretionary, and the loans made from the sub-fund were subject to repayment.

9. HMRC disagree and set out in essence three routes to a conclusion that sums of earnings subject to PAYE and NICs were paid:

> (1) On the facts, the sums were the directors' earnings before they become subject to the trust. What happened thereafter was simply a situation where the director was agreeing for his earnings to be used in a certain way. The contribution to the EBT was thus a redirection of earnings ("the redirection argument").
>
> (2) Although HMRC do not allege sham (as the term is commonly understood from the case of *Snook*), relying on the case-law approaches set out in *Antoniades v Villiers* and *Autoclenz v Belcher* they argue the discretionary trust was really a bare trust. The appellant disputes this case-

law approach is valid and in any event say it would not, on the facts, allow the tribunal to find the discretionary trust was a bare trust ("the *Antoniades/ Autoclenz* argument").

(3) Alternatively, HMRC say that under the *Ramsay* approach, viewing the facts realistically and applying the legislation purposively, the appellants received "earnings" when amounts were paid into the sub-trusts. ("the *Ramsay* argument"). Further even if the approaches in 2) and 3) were not accepted in relation to the analysis of the trust then those should apply in relation to the interest free loans made to the directors which under either 2) or 3) should be viewed as tantamount to payments of earnings – i.e. under 2) (deploying the *Antoniades / Autoclenz* argument) the loans were not real loans but unconditional payments or under 3) (deploying the *Ramsay* argument*)* there was no practical likelihood the loans would ever have to be repaid unless the appellant wanted that to happen.

10. In order to reach a conclusion on the issues before the tribunal it is necessary to set out the facts and background statutory provisions in more detail.

Evidence

11. On behalf of the first appellant and second appellant the tribunal heard oral evidence from Mr Anthony Harrison, and Mr Bharat Varsani who were directors of the respective appellant companies, and from Mr Mark Schofield, the managing director of Tenon (IOM) Limited (now Optimus Fiduciaries Limited) who were appointed by each of the appellants as one of the professional trustees of the EBT. All witnesses had served written witness statements in advance and were subjected to cross-examination by the HMRC. The witness statements exhibited various pieces of correspondence between PSL, the scheme adviser, and the appellants together with copies of draft and final board minutes, correspondence between the appellants and the professional trustees, and directors and deeds establishing the trusts and sub-trusts.

12. I also had before me the written report of Mr Steven Brice, an accountancy and financial reporting expert. His evidence was put forward on behalf of the appellants in relation to the corporation tax aspects of the appeals which I cover in the latter sections of this decision.

13. Prior to the hearing the parties had agreed a statement of facts which I have integrated within the next section which sets out the uncontentious matters of background facts as to the appellants' background, what happened in relation to the scheme and when. I deal with the disputed issues of fact and the legal analysis in relation to them in the relevant discussion sections on the various issues.

14. In terms of the oral evidence each of the appellants' directors understandably faced similar challenges in recollecting events which had taken place some considerable time before this hearing. Mr Schofield's recollections appeared clearer, perhaps because the workings of the EBT and his involvement in it were matters he was involved in on a day to day professional basis. I found Mr Schofield and Mr Varsani to be credible witnesses. As regards Mr Harrison I agree with HMRC's

submission that he was an unsatisfactory witness. His denial that he did not use template board minutes and employee notices which PSL had sent in advance and his denial that he had been told adult beneficiaries would have de facto control were implausible given the content and sequencing of the documentary evidence. Those denials in my view sprang from the attitude Mr Harrison appeared to me to adopt of not wishing to concede anything in cross-examination which he perceived as being prejudicial to the appellant's case. While I reject those denials I do not reject Mr Harrison's evidence in its entirety but approached with caution those subject areas which the witness, in my view, may have perceived as either serving or prejudicing his case.

Findings of Fact

The appellants each used schemes devised by PSL. As regards the two appellants and the years the scheme was carried out, the steps taken, the documents executed followed broadly the same pattern. The draft letters and board minutes sent by PSL were implemented by the appellants and directors. The trust, sub-trust and loan documents, unless noted otherwise were materially the same. While I have set out the findings in relation to the steps taken in relation to OCO y/e 30 June 2005 in more detail similar facts also apply to in relation to the OCO appeal in relation to y/e 2006 and the Toughglaze appeals. The variations that there are, are the obvious ones to do with the background and history of the two different appellants, variations in relation to the amounts involved, but also as to what specific recommendations particular directors suggested to the trustees. The findings of fact concerning the particular directors' understanding of the scheme are dealt with in the relevant discussion sections as are the facts pertaining to the nature of the nature of the trusts and trustees' duties, and the nature of the loans all of which are matters of contention.

(A) The OCO Appeal

Background:

15. OCO has been in business since 1979. It manages several large maintenance and service contracts for local authority and public sector clients, including a number of London Boroughs and Housing Associations testing various electrical and heating systems for compliance and attending to boiler breakdowns and similar work. Its specialist employees are mechanical, electrical and environmental engineers. In around 2005 the company employed 100 staff and had an annual turnover of roughly £12 million. In 2015 the company employed around 180 staff and the turnover increased to around £17 million. At all material times, OCO had four directors: Christopher Oborne, George Oborne, Philip Cowdery and Anthony Harrison. At all material times, the directors and their wives each owned 20.83% i.e. 25,000 shares of OCO's paid up issued share capital. The remaining 16.67%, i.e. 20,000 shares was held by the trustees of the OCO Directors Pension Scheme.

16. Mr Harrison's main responsibility was in the day-to-day running of the company and in managing the company's fleet.

17. The accounting period of OCO for corporation tax purposes ends on 30 June each year. OCO established an employee benefit trust ("EBT") in each of the years ending 30 June 2005 and 30 June 2006.

18. The directors received monthly salary from the company. For the years ending 20 June 2005 and 2006 they were paid around £150,000 per year.

(1) OCO: year ending 30 June 2005

19. The company was looking for a tax efficient way of rewarding key employees. In or around May 2005 Mr C Oborne entered into discussions with PSL around implementing a "declaration of trust strategy". PSL sent its terms of engagement to the company (addressed to Mr C Oborne) on 11 May 2005. The letter mentioned that regulations regarding disclosure of tax avoidance scheme regulations had been made in relation to the scheme. The fees were calculated as a percentage (12%) of the amount used in the strategy.

20. At some point between 21 and 23 June 2005, the board of directors of OCO resolved to set aside £400,000 for awards to be made to key employees in respect of their service for the year ending 30 June 2005.

21. As HMRC rely on the board minutes and there is some controversy over its significance I set it out in full. All directors (Mr Harrison, Mr Cowdery, Mr C Oborne, and G Oborne were recorded as present). The minutes stated:

> "1.The meeting was held to discuss employee bonus arrangements for the ending 30th June 2015.
>
> 2. There was discussion of the likely level of profitability for the year and consideration was given to the total amount that should be set aside by the company for awards to be made to key employees in respect of their service for the year ending 30th June 2005. It **was resolved** to set aside a sum of £400,000 in total.
>
> 3. The board then considered the creation of an employee benefit trust for the benefit of employees of OCO Limited, which would offer considerable flexibility in the way in which benefits could be provided. Mr A J Harrison explained that he had been investigating (on behalf of the company) various ways in which the funds could be used to benefit employees. Mr A J Harrison reported that Premier Strategies Limited (PSL) had provided advice on the creation of sub-trusts for the benefit of individual employees and their families. PSL had advised that the use of the sub-trusts could defer or in certain circumstances even eliminate income tax and NIC, yet allow value to be passed to the employee.
>
> 4.The Board resolved that the £400,000 set aside would be used to create an employee benefit trust for the benefit of the employees of OCO Limited and that the trust would be used to create sub-trusts for the benefit of key employees and their families.

> 5. There was then a discussion about which employees and directors it would be appropriate to include in the bonus arrangements for the year. After discussion a provisional list was drawn up of the following people:
>
> Mr C Oborne Mr G Oborne Mr AJ Harrison Mr PJ Cowdery
>
> 6. At this stage no final decisions wer made on the allocation of the bonus pool between these employees as the Board wished to give further thought to the matter. The Board also reserved the right to add further names to the list, and in extreme cases delete names from the list, but at this stage was content that persons named above were the most appropriate recipients of an award.
>
> **7. The Board resolved** to meet again shortly to discuss final allocation of awards and to determine the appropriate timing for making awards.
>
> **8. The Board also resolved** that Mr AJ Harrison /Mr C Oborne should write to the employees on the list above informing them of the Board's preliminary decision. A letter in agreed form is annexed to these minutes.
>
> 9. There being no further business the meeting closed.
>
> [signatures of Mr Harrison and Mr C Oborne appear at foot].

22. While the board minutes were dated 13 June 2005, it seems unlikely this was correct – as on 21 June 2005 PSL wrote to Mr Harrison at OCO mentioning PSL's understanding that the company was considering establishing an employee benefit trust that could be used to create sub-trusts for the benefit of certain key individual employees. It enclosed a draft board minute and a document to be completed and supplied to each employee who it was intended was to be included within the bonus arrangement stating that "this should provide each employee concerned with the expectation of an award after the year end." The board minute was identical to that in relation to the meeting stated to have been held on 13 June 2005 except that the employee names were filled in and Mr C Oborne's name was also mentioned in connection with sending letters to the employees informing them of the Board's preliminary decision. PSL's letter also enclosed a letter detailing the key principles of the Declaration of Trust Strategy. After setting out the mechanism that had been developed had obtained a favourable opinion from tax counsel and was not affected by provisions in the Finance Act 2003 restricting deductions for EBT contributions the letter stated:

> "…The company through this new mechanism would create a funded EBT that may be used to incentivise key personnel in the company. The trustees would initially be the company. However at a later date the company may wish to appoint a professional trust company to administer the fund. We would be able to recommend suitable trustees if required.
>
> The EBT may be used to reward key employees in many ways including providing key employees with a sub-fund under the Trust. Broadly the sub-fund will be a discretionary fund established for the

> benefit of the employee's family but will be de facto controlled by the adult beneficiaries of the sub-fund. The funds or other assets in the EBT may then be assigned to the sub-fund of the employee. The assignment of the EBT's assets to the sub-fund is not a taxable benefit on the employee and this view is supported by leading Tax Counsel.

23. On 23 June 2005, OCO, in a letter headed "Bonus arrangements for the years ending 30 June 2005", wrote to Mr G Oborne, Mr C Oborne, Mr Cowdery and Mr Harrison indicating OCO's intention to make an award. The letter reflected the drafting in the Premier template enclosed with the 21 June 2005 letter above. The letters recounted to each of the directors who had been present at the meeting and who had taken the decision to put themselves on the preliminary list of bonus recipients that the company was delighted to tell the director that the director had been included on the list. The letter stated "A sum of money has been set aside for bonus payments and a preliminary list of employees who are likely to receive bonuses has been drawn up." The letter went on to say:

> "At this stage I must stress that no final decisions on allocations have been made and that this letter does not create any entitlement to any amount. Nevertheless I thought that you would want to know of our current intentions."

24. On 30 June 2005, OCO made a declaration of trust over funds of £100 to create the OCO Limited Employee Trust (the "OCO EBT 2005"). OCO resolved to act as initial trustee of the OCO EBT 2005. There was no restriction in the Deed establishing the OCO EBT 2005 expressly prohibiting the trustees from making payments of remuneration.

25. The minutes recorded that there was a discussion on the amount to be set aside for the trust. No explanation was given for why this was £100 not £400,000. It was resolved the board of directors "would monitor the effectiveness of the Trust and review possible extra funding." The draft trust was said to have been produced to the meeting with a memo summarising its key features. The memo explained that:

> "The Trust is discretionary…but no employee beneficiary has a right to receive a Trust distribution until the trustees decide to make one to him. The company will suggest to the trustees how much, when and to whom to distribute Trust property, and the trustees are required to consider (but are not obliged to follow) those suggestions".

26. The Background section to the Trust deed stated that the settlor (the company) "wishes to establish a trust fund for the benefit of its employees and dependants and the employees and dependants of any Group Company".

27. The Overriding powers at 4.2 provided:

> "THE Trustees may appoint the Trust Fund and the income of it (or any share or part of it) upon such trusts in favour of all or any one or more exclusively of the other or others of the Beneficiaries and if more than one in such shares and proportions and with and subject to such powers and provisions and generally in such manner in all respects as

the Trustees consider to be in the interests of all or such one or more of the Beneficiaries."

28. Clause 10 on Absolute Discretion provided:

> "10.1 THE Trustees shall exercise the powers and discretions vested in them as they shall think most expedient for the benefit of all or any of the Beneficiaries under this declaration of trust and may exercise or refrain from exercising any power or discretion for the benefit of any one or more of them without being obliged to consider the interests of the others or other of them.
>
> …
>
> 10.3 SUBJECT to clause 10.1 and Clause 10.2 every discretion vested in the Trustees shall be absolute and uncontrolled as shall every power vested in them and every power so vested shall be exercisable at their absolute and uncontrolled discretion and the Trustees shall have the same discretion in deciding whether or not to exercise any power.
>
> 10.4 In the exercise of the powers conferred on them by this declaration of trust the Trustees shall make such enquiries as to the identity of the Beneficiaries as they consider appropriate for the purposes of enabling them to exercise the relevant power and without prejudice to the above the Trustees shall be entitled in the absence of manifest error to rely without further enquiry on information supplied to them by or on behalf of any Group Company as to whether any individual is or is not a Beneficiary"

29. The Beneficiaries were set out in the Schedule to the deed as:

> "1. Any individual who is or has been since the date of this declaration of trust an employee of any Group Company…
>
> 2. The wives husbands widow and widowers of any of the Employees
>
> 3. The children or stepchildren and remoter issue (and whether or not living at the date of this declaration of trust) of any of the Employees
>
> 4. The parents of any of the Employees.
>
> 5. Any other person who is wholly or partly financially dependent upon any of the Employees.
>
> 6. Any body which is charitable."

30. On 11 July 2005, OCO resolved to make a further declaration of trust over further funds of £399,900 plus any accrued interest held in its Royal Bank of Scotland International bank account to be held under the terms of the OCO EBT 2005.

31. On 28 July 2005, Tenon (IOM) Ltd and Tenon (IOM) Nominees Ltd were appointed as additional trustees to the OCO EBT 2005. On 2 September 2005 PSL sent an e-mail to Mr Harrison copied to the Obornes with a draft Notice that might be used to notify employees of the existence of the EBT and recommending it be

displayed in a prominent position for employees to view. The notice included explained the employee was a potential discretionary beneficiary of the trust and that:

> "The Company will ask the Trustees to consider making appropriate benefits and bonus payments to employees who they feel have shown the necessary commitment to help drive the company forward in the future."

32. The e-mail went on to say that it was PSL's understanding that the company wished to make a recommendation to the trustees and enclosed a draft letter and board minutes.

33. The draft letter to the trustee suggested the trustees consider the use of a revocable sub-trusts for the benefit of certain employees (listed as the directors) and their families and emphasised it was recognised it was for the trustees to determine whether, and if so how, when and in what manner to exercise some or all of the powers and discretion conferred on them by the trust deed.

34. On 6 September 2005, OCO made a recommendation to the trustees to consider the use of revocable sub-funds for the benefit of certain employees and their families and allocating £99,000 to each. The proposed awards were intended to be in recognition of the services provided by the key employees of the company and their contribution towards the success of the company during the period ending 30 June 2005. Mr Harrison's view was the EBT constituted recognition for the hard work he and the other directors had undertaken. (Although Mr Harrison's evidence also referred to the company's recommendation being an incentive to maintain performance in the future I do not make a finding of fact to that effect. It appears implausible to me that the four directors who between them and their wives owned and controlled the company would need any additional incentive than that which arose from such status to make them perform better.)

35. On 6 September 2005, a majority of the trustees (Tenon (IOM) Ltd and Tenon (IOM) Nominees Ltd) resolved to create subfunds for the benefit of Mr C Oborne, Mr G Oborne, Mr Cowdery and Mr Harrison and their respective families. £99,000 was appointed by the trustees to each sub-fund.

36. The sub-fund deeds were drawn up and presented at a meeting of the above trustees. The recitals to the sub-fund deed recorded that the Trustees wished to exercise the power of appointment conferred on them by clause 4 of the Settlement in the manner appearing in the deed for the benefit of the particular director. The sub-fund was defined as including the £99,000 sum and the sub-fund beneficiaries were defined as the named director, his wife or widow, children or step-children, remoter issue, parents, financial dependents or "any body which is charitable". Clause 3 set out that the sub-fund and income thereof were to be held on the trusts and with and subject to the powers of the Settlement subject to various modifications e.g. the definition of beneficiaries.

37. On 7 September 2005 PSL wrote to the directors with draft letters seeking reflect the sub-fund beneficiaries' wish "to make a recommendation regarding an investment opportunity that may be of interest to the trustees". The draft letters stated:

> "I understand that a sub-trust has been created for the benefit of myself and my family. I now wish to make a recommendation regarding an investment opportunity that may be of interest to the trustees. I understand the trustees have complete, independent and unrestricted authority over how to invest the assets in the sub-trust. I would be grateful if you could contact me at the earliest opportunity to discuss the matter."

38. Although the draft letters did not mention a loan each of the four attachments were titled under the attachment icon "Loan from Subfund request".

39. In or around 13 September 2005 a telephone conversation took place between Mr C Oborne and PSL as to the directors' wishes and on 13 September PSL sent draft letters providing the trustees with the directors' bank details and stating the director wished to apply for an interest free loan and that if this was acceptable to the trustees that the director looked forward to receiving the loan documents with details of the terms.

40. Between 8 and 13 September 2005, Mr C Oborne, Mr G Oborne, Mr Cowdery and Mr Harrison wrote to the trustees to ask them to consider either investments or a mixture of investments and interest free loans.

41. Mr C Oborne, Mr G Oborne and Mr Harrison each wrote on 13 September 2005 to request loans of £24,000 each. Mr Cowdery's letter stated that it was his wish that £50,000 be sent to XS Marine Investments Ltd. and £25,000 to Brass Hat Films Slate 3 LLP.

42. On 22 September 2005, Mr C Oborne, Mr G Oborne, Mr Cowdery and Mr Harrison each wrote to the trustees to apply for an interest free loan of £99,000.

43. On 22 September 2005 the trustees approved the interest free loans. The trustees subsequently sent agreements stated to be loan agreements to each borrower. The agreements were signed by all parties on 23 September 2005 and the funds released to the accounts nominated by the borrower.

44. The repayment clause in the loan agreement (3.1) provided:

> "The loan shall become due and payable one month after service of written demand by the Lender on the Borrower".

45. The Lender was defined as Tenon (IOM) Ltd and Tenon (IOM) Nominees Ltd and OCO Limited as trustees of the OCO Limited Employee Trust Re The [named director] and Family Sub-Fund together).

46. OCO and Tenon (IOM) Nominees Ltd retired as trustees on 3 April 2006.

(2) OCO: year ending 30 June 2006

47. According to Mr Harrison there was no significant difference in the operation of the scheme between the 2005 and 2006 years.

48. On 23 May 2006, OCO made a declaration of trust over funds of £100 to create the OCO Limited Employee Trust 2006 (the "OCO EBT 2006"). (In relation to their corporation tax arguments HMRC point out that in contrast to the resolution on 13 June 2005 which started the process for that year off there is no such resolution in this case.) OCO resolved to act as initial trustee of the OCO EBT 2006. There was no restriction in the Deed establishing the OCO EBT 2006 expressly prohibiting the trustees from making payments of remuneration. The memorandum accompanying the board's resolution stated "Trust may not offer tax advantage or savings for individual beneficiaries since trust distributions made to employees who are tax resident in the United Kingdom when a distribution entitlement arises will, in general, be taxable as additional employment income".

49. On 31 May 2006, OCO resolved to make a further declaration of trust over further funds of £419,900 plus any accrued interest held in its Royal Bank of Scotland International account, to be held under the terms of the OCO EBT 2006.

50. On 8 June 2006, OCO decided to appoint a professional trustee to assist with the administration of the OCO EBT 2006. On 20 June 2006, Tenon (IOM) Ltd and Tenon (IOM) Nominees Ltd were appointed as additional trustees to the OCO EBT.

51. On 30 June 2006, OCO made a recommendation to the trustees to consider the use of revocable sub-funds for the benefit of certain employees and their families.

52. On 30 June 2006, a majority of the trustees resolved to create subfunds for the benefit of Mr C Oborne, Mr G Oborne, Mr Cowdery and Mr Harrison and their families and appointed £104,000 to each sub-fund. As a result, £4,000 remained in the OCO EBT 2006. (According to Mr Harrison this sum was left in the EBT for use to benefit other employees of the company, in particular the administrative staff in the Bromley office. But, given there is no supporting documentary evidence that this was the company's intention at the time and also, as explained above given the concerns about accepting Mr Harrison's evidence where he might perceive it as furthering his case (irrespective of whether it did in fact further his case) I am unwilling to make a finding of fact that this was in fact the company's intention).

53. On 12 July 2006 Mr C Oborne, Mr G Oborne and Mr Cowdery each wrote to the trustees to apply for an interest free loan of £103,000. Mr Harrison subsequently applied for an interest free loan of £50,000 on 12 July 2006.

54. On 14 July 2006, the trustees approved the interest free loans. The trustees subsequently sent an agreement stated to be a loan agreement to each borrower. The agreements were signed by all parties on 18 July 2006 and the funds were released to an account nominated by the borrower.

55. OCO decided to retire as trustee on 31 January 2007 and OCO and Tenon (IOM) Nominees Ltd retired as trustees on 8 February 2007.

56. On 28 February 2008, OCO made a request to the trustee to consider using the monies held in the OCO EBT 2006 to fund a staff party to benefit all employees of OCO. In February 2008, the trustees authorised OCO to incur the costs in connection with the staff party up to the maximum sum of £6,000. The trustees agreed to reimburse OCO when they received proof of costs incurred. A payment of £5,562.48 was made to reimburse OCO on 30 April 2008.

57. Mr Harrison subsequently asked the trustees to consider making an investment of £50,000 into the Aria Absolute Income Protected Fund (Class B) on 9 March 2009.

58. This request was revised by a letter on 23 March 2009, to ask that £58,500 be invested into the Aria Absolute Income Protected Fund (Class A). On 6 April 2009, the trustees approved an Aria Structured Individual Investor Pack. On 27 April 2009 funds were transferred totalling £58,500.50. This was based on advice given to Mr Harrison from Graham Hinham Private Clients Limited.

(B) The Toughglaze Appeal

Background

59. Toughglaze was established in 1993 employing around 15 people and grew over the years to become a leader in the glass manufacturing and processing industry including the supply of toughened and laminated glass. Six to seven years down the line its profits reached around £1 million to £3 million. By the early 2000s it employed around 100 people and by 2015 around 200 people. Mr Bharat Varasani's role in the company was to deal with various technical aspects of the operation of the machinery required for the toughening and processing of the glass, together with numerous business development and sales related matters.

60. Toughglaze's accounting period for corporation tax purposes ends on 31 May each year. Toughglaze established an EBT in the years ending 31 May 2004, 31 May 2005 and 31 May 2006. During the years ending 31 May 2004, 2005 and 2006, Toughglaze had three directors: Mr Vipul Shah, Mr Ashok Varsani and Mr Bharat Varsani. The directors and their wives owned 33.33% of Toughglaze each. Without the wives' shareholdings the director's percentages were equivalent to 30.8%.

(1) Toughglaze: year ending 31 May 2004

61. On 21 May 2004, the Board of directors of Toughglaze resolved to set aside the sum of £1,000,000 for awards to be made to key employees in respect of their service for the year ended 31 May 2004. Mr Shah, Mr B Varsani and Mr A Varsani's names were included on a provisional list of the employees and directors which it would be appropriate to include in the bonus arrangements for the year.

62. On 14 June 2004, Toughglaze resolved to make (and thereafter duly did make) a declaration of trust over funds of £100 to create the Toughglaze (UK) LimitedEmployees Trust 2004 (the "Toughglaze EBT 2004"). On the advice of PSL Toughglaze was the initial trustee of the Toughglaze EBT 2004. There was no restriction in the Deed establishing the Toughglaze EBT 2004 expressly prohibiting the trustees from making payments of remuneration.

63. At a meeting of Toughglaze's Board of directors on 21 June 2004, it was noted that a trust had been declared over funds of £100 in order to establish the Toughglaze EBT2004. It was resolved to make a further declaration of trust over the remaining funds (of £999,900, plus any accrued interest) which had been set aside on 21 May 2004.

64. On 28 June 2004, Toughglaze resolved to write to Tenon (IOM) Ltd to determine whether suitable terms could be agreed for them to act as trustees and assume responsibility for the administration of the Toughglaze EBT 2004.

65. On 29 June 2004, Tenon (IOM) Ltd wrote to Toughglaze confirming that it was willing to act as trustee of the Toughglaze 2004 EBT and also proposing that Tenon (IOM) Nominees Ltd should be appointed as additional trustee with Tenon (IOM) Ltd.

66. On 8 July 2004, Tenon (IOM) Ltd and Tenon (IOM) Nominees Ltd resolved to accept appointments as trustees of the Toughglaze EBT 2004. Also on 8 July 2004, Toughglaze, Tenon (IOM) Ltd and Tenon (IOM) Nominees Ltd executed a deed appointing Tenon (IOM) Ltd and Tenon (IOM) Nominees Ltd as additional trustees.

67. At a meeting of Toughglaze's Board of directors on 13 July 2004 it was resolved that Toughglaze should suggest to the trustees of the Toughglaze EBT 2004 that they investigate whether the creation of subtrusts was appropriate. This was stated to be "in respect of the services of the beneficiaries of the Trust were employed by Toughglaze Limited…" and was done on the advice of PSL.

68. It was further resolved that, if the trustees considered that it was appropriate to create subtrusts, the assets of the trust be appointed on to subtrusts for Mr Vipul Shah (and his family), Mr Bharat Varsani (and his family) and Mr Ashok Varsani (and his family) in equal one third shares. Toughglaze subsequently wrote to the trustees of the Toughglaze EBT 2004 to this effect.

69. On 16 July 2004, a majority of the trustees of the Toughglaze EBT 2004 resolved to accept this recommendation and, thereafter, executed deeds appointing the trust property as follows:

> (1) £333,333.33 to a sub-trust for the benefit of Mr Shah (and his family and others);
>
> (2) £333,333.33 to a sub-trust for the benefit of Mr A Varsani (and his family and others); and

(3) £333,333.34 to a sub-trust for the benefit of Mr B Varsani (and his family and others).

70. On 1 September 2004, Mr Shah, Mr A Varsani and Mr B Varsani each wrote to the trustees requesting an interest free loan in the sum of £285,000.

71. On 16 September 2004, a majority of the trustees of the Toughglaze EBT 2004 resolved to make unsecured loans of £285,000 to Mr Shah, Mr A Varsani and Mr B Varsani. The loans were stated to be repayable at one month's notice. Subsequently, the trustees entered into agreements stated to be loan agreements with Mr Shah, Mr A Varsani and Mr B Varsani.

72. On 27 October 2004, Mr Shah, Mr A Varsani and Mr B Varsani each wrote to the trustees requesting an interest free loan of £48,000 payable to an account in the name of Circle Investments Ltd. Circle Investments Ltd was a company that was set up primarily to carry out various property investments mainly in Germany. The investments were in commercial property, namely out of town supermarkets. PSL had advised the beneficiaries that any gains or income arising from offshore investments made by the Toughglaze EBT 2004 would be subject to UK tax only if remitted to the UK. In the event, the investment company was not successful and went into administration.

73. On 28 October 2004, a majority of the trustees resolved to make the loans which had been requested under the terms of the previous loan agreements with the directors. On 10 March 2005, the Board of directors of Toughglaze resolved that Toughglaze should retire as trustee, leaving Tenon (IOM) Ltd and Tenon (IOM) Nominees Ltd as the sole remaining trustees. Toughglaze therefore wrote to Tenon (IOM) Ltd to that effect on 10 March 2005.

74. On 4 April 2005, the trustees resolved that Toughglaze and Tenon (IOM) Nominees would retire as trustees of the Toughglaze EBT 2004. A deed of retirement was executed on 4 April 2005 to give effect to that resolution.

75. On 20 December 2006, Mr Shah and Mr B Varsani wrote to the trustees, indicating that they wished to make a part repayment of the loans made to them from the subtrust. On 27 December 2006, Mr A Varsani wrote to the trustees, indicating that he wished to make a part repayment of the loan made to him from the subtrust.

76. On 2 January 2007 the Tenon (IOM) Ltd (which was, by now, the sole trustee of the Toughglaze EBT 2004) resolved to accept the part repayment.

77. On 3 January 2007, Tenon (IOM) Ltd resolved, at the directors' request, to make a loan to Circle Investments Ltd in the sum of £206,626 in respect of each of Mr Shah, Mr A Varsani and Mr B Varsani and the trustee and Circle Investments Ltd entered into a loan agreement. This was for the purpose of Circle Investments Ltd investing in property.

(2) Toughglaze: year ending 31 May 2005

78. On 26 May 2005, the directors of Toughglaze resolved to set aside a sum of £1,000,000 to create an employee benefit trust for the benefit of its employees. It was also resolved that the trust would be used to create subtrusts for the benefit of key employees and their families.

79. At paragraph 4 the minute explained

> "…the trust would be create sub-trusts for the benefit of key employees and their families. Premier Strategies had advised that the attached deed would not allow the trust capital to be paid out as remuneration but would allow the capital to be used to provide benefits such as interest free loans."

80. On 28 October 2005, Toughglaze made a declaration of trust over funds of £100 to create the Toughglaze (UK) Limited Employees Trust 2005 (the "Toughglaze EBT 2005"). Toughglaze resolved to act as the initial trustee of the Toughglaze EBT 2005.

81. Under clause 13 of the Deed establishing the Toughglaze EBT 2005, the Trustees were (inter alia) precluded from causing or permitting any of the Trust Fund (or the income thereof) to become employees' remuneration within the meaning of Finance Act 1989 ("FA 1989") s 43(2).

82. On 2 November 2005, Toughglaze resolved to make a further declaration of trust over further funds of £999,900 plus any accrued interest held in its Royal Bank of Scotland International bank account to be held under the terms of the Toughglaze EBT 2005.

83. Following the declaration of trust over additional funds, on 8 November 2005 Toughglaze resolved to appoint a professional trustee to assist with the administration of the Toughglaze EBT 2006. On 14 November 2005, Tenon (IOM) Ltd and Tenon (IOM) Nominees Ltd were appointed as additional trustees of the Toughglaze EBT 2005.

84. On 22 November 2005, Toughglaze made a recommendation to the trustees to consider the use of revocable subfunds for the benefit of certain employees and their families. This followed the board meeting on the same date and was on PSL's recommendation.

85. On 24 November 2005, a majority of the trustees resolved to create subfunds for the benefit of Mr Shah, Mr A Varsani and Mr B Varsani and their respective families.

86. The trustees appointed £333,300 to each sub-fund.

87. On 7 March 2006, Toughglaze decided to retire as a trustee. Toughglaze and Tenon (IOM) Nominees Ltd retired as trustees on 4 May 2006. On 3 May 2006, Mr Shah, Mr A Varsani and Mr B Varsani wrote to the trustees requesting loans of €72,150.

88. The trustees approved interest bearing loans of €72,150 to each beneficiary. The trustees subsequently sent agreements stated to be loan agreements to each borrower. The loan agreements were signed by all parties on 12 May 2006 and the funds were released to the borrower.

89. On 19 July 2006, Mr Shah wrote to the trustees of Mr Shah's subfund, requesting a loan to the Mr A Varsani subfund. Also on 19 July 2006, Mr B Varsani wrote to the trustees of Mr B Varsani's subfund, requesting a loan to the A Varsani subfund. Also on 19 July 2006, Mr A Varsani wrote to the trustees of Mr A Varsani's subfund, requesting a loan of £800,000.

90. On 21 July 2006:

(1) The trustees of the Mr Shah subfund approved a loan of £260,000 to the Mr A Varsani sub-fund.

(2) The trustees of the Mr B Varsani subfund approved a loan of £260,000 to the Mr A Varsani sub-fund.

(3) The trustees of the Mr A Varsani subfund approved (i) a loan of £800,000 to Mr A Varsani, and (ii) the loans of £260,000 from the Mr B Varsani subfund and the Mr Shah subfund.

91. Loan agreements were signed by the parties and the funds were released to the borrower. The loans were at interest of 4% above base, save for the loan to Mr A Varsani, which was interest-free.

(3) Toughglaze: year ending 31 May 2006

92. On 17 May 2006, Toughglaze resolved to set aside £1.5m to establish an employee benefit trust.

93. On 29 September 2006, Toughglaze made a declaration of trust over funds of £100 to create the Toughglaze (UK) Limited Employees Trust 2006 (the "Toughglaze EBT 2006"). Toughglaze resolved to act as the initial trustee of the Toughglaze EBT 2006. Under clause 13 of the Deed establishing the Toughglaze EBT 2006, the Trustees were (inter alia) precluded from causing or permitting any of the Trust Fund (or the income thereof) to become employees' remuneration within the meaning of FA 1989 s 43(2).

94. On 17 October 2006, Toughglaze made a further declaration of trust over further funds of £1,499,900 plus any accrued interest held in its Royal Bank of Scotland International bank account to be held under the terms of the Toughglaze EBT 2006.

95. Following the declaration of trust over additional funds, on 31 October 2006 Toughglaze resolved to appoint a professional trustee to assist with the administration of the Toughglaze EBT 2006. On 27 November 2006, Tenon (IOM) Ltd and Tenon (IOM) Nominees Ltd were appointed as additional trustees of the Toughglaze EBT 2006.

96. On 29 November 2006, Toughglaze made a recommendation to the trustees to consider the use of revocable subfunds for the benefit of certain employees and their families.

97. On 29 November 2006, a majority of the trustees resolved to create subfunds for the benefit of Mr Shah, Mr A Varsani and Mr B Varsani and their respective families.

98. The trustees appointed £499,960 to each sub-fund. On 5 December 2006, Mr Shah, Mr A Varsani and Mr B Varsani each wrote to the trustees to ask them to consider making interest bearing loans to Circle Investments Ltd of £500,000 each. Mr Varsani's evidence was that the proposed loans were interest-bearing because the investments made by Circle Investments Ltd. were forecast to be profitable and having an interest bearing loan was more tax efficient as the interest could be deducted as an expense.

99. The trustees approved interest bearing loans of £499,960 to Circle Investments Ltd. The loans were stated to be repayable on one month's written notice. The trustees subsequently sent agreements to Circle Investments Ltd which were signed by all parties on 6 December 2006 and the funds were released to Circle Investments Ltd.

100. Toughglaze resolved to retire as a trustee on 29 January 2007.

Findings of fact from Evidence of Mark Schofield

101. Mr Schofield is the managing director of Optimus Fiduciary Limited ("Optimus") which was previously known as Tenon (IOM) Limited ("TIOM") and was a subsidiary of RSM Tenon Group PLC. He was also at all material times a director of Tenon Nominees Limited, a wholly owned subsidiary of TIOM.

102. He is a Chartered Certified Accountant with over 25 years' experience in the offshore financial centres of Jersey and the Isle of Man. He joined KPMG in Jersey in 1986 and subsequently moved to the Isle of Man in 1991 where he joined Coopers & Lybrand. Whilst working at Coopers and Lybrand, he joined their trust company, Abacus Limited.

103. He was part of the team that established TIOM in 2002 having moved from Abacus Limited and was its first and only Managing Director. At the time TIOM was established he had a strong relationship with the directors and management team of PSL. TIOM was initially created to manage and provide administration services for offshore trusts and companies established by clients of PSL who had previously outsourced this function to third party providers.

104. Optimus provides a range of fiduciary services to its clients. Amongst other services, Optimus provides professional trustees and directors to manage trusts and companies based both in the Isle of Man as well as a number of other international jurisdictions. Typically, Optimus would charge a one off fee for professional trustee services which would be a sixth of what PSL would charge and this invoice was raised to PSL. PSL charged 12% of the amount in the strategy, which meant Optimus

would receive 2%. However, there was scope under the terms of engagement to raise additional fees should the trust invest other than in cash, relatively simple investments or loans. For example, if investments were made in property, additional fees would be charged for ongoing administration. Optimus continues to provide professional trustee services to trusts created by OCO and Toughglaze.

105. Mr Schofield's view was that it was important that PSL, TIOM and their legal advisers worked closely together to deliver seamless service to PSL's clients. The team of directors and managers of both businesses met on a regular basis and discussed issues that arose on client delivery and how those issues could be avoided in the future. Technical and legal matters were also discussed. For example, potential changes in legislation and the effect of those on the planning. The TIOM team involved in the implementation of this particular EBT planning had met and interacted with the PSL team and there was daily communication between the two teams.

106. Although Mr Schofield had not witnessed a PSL client meeting, it was his understanding that when PSL was in dialogue with companies considering using an EBT arrangement, it was presented to them effectively as a 'one-stop shop'.

107. In October 2002, TIOM employed just two people, its founding directors. Four more joined in December 2002 and it has continued to grow from that point. At its peak, TIOM employed around 47 or 48 people. Between 2004 and 2006 it employed around 20 to 35 people. As at 2015, Optimus had three directors and employed 35 staff. Minutes from every board meeting for client companies and trusts were physically held and properly recorded. There were around 400 clients who had participated in the EBT planning relevant to these appeals. There were therefore, many funds to look after.

108. Mr Schofield's experience from administering this particular type of EBT planning suggested that following the appointment of Tenon (IOM) Ltd and Tenon Nominees Ltd as trustees, most clients would request that a number of sub-funds be created, typically for directors of the settlor company, and that funds be appointed on to those sub-funds from the main fund. His experience then suggested that in most cases the principal beneficiary of each sub-fund would request a loan from the trustee typically for the balance of cash held in the sub-fund. (By principal beneficiary Mr Schofield meant the particular named director in relation to whom the sub-fund had been set up – the term "principal beneficiary" was not a defined term in the relevant trust deeds.) Around 95% of cases progressed in this way. Tenon (IOM) Ltd employed sufficient people to be able to deal with the administration and processing tasks associated with accepting the trustee appointments, amending the bank mandate so that the TIOM trustees took control of the bank account, creating the sub-funds, considering loan requests (although it is HMRC's case there was no real consideration by the trustees) and subsequently processing those loans. At the busiest times TIOM employees worked a significant number of extra hours, for which, additional fees were charged.

109.TIOM used, and Optimus continues to use, a database called Viewpoint which holds client data. The company spent significant time developing processes within Viewpoint so that it provided various 'triggers' based on experience of how a client would likely proceed when using the EBT planning strategy. For example, if a loan was requested by a beneficiary, when this request was entered onto the system it would remind the trustees that the due diligence would need to be completed in respect of the proposed borrower for example because of anti-money laundering regulations. The system would then trigger a draft loan agreement for the trustees to review and consider.

110.If approved at a trustee meeting, the loan agreement was provided to the beneficiary to consider the terms available. Should the beneficiary wish to proceed, they would sign and return the loan agreement for the trustee to sign. It was necessary to build in such safeguards to minimise human errors in completing the necessary steps to implement the wishes of beneficiaries.

111.Viewpoint thus provided a reminder in this way of things which had to be carried out but it acted more as a "stopper" rather than something which prompted action. Mr Schofield did not consider the processes followed by the trustees were automatic by any means; in his view human action and consideration always came before Viewpoint's triggers.

(1) What generally happened at each stage

(1A) When clients declared a trust

112.TIOM would not necessarily know when a client declared a trust. However, there was frequent dialogue between the two teams so TIOM would have a good idea of the number of clients PSL were anticipating to implement the strategy.

(1B) When additional trustees were appointed

113.In terms of the decision to become a trustee, various Know Your Client' procedures were adhered to. The first thing which was done was the client inception procedures. This involved checking the identity of at least two directors, and any shareholder with a greater than 10% interest in the business. The trustees would also check that the business existed, who was behind it, who was running it and what it did.

114.To facilitate the planning for clients, PSL collected the required due diligence and pass this on to TIOM. Although the appointment of the trustee was made by the company in a given case, the company would have been following PSL's instructions.

115.In terms of why the trustee accepted a given appointment, there were various factors:

(1) whether there had been a group introduction;

(2) whether the trustee understood what was going to be implemented; and

(3) whether it made commercial sense for the trustee, namely the fee arrangements.

116. In terms of due diligence on individual people and the settlor company, this involved, in terms of information gathering, the following:

(1) considering the company's memorandum and articles;

(2) considering the certificate of incorporation;

(3) carrying out checks on search websites (including Worldcheck and Google);

(4) viewing the company's website;

(5) reviewing shareholder names, with enhanced checks on anyone owning more than 10% of the share capital; and

(6) obtaining a passport copy and utility bill for any shareholder owning more than 10% and for the board of directors.

117. This reflected both Isle of Man money laundering regulations and also a policy which the trustees were comfortable with. As well as formal due diligence, there were telephone conversations throughout the process by which the trustees got to know the settlor company.

(1C) When the client and first trustee retired

118. In nearly all the cases, the client retired as a trustee and there are relatively few cases where the client remained as a trustee. In Mr Schofield's view the main reason for the client retiring was to ease the administration burden around decision making processes in that decisions could be made quicker where the settlor company had retired as a trustee and in addition, if there was income arising in the trust, the non UK resident trustee resulted in no exposure to UK income tax.

Declaration by employer, appointment of professional trustees and retirement of appellant as trustees

119. It is clear the initial declaration of trust by the employer company was something which was done at PSL's instigation. Although the way in which the appellant directors' evidence was put could be taken to suggest that the subsequent appointment of the professional trustees and the later retirement of the employer company as a trustee followed on from considering PSL's advice which was given only once the employer company had been appointed I find, for a number of reasons, that the plan at the outset of the scheme, was that each time the employer would declare trusts and that then professional trustees, and furthermore the particular trustees TIOM and Tenon Nominees (IOM) Ltd would be appointed.

120. That this is the case is consistent with PSL's letter of advice of 21 June 2005 which mentioned the possibility of professional trustees and being able to make recommendations and the fact that the bank account set up was an Isle of Man Bank account (there was no indication that PSL or the appellant had any reason to bank

there). It is also consistent with there being frequent contact between PSL and the Isle of Man trustees as to the likely take up of the scheme which allowed the trustees to plan their upcoming workload – there would be no need for this liaison if it was not known at the outset that 1) professional trustees would be appointed 2) that the professional trustees used would include TIOM. There was no indication any of the directors had the knowledge or expertise in trustee obligations so as to suggest they would want to take on the role for reasons other than because this was what they had been advised to do by PSL. The appellants' conduct in declaring themselves trustees again in subsequent years having encountered and made contact with the Isle of Man professional trustees in previous years suggests the appellants were simply following the advice of PSL as regards appointment and retirement rather deciding for themselves that they should declare trusts, and then deciding for themselves that it was a good idea to appoint professional trustees and then retire.

The Relevant Legislation

121. The relevant statutory provisions (which were helpfully summarised and set out in the appellants' skeleton argument and which I gratefully adopt with minor modifications) are as follows:

Income Tax

122. Part 2 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA") imposes a charge to tax on employment income, and that charge is, by virtue of s 6, a charge to tax on, amongst other things, "general earnings". The definition of "general earnings" is found in s 7 and depends in part on the concept of "earnings", which is defined in s 62. So far as is material, s 62 provides:

> "62 Earnings
>
> (1) This section explains what is meant by 'earnings' in the employment income Parts.
>
> (2) In those Parts 'earnings', in relation to an employment, means –
>
> (a) any salary, wages or fee,
>
> (b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or
>
> (c) anything else that constitutes an emolument of the employment.
>
> (3) For the purposes of subsection (2) 'money's worth' means something that is–
>
> (a) of direct monetary value to the employee, or capable of being converted into
>
> money or something of direct monetary value to the employee.
>
> (4) ..."

123. Section 684, ITEPA provides that HMRC must make regulations with respect to the assessment, charge, collection and recovery of income tax in respect of PAYE income. Under that provision HMRC have made the PAYE Regulations. They apply where an employer makes "a relevant payment to an employee during a tax year" (reg. 21(1)).

124. A "relevant payment" in this context means "a payment of, or on account of, net PAYE income" (reg.4), and "net PAYE income", for the purposes of this appeal, is "any taxable earnings from an employment in the year (determined in accordance with section 10(2))" (s 683, ITEPA), less certain deductions; and s 686, ITEPA defines, for the purposes of PAYE regulations, when a payment of, or on account of, PAYE income of a person is treated as made.

125. "Taxable earnings" are defined in s 10, ITEPA, and, for the purposes of the present appeals, turn on the definition of "earnings" in s 62, as set out above.

National Insurance Contributions

126. Section 6 of the Social Security Contributions and Benefits Act 1992 ("SSCBA") provides that where in any week "earnings" are "paid to or for the benefit of an earner" then both a primary Class 1 contribution and a secondary Class 1 contribution are payable. For these purposes, "earnings" include "any remuneration or profit derived from an employment" (s.3, SSCBA). Section 6(4), SSCBA provides that the primary contribution is the liability of the earner (i.e. the employee) and the secondary contribution is the liability of the employer. The employer is, however, liable to pay both the secondary contribution of its own and also, in the first instance, the earner's primary contribution "on behalf of and to the exclusion of the earner" (para 3, schedule 1 to SSCBA).

127. Class 1A NIC are due on earnings charged to income tax as benefits in kind (s.10, SSCBA).

Case-law Issues

128.In this next section I deal with the case law I was referred to in relation to the redirection, *Antoniades/Autoclenz,* and *Ramsay* issues before moving on to consider how the propositions from the case law should be applied to the relevant facts.

1) Case law – The redirection issue

129.As pointed out by the appellant the concept of "earnings" connotes remuneration derived by the employee from the employment which can take the form of a salary, wage, fee, bonus, tip or some other form of profit or benefit in money or money's worth. There is no dispute that in order to characterise a sum as earnings it must be established that the sum derives from employment; this is often described as a question of source. Many cases as identified by Lord Wilberforce in *Brumby v Milner* turn on the very point of whether an amount is "from" the employment or office.

130. There is also no dispute that once something is "earnings", then it does not matter what the employee then chooses to do with it. For instance the employee may choose to have the earnings redirected to a third party and if so the amounts are no less earnings. This principle is referred to in the cases which follow, in particular *Smyth v Stretton* as explained in *Edwards v Roberts*.

131. The crux of the appellants' submission is that the authorities make it clear that while the question of source is a *necessary* condition for earnings it is not a *sufficient* condition. The particular issue between the parties is whether there is, as the appellant argues, a further question of looking from the employee's point of view to see what has been received. Furthermore the authorities are clear earnings are confined to money or something that can be turned into money (money's worth).

132. For the above propositions the appellant refers to the House of Lords' decision in *Tennant v Smith* 3 TC 158. The case concerned a bank manager whose employer gave him free accommodation which he was required to occupy. The court held that emoluments were confined to actual money payments and to benefits in kind which were capable of being turned into money by the recipient. The appellant refers to Lord McNaughton's speech (which in turn was endorsed as a statement of established authority in Lord Reid's decision in *Heaton v Bell* [1970] AC 728 at 744E):

> "…a person is chargeable under income tax…under Schedule E…not what saves his pocket but on what goes into his pocket and the benefit of which the appellant derives from a having a rent-free house provided for him by the bank brings him nothing which can be reckoned upon as a receipt or properly described as income".

133. While the application of that principle is clear in the case e.g. of a monthly salary paid to an employee, the particular issue which arises in this case is over how any such requirement of receipt in the hands of the employee applies in situations where earnings are redirected to someone else; in particular at the point in time a trust was declared over the sums were they earnings of the director already?

134. HMRC refer to the Court of Session's decision of *Murray Group* [2016] STC 468 as an illustration of the principle of "redirection" against a similar but not identical factual backdrop of a scheme involving a declaration of trust and funding of sub-trusts. As a decision of a Scottish court, it is accepted that it is not strictly binding on the FTT sitting in England and Wales. Further, whilst a decision of a notionally superior court in one part of the UK might ordinarily be followed by a tribunal sitting in another part, especially on questions of tax, the appellants submit, further to their detailed, (and in HMRC's view unjustified), critique of the decision that *Murray* should not be followed. In order to understand the appellant's arguments on the receipt principle and to make sense of the appellant's critique it is necessary to deal with various decisions which preceded *Murray* and it is convenient to take these chronologically given the later decisions consider and discuss the earlier ones.

135. The common thread running through the various authorities are fact patterns where amounts are transferred to or segregated within a fund or trust in relation to which an employee or director has a contingent right to receive amounts whether that

is through the fulfilment of certain conditions or through the exercise of someone else's discretion. The question in such circumstances which the court must grapple with is whether the amount that is contributed to the fund is to be regarded as paid from "earnings" or whether there are "earnings" only when something is paid out to the employee ?

136. In *Smyth v Stretton* [1904] 5 TC 36 which was a decision of the High Court, the Board of Governors of Dulwich College established a provident fund for teachers. The Scheme provided "that the following increase of Salaries shall be granted.." subject to various conditions. The scheme provided for 1) a 5% increase payable on retirement or death for whatever reason 2) an extra 5% increase of salaries for assistant masters having between 5 and 15 years' service but if the assistant master who had less than 10 years resigned for reasons other than ill-health then he was not entitled to it or the accumulations on it. His estate was entitled the sum accumulations if he died in service or in the case of ill health retirement if the governors granted it at their discretion.

137. Channell J held 1) was clearly salary and taxable but as to 2) the position was arguable. However taking account that the extra 5% was put together with 1), that it was stated to be salary, and there being no reason not to treat it as salary just because there was a binding obligation as to what to do with it, and noting that the master would probably get it in certain events but would not get in others, he concluded 2) was additional salary and taxable and was none the less so because there had been a binding obligation created between the assistant masters and governors that they should apply it in a particular way.

138. His judgment referred to *Bell v Gribble* [1903] 1 KB 517 (a decision of the Court of Appeal) as being very much on point and as establishing :

> "..that a sum receivable by way of salary or wages is not the less salary or wages taxable because for some reason or another the person who receives it has not got the full right to apply it just as he likes. The fact that income which is income but which has even by the operation of some statute to be devoted compulsorily to some other purpose or another does not prevent it being income."

139. *Edwards v Roberts* (1935) 19 TC 618 concerned the issue of whether payments into a fund were taxable as earnings as opposed to the amount received from the fund. The question arose as to whether *Smyth* applied or not. As pointed out in HMRC's skeleton this decision was helpfully summarised in Rimer LJ judgment in *Forde:*

> 32… Mr Roberts was employed by a company under a 1921 service agreement which provided that, in addition to his annual salary of £425, he had an interest in a 'conditional fund'. That fund was created by the payment by the company at the end of each financial year to trustees of a sum out of its profits, to be invested in the company's shares or stock. Subject to forfeiture in certain events, Mr Roberts was entitled to the income produced by his fund at the end of each financial year. He was also entitled to receive part of the capital of his fund (or the investments representing it) at the end of five financial years and of

each succeeding year and, on death in service or on the termination of his employment, to receive the whole amount standing to the credit of the fund. He resigned in 1927 and the fund trustees transferred to him the shares purchased out of the payments made to them by the company over the years 1922 to 1927, valued at £1,640. He was assessed to tax on that value for 1927/28. He appealed, asserting that immediately a sum was paid to the trustees by the company, he obtained a beneficial interest in it which became part of his emoluments for the year of payment and that therefore his assessment for 1927/28 should not exceed the amount paid by the company to the trustees during that year. The Commissioners and Singleton J regarded themselves as bound by *Stretton's* case to agree. The Court of Appeal, reversing Singleton J, disagreed and upheld the assessment.

33.Lord Hanworth MR regarded the case as distinguishable from *Stretton's* case. There, but for the decision to establish the fund, the masters would have been paid a larger sum by way of salary each year; the payments were the masters' contributions to the fund by way of a deduction from their salary. He said in relation to the instant case (at 637/638):

'… this is an emolument which accrued and was payable not in each successive year, but in the sixth year, and was to be paid when it was handed over in 1927 and not before. It is quite true that a proportion of this amount might have been paid ex gratia by the employers if death had supervened, or if under Clause 9 he had been deemed unfit to go on with his service. Taking the normal course, he was not entitled to anything until the lapse of six years, and his right could have been entirely defeated by the events which are tabled in (A), (B) and (C) of Clause 10 of the agreement … It seems to me that the facts in this case stand apart from that principle [that of *Smyth v Stretton*], and that under these circumstances there could not be said to have accrued to this employee a vested interest in these successive sums placed to his credit, but only that he had a chance of being paid a sum at the end of six years if all went well. That chance has now supervened, and he has got it by reason of the fact of his employment, or by reason of his exercising an employment of profit within Schedule E.'

140.To the above summary I would note that in considering the issue of whether the taxpayer had as much a right to be paid the amounts in issue as he had to his salary "…really come back to a question of fact and the interpretation of the agreement". Distinguishing *Smyth* Lord Hanworth MR found in that case the taxpayers:

"…would have been paid a larger sum but for the fact that the Governors intended and decided to start this fund, which was for the purpose of securing the benefits to them as when they reached a certain age, and then it was what they called a contributory scheme, to which they were bound to contribute; it was a deduction from salary."

141. This was contrasted with the facts of *Edwards* where there was no right to be paid if there was no dividend or if there was no sum put to reserve (Lord Hanworth MR had noted earlier at pg 735 how the fund was derived from a formula based on net profit). It was noted how the right to be paid all depended on the "will and discretion of the directors". Reverting to Rimer LJ's summary:

> 34.Romer LJ, at 639, agreed and described Stretton's case [*Smyth*] as:
>
> '… no more than an illustration of a well-established principle … that for the purposes of taxation of a man's income it matters not what the man has thought fit to do in the way of spending that income or investing it.'
>
> The case under appeal was, however, quite different. What had happened in it was that (at 640):
>
> 'The Company agreed to pay to the employee during his service his salary at the rate of £425 per annum, but agreed "as an additional inducement to the Employee more effectively to perform his duties and assist in promoting and advancing the interests of the Company" that the Company would in the year 1927 pay him the sum of £1,639. That being so, it seems to me clear that the £1,639, though in truth an emolument of the office held by Mr Roberts, was an emolument for the year in respect of the year 1927, and cannot be treated as made up of a series of emoluments for the preceding years.'

142. At Pg 640 Romer LJ in relation to *Smyth* commented:

> "One can hardly say that that case, being merely a question of the construction to be put upon a particular agreement, is any authority which helps us when we are endeavouring to put a proper construction upon an agreement which is totally different from the agreement with which Mr Justice Channell had to deal with."

143.Maugham LJ also analysed the agreement contrasting the fact that whereas in *Smyth* it referred to salary, in the present case the agreement distinguished the sums in question from salary. The sums were to be set aside from profit and were conditional on the profit-earning from the point of view of the company, also Mr Roberts only received payment if certain events mentioned in agreement complied with "benefits which he might conditionally become entitled to under agreement not in a true sense part of salary".

144.*Forde v McHugh* [2014] UKSC 14 concerned a company which had set up an unapproved retirements benefits scheme for employees by way of trust to which the company made contributions for the benefit of a director, Mr McHugh. The issue as set out at [14] of the Supreme Court's decision was whether the appellant company had paid earnings to or for the benefit of Mr McHugh when it made the transfer to the trust at a time when Mr McHugh's interest in the assets was only a contingent one which might have been defeated by his death before the specified retirement age. In particular the question which arose was whether the transfer was a payment of "earnings" under the relevant NICs legislation? HMRC were arguing that both the

payments into the trust and out of it were earnings but that double counting was avoided by specific earnings "disregards" in the NICS regulations for pensions / unapproved retirement benefit scheme payments.

145. Lord Hodge (gave the court's judgment with which Lords Neuberger, Sumption, Reed and Toulson JJSC agreed).

146. At [16] he dealt with HMRC's position as follows:

> "On this narrow issue, HMRC's stance before this court was remarkable. Because of the assumptions on which the subordinate legislation had been framed, Mr Jones had to submit that earnings are paid to an earner both when assets are transferred to a pension scheme to be held on a trust and also when payments are made from the trust fund. HMRC looked to the payment and not to what the earner received. HMRC argued that the payment into the trust fund was earnings because it was a sum paid as the quid pro quo for past or future services. It was part of Mr McHugh's remuneration. The sum went to a trust fund which was solely for the benefit of Mr McHugh and his wife. Mr McHugh, it was submitted, was immediately better off because he had the hope of receiving the trust fund in the future, and his family would benefit if he did not survive until his retirement age. Payments to him out of the trust fund would as a matter of principle also be earnings when made because they also were payments to him in respect of his employment. On this approach, double-counting was avoided only by Part VI of Schedule 3 to the 2001 Regulations which disregards, among others, payments by way of pension (para 1) and payments by way of relevant benefits pursuant to an unapproved retirement benefits scheme (para 4)"

147. He went on to reject the argument for three reasons:

> (1) It was counter-intuitive that a person could earn remuneration both when his employer paid money into a trust to create a fund for his benefit and again when at a later date the trust fund was paid out to him, and absent clear words or necessary implication Parliament could not have intended it. At [17] he stated "the use of "earnings" points the reader towards what the employee obtains from his employment. Looking to what the earner receives avoids the counter-intuitive result."
>
> (2) HMRC's view could only be sustained by ignoring what was received but by doing that the term "earnings" was denuded of meaning such that the phrase "earnings are paid" would amount to "payments are made".
>
> (3) The value was of the contingent right to the trust fund as at the retirement date – calculation of that would not be simple.

148. At [20] Lord Hodge noted that no argument was advanced by as to whether a payment into a pension or bonus fund might properly be analysed as a payment out of the earner's salary as in *Smyth*. As there is some controversy between the parties as to

the question of what if anything *Forde* had to say on the issue of redirection in view of paragraph 16 of the Supreme Court's decision I set this out in full:

> "Having reached this view on the issue which the parties presented in this appeal, I comment briefly on some of the cases to which counsel referred. This case was presented as a test case on the issue of principle. No argument was advanced as to whether a payment into a pension or bonus fund might properly be analysed as a payment out of the earner's salary as in *Smyth v Stretton* (1904) 5 TC 36. Mr Jones stated that HMRC might take that point in an appropriate case. *Edwards v Roberts* (1935) 19 TC 618 assists in this case not because it is correct to equate "earnings" in NICs legislation with "emoluments" in income tax legislation but because of its application of the general law in relation to a contingent interest and its focus on what an employee receives. In that case an employee received a salary and also, if he remained in employment for more than five years, a right to receive at the end of a subsequent financial year part of the capital of a trust fund into which his employer paid a proportion of its annual profits. [*Lord Hodge then quoted the extract at [139] above "under these circumstances there could not said to have been accrued…"]*

149. That brings us finally to *Murray Group Holdings Ltd and others v HMRC* [2016] STC 468 which was a decision of the Court of Session (Inner House). A company within the Murray Group set up an EBT and any company within the group which wished to benefit one of its employees made a cash payment to the trust in respect of that employee. Two types of employees were considered (footballers and non-footballers). The paying company recommended the trustee of the trust to resettle the sum in question on to a sub-trust, and would ask that the income and capital of the sub-trust should be applied in accordance with the wishes of the employee. The beneficiaries of the sub-trust were chosen by the employee, and were generally the members of his family. In practice the trustees of the sub-trusts invariably gave effect to the wishes of the employee. The employee would be appointed protector of the sub-trust, and the trustee of the sub-trust would then lend the employee the money that had been advanced to the sub-trust from, ultimately, his employer. HMRC assessed the employers for PAYE income tax and NICs in relation to the foregoing.

150. The FTT by a majority held that the benefit enjoyed by the employee and his family resulted from the exercise of a discretionary power by the trustee of the sub-trust and that the payments made to the trustees were not, and did not become, emoluments or earnings of the employees, and were therefore not subject to income tax. The Upper Tribunal upheld this result but its decision was then reversed by the Court of Session.

151. The Court of Session accepted HMRC's submission that the scheme involving payments to the various trusts and the application of the moneys so paid amounted to a mere redirection of earnings. At [56] Lord Drummond Young, who gave the opinion of the court, having considered the Privy Council's decision in *Hadlee v IRC* [1993] STC 294, the House of Lords decision in *Brumby v Milner* [1975] STC 644 and the High Court's decision in *Smyth* explained:

> "The fundamental principle that emerges from these cases appears to us to be clear: if income is derived from an employee's services qua employee, it is an emolument or earnings, and is thus assessable to income tax, even if the employee requests or agrees that it be redirected to a third party."

152. At [58] the opinion noted that in assessing the liability of a transaction to tax the imperative was "in every case to determine the true nature of the transaction, viewed realistically."

153. Applying the above principles to the facts to the two sets of employees in issue. In relation to the employees who were not footballers it was stated at [59]:

> "…the critical element is that bonuses were paid on the basis of the work performance of the employee in question, qua employee, and the profitability of his employing company. Thus the amount of the bonus was determined by reference to the employee's employment activities. While the bonuses were discretionary, and there was no contractual entitlement to them, it is very obvious that they were derived from and based on the work done by the particular employee."

154. As regards the footballing employees the court noted at [60] that:

> "when a contract of employment was concluded, an additional side letter provided for a discretionary trust payment. It seems to us self-evident that the obligations in the side letter were part of the employee's employment package and provided him with additional remuneration…once it is accepted that the bonus payments represented consideration for a footballer's services qua employee, it inevitably follows that those payments represented emoluments or earnings of the footballer in question."

155. At [15] they had noted:

> "In our opinion the payments were, quite simply, bonus payments arising out of the footballer's employment, but paid to a third party, the Trustee of the Principal Trust. Two facts are critical: payments were made by the employer, albeit through a trust mechanism; and those payments were made because of the services rendered by a particular employee in such a way that they enured for the benefit of persons who were, realistically, chosen by that employee, through trust purposes to which he assented."

156. At [23] the court mentioned it had been referred to documents in which one of the footballers' remuneration had been agreed and a schedule which under the heading of annual salary also mentioned a contribution to the trust. The court saw this as demonstrating that the payment to the principal trust was part of the total remuneration package.

157. At [61] it was noted that "the redirection of earnings occurred at the point where the employer paid a sum to the trustee of the Principal Trust, and what happened to the moneys thereafter had no bearing on the liability that arose in consequence of the redirection. At [65] the court went on to state that:

> "…the critical point when it can be said that an emolument or earnings has been paid is when the employer makes a payment either directly to the employee or in a manner that has been requested or at least acquiesced in by the employee. In the present case the payment to the trustee of the Principal Trust occurred at the point when funds left the employer, and they were made to an entity that had been selected by the employee (through the arrangements in the side letters), or at least acquiesced in by the employee, as the manner in which the funds would be channelled to his own sub-trust."

158. The court also found it immaterial (at [62]) that there was no contractual entitlement to the sums paid noting that it had long been recognised that gratuities were subject to income tax. It rejected the argument that taxing payments made to the trustees would give rise to double taxation. At [63] regarding the question of whether sums had been placed at the "unreserved disposal of the employee" (as in *Aberdeen Asset Management Ltd v HMRC)* the court stated:

> "…In dealing with the redirection of income, however it will not normally be relevant whether or not sums are the employee's unreserved disposal. The employee chooses to redirect part of the consideration for this employment – emolument or earnings. In so doing he obviously hopes that those trustees will apply the funds in the manner that he has requested, in this case in accordance with the letters of wishes. He nevertheless runs the risk that they will not do so. Whatever happens, the sums paid to the trustees were redirected from income, and that is enough to render them liable to income tax in the ordinary way."

159. In relation to the question of the application of PAYE the court concluded at [90] that a payment of emoluments or earnings was made at the point where the relevant employer made a payment to the trustee of the Principal Trust.

160. In the section of its decision from [67] onwards where the court considered various decisions it had received submissions on it found that the Supreme Court's decision in *Forde* was readily distinguishable because: 1) *Forde* was primary concerned with NICs, 2) concerns over double taxation did not arise; the funds were trust capital (the situation being no different as if an employee had used part of his post-tax benefit to fund a trust for the benefit of his family) 3) there was no difficult with depriving the words "earnings" or "emoluments" from their relevant meaning 4) the computation of tax was not especially complicated, and 5) *Forde* was not concerned with arguments advanced in *Murray* on redirection.

161. At [71] the court rejected an argument that its approach if applied to *Edwards v Roberts* would generate the opposite result to what the Court of Appeal had decided:

> "In considering *Edwards* it is important to bear in mind that a critical feature of the Court of Appeal's reasoning was that the taxpayer was not entitled to anything until the lapse of six years, and his right could have been entirely defeated if he had, for example, left his employment during that period: see Lord Hanworth MR at pages 35-36. In the present case, by contrast, the various trustees became entitled to funds

> immediately, to hold them as redirected income of the employee in question. The position is the same as that in *Smyth v Stretton* and Hadlee v IRC, and is distinguishable from *Edwards v Roberts*."

162. Considering *Heaton v Bell* and the principle that emoluments had to be money or money's worth the court noted at [72] that the sums payable to the trustees of the principal trust and in due course to the trustees of the various sub-trusts took the form of cash and consequently the money / money's worth principle did preclude the payments in *Murray* from being treated as emoluments. *Heaton v Bell* which HMRC depict as a case about redirection, was a decision of the House of Lords. The employee had the option of hiring a car and if he did then a sum was deducted from his wages – the question was whether emoluments was £100 or £95 plus free use of car. The House of Lords held 4:1 (Lord Reed dissenting) the emolument was £100 and that the employee was merely agreeing to £5 of that being deducted by employer as consideration for the car. (It did this on the basis of analysis of contractual arrangement (Lord Morris 747G, Lord Upjohn pg 760).

163. The employers in Murray Group sought and obtained leave to appeal to the Supreme Court. That hearing took place earlier this year in March and a decision is awaited.

Parties' submissions / issues on case-law

164. Having set out the various authorities I return to the parties' submissions and the particular issues in contention between them.

165. As regards the appellant's submission that one must look to the position of the employee in question to see what he or she has received, in addition to the statement in *Tennant v Smith* the appellant relies on *Forde v McHugh* [17] and *Edwards v Roberts* (pg638, 640 and 641). Embodied within that principle (and the proposition that earnings must be money or money's worth) and both those cases is the outcome that there are no earnings when an employer pays into a conditional or contingent fund.

166. HMRC point to *Murray* as a case which shows that the receipt of money or money's worth is not necessary in redirection cases. They refer to *Murray* for elucidation of the principle, long evident in tax law that you can have earnings which are not physically received by the employee but are nevertheless earnings if the correct characterisation is that he or she has agreed or directed the payment by the employer of sum.

167. Contrary to HMRC's view, the appellant argues *Murray* should not be followed. It is not as indicated above binding and the FTT should not follow the decision because it overlooks or fails to properly, apply fundamental principles from higher authority decisions.

168. In particular the appellant argues *Murray* conflicts with *Forde* and well established principles in *Tennant v Smith* and *Heaton v Bell.* It does not recognise, principles on receipt, that payments into conditional funds are not being earnings, and

the need for money or money's worth. It begs the question of whether something is earnings in first place.

169.As can be seen from the extracts above at [160], the Court of Session distinguished *Forde* on a number of bases which are attacked by the appellant and defended by HMRC. As highlighted by the appellants the view that *Forde* was restricted to the field of NICs is difficult to sustain given that Supreme Court appeared to have considered that the NICs concept of "earnings" was wider than the equivalent income tax concept.

170.However, a more persuasive ground of distinction, in my view, is that *Forde v McHugh* did not deal with redirection. Paragraph [20] of the decision is consistent with HMRC's observation that it had been accepted in *Forde* that this was an "*Edwards v Roberts"* case. That being the case it is difficult to see how the Supreme Court would have needed to turn its attention to the question of whether the contribution into the trust amounted to a redirection. I see Lord Hodge's reference to *Edwards v Roberts* assisting "in this case" as referring to the *Forde* facts – it reflected HMRC's counsel's submission that it was accepted the facts of *Forde* were akin to an "*Edwards v Roberts"* case. I do not read it as having anything to say that if the Respondents took a "*Smyth v Stretton"* case then that would be answered by *Edwards v Roberts*. I disagree with the appellant's opposing argument that what Lord Hodge said at [16] cut across the view that a redirection argument was not put in *Forde*. ("In each case I would characterise the payment *from* the trust or escrow fund as deferred earnings and it follows that the payment *into* the trust or escrow account would not be earnings.") There was no analysis here of whether the payment into the fund was a redirection of the appellant's earnings– and if that had in fact been considered it would be conspicuous that no mention of the court's views on the argument were made when Lord Hodge recited HMRC's reservation on the point in [20].

171.While the appellant criticises *Murray* for not dealing with *Brumby v Milner* (which, according to the appellants, suggests *Murray* was wrong on there being no potential taxation on what comes out of a fund) I disagree that that is how *Brumby* is to be read. The facts of *Brumby* involved a profit sharing scheme where the company lent money to a trust to buy shares in the company and where the primary purpose was to use the shares to provide income for division amongst the employees. On termination of the scheme any balance was to be distributed among existing and former employees in the trustees' discretion. The appellant highlights that the key point was that when the scheme was wound up the amounts paid to employees were assessed to income tax under Schedule E not the money paid into the scheme.

172.But, the issue was whether the capital distribution was "from" the employment (it having been accepted that income distributions were from employment) or whether it arose from something else (the company's decision to wind up the profit-sharing scheme). The case did not consider the taxability of payments into the scheme still less any argument about redirection (Neither *Smyth* nor *Edwards v Roberts* were referred to). That addresses the criticisms that the Court of Session was wrong to dismiss concerns about of double taxation. If on a proper analysis what is put into a fund is already earnings – then there would be no question of amounts being taxed on

being received. It cannot be assumedthe analysis deployed in *Brumby* would not have required the sums going into the scheme to be taxed because in *Brumby* the issue of redirection did not arise.

173.It follows also that the appellant's criticism that *Murray* failed to have regard to the principle that payments into contingent funds are not earnings is unmerited. As explained in *Murray* if the sums are earnings when they go in, then the contingency of money coming out is irrelevant; it is akin to someone choosing to invest their salary in a family trust. In other words while there can be no dispute, as confirmed by *Forde v McHugh* that a conditional interest does not amount to earnings, that issue is beside the point as we are concerned with the prior question of whether what was directed towards the contingent right was earnings in the first place.

174.However, although I agree the exploration of redirection in *Murray* can proceed unimpeded by *Forde* I do accept there is merit in some of the appellant's other criticisms which mean there are limitations to the extent any wider principles that can be drawn from the decision in terms of identifying when earnings have arisen which have then been redirected. It is notable that in each of the cases where the question of redirection is broached *Smyth* and *Edwards v Roberts* and in *Heaton v Bell* the question of redirection involves an analysis of the particular facts and circumstances of what was agreed between the employer and employee (see [142], [143] and [162] above).

175.Key among these, submits the appellants, is the appellants' argument that the Court of Session was "blinded by" the source principle and did not consider the necessary element of receipt. Crucially, according to the appellants, the court did not consider the prior question of the basis on which it is established that the taxpayer might be regarded as having earnings which it was in a position to redirect.

176.In so far as the analysis in *Murray* relies on *Smyth* then the appellants argue *Smyth* is hardly a compelling authority noting the preface of Channell J judgment was "..I am not altogether satisfied with the decision I am about to come to in this case. I think it is arguable." Ultimately, the appellants argue, the judge in the case wrapped up the extra 5% element with other elements which were increases in salary and decided it should be treated in the same way. The appellants also point out that *Edwards v Roberts* the Court of Appeal was lukewarm about *Smyth* – the courts below had felt obliged to apply *Smyth*. But, while *Smyth* may not be the most compelling authority, it draws its authority from the Court of Appeal's decision from *Bell v Gribble* and remains authority nevertheless; the Court of Appeal in *Edwards v Roberts* chose to to distinguish rather than overrule it and the case did not receive any detailed comment by the Supreme Court when mentioned in *Forde v McHugh*.

177.Two main issues emerge for resolution from the above survey of the case-law and the parties' submissions.

Necessity for receipt and how does it apply in a case of redirection?

178. While HMRC argue that receipt is not a necessary component of earnings giving the example of an employee who has assigned future non-contractual bonuses; they would be as much earnings of the employee as if he or she had received money directly) the authorities (e.g. *Tennant v Smith*) do point to a requirement that money or money's worth is received. If it were the case that all that was relevant was the source of the amount there could any number of payments to third parties which would be caught as earnings because they can be said to derive from an employee's employment but which are clearly not earnings– e.g. a payment from an employer to a third party supplier for materials or equipment the employee needed to do their job). However when it comes to cases of redirected earnings it is inherent in the concept of redirection that "physical receipt" by the employee is not necessary – if it were the notion of redirected earnings would be meaningless; it would cover every situation where an employee who had physically received their earnings themselves then did something with it.

179. One way of reconciling these two propositions (that the employee must have received something, and that situations of redirected earnings are possible in which case the earnings may not physically have been received by the employee) is to accept that while there must be receipt, the notion of receipt can be viewed as covering situations beyond physical receipt where the employee has some form of rights or interest in the sum. This could range from "entitlement" at one end of the spectrum to something looser such as an allocation, earmarking or attribution of a sum to the employee. Although in the particular facts of e.g. *Smyth v Stretton* and *Heaton v Bell* the relevant rights appeared to be contractual that does not appear to be a pre-requisite.

180. Another angle from which to approach the matter is to note the point picked up on by the Court of Session's decision in *Murray*, and in *Smyth* as regards the need for the employee's agreement or acquiescence. This point also underlay the House of Lords' analysis in *Heaton v Bell* where it was noted that the employee had agreed to the deduction from his salary. However rather than being an indicator in and of itself, in my view, it confirms the need for it to be established that the employee has some form of rights or call over the sum in issue, the fact an employee agrees or acquiesces to the employer doing something with an amount in relation to which he or she has no interest or rights would be meaningless. In other words the need to seek out agreement or acquiescence only makes sense when it is reflective of the employee's prior rights or interest – but it cannot turn something into earnings which was not earnings in the first place.

181. Whether there is an entitlement to the sum or some other means by which the employee can be said to have rights or an interest in is therefore relevant in any analysis of whether sums have been redirected. Although HMRC point to non-contractual bonuses and gratuities paid to employees clearly being earnings despite the lack of entitlement the point is one of timing in that it is not until the money ends up in the employee's hands and the bonus or gratuity then belongs to the employee that the entitlement or interest arises. If a non-contractual bonus or gratuity was said to be redirected then there would need to be some point in time when it was

established that the taxpayer was entitled or had rights over to the sum sought to be redirected. That is a separate issue of the source of the payment and whether that arises from the employment or not.

182. Therefore while it is clear cases of redirected earnings may arise the necessity for receipt is not eliminated but modified. It must be established the employee has some rights or interest in the sum said to be earnings such that their agreement or acquiescence in how the sum is deployed is relevant. The rights or interest, may but need not necessarily entail, a contractual entitlement.

Test for redirection: HMRC's argument that all that is required is to show that "but for payment to the third party the money would go to employee as remuneration"

183. HMRC accept it is not enough that sums *could* have been paid as remuneration (which must be correct because otherwise, as the appellant points out, any money in the company would then be earnings as directors could always agree to pay themselves more), but argue that if it can be shown that the payment *would* have been paid as remuneration then it amounts to redirected earnings.

184. The reference to this test emerges from Lord Hanworth MR's analysis of why *Edwards v Roberts* was distinguishable on the facts from *Smyth v Stretton*. He certainly regarded it as relevant that *Smyth v Stretton* [the masters] "would have been paid a larger sum but for the fact that the Governors intended and decided to start [the fund]…". I agree with appellant however that this circumstance is something that may well be present when a redirection of earnings has taken place – but it cannot be determinative. While it might be possible to infer from the fact the payment "would have been paid as bonus but for…" the redirection that the employer viewed the employee as having some kind of rights to it that does not mean the amount was *actually* subject to the employee's rights or interest such that it was earnings of the employee prior to redirection. In other words the fact there are earnings in that hypothetical world of what would have happened does not satisfy the need to show the employee's rights or interest in real word of what did happen.

185. In summary my conclusions on the legal propositions relevant to the redirection issue are:

> (1) Source (the question of whether the sum is from earnings) is a necessary but not sufficient condition for something to be earnings.
>
> (2) In situations where there is not a physical receipt of money or money's worth the employee must have some rights or interest over the money or money's worth such that the issue of the employee's agreement or acquiescence becomes relevant– that may, but need not necessarily, entail a contractual entitlement.
>
> (3) Whether there has been a redirection of earnings will depend on construing all the facts and circumstances surrounding what was agreed between the employer and employee as regards the sums. The fact that a

sum would have been paid as earnings but for the redirection of the sum is not determinative of whether the sum is earnings.

2) Case law on *Antoniades / Autoclenz* issue: Whether as a matter of law is the tribunal able to ignore documents where parties never seriously intended them to have practical effect

186. This next section arises out of HMRC's arguments, that as a matter of law 1) the EBT and sub-fund documents, which they say purported to confer discretionary powers on the trustees and 2) the documents they say purported to create a loan between the trustees and the directors are to be ignored as the parties never seriously intended them to have practical effect. In reality the trust was a bare trust; the loan was not a real loan. HMRC rest these arguments principally on the House of Lords' decision in *Antoniades v Villiers* and the Supreme Court's decision in *Autoclenz v Belcher* [2011] UKSC 41. As confirmed in correspondence with the appellant further to the appellant's request, HMRC do not allege "sham" in the *Snook v London & West Riding Investments Ltd.* sense of acts done or documents executed by which the parties thereto intend to deceive third parties or the court as to the true nature of their legal relationship. No suggestion is made of dishonesty or an intention to mislead by one or other of the parties to the documents but that does not matter to HMRC's case which is that *Snook* sham is not the only situation where a court may disregard the documents parties have entered into.

187. The appellant submits HMRC's arguments are not sustainable on those cases as properly interpreted; as HMRC have confirmed, they do not allege sham the legal documents that were effected reflect the true state of the parties' legal relationships.

188. The question then is whether the case-law supports HMRC's view that there is a means by which documents may be disregarded which does not depend on dishonesty or any intention to deceive and with that issue in mind I now turn to the decisions the parties referred me to.

189. The facts of *Snook v London & West Riding Investments Ltd* [1967] 2 QB 786 concerned an action for conversion by Mr Snook in relation to a car that the defendant finance company had repossessed. The defendant had entered into a transaction with another finance company (Auto Finance) who themselves had transacted with the original finance company who had lent Mr Snook the car on hire-purchase. One of the issues which arose was whether the defendants were seeking to enforce documents arising from these transactions which were a sham.

190. In the county court the judge found that although the transaction documents between the defendant and Auto Finance were, in form, a sale and re-letting, they were a sham to cover up an illegal loan of money on the security of goods; this was the case even though the judge found the defendants were innocent of any irregularity by which the deal was carried out. The judge found in favour of Mr Snook.

191. The Court of Appeal (Diplock and Russell LJJ majority, Denning MR dissenting) allowed the appeal, the majority concluding the executed documents were not a sham.

Diplock LJ (at pg802 C-F) having described the word sham as "popular and perjorative" set out his view of what it meant in legal terms as follows:

> "I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. But one thing in clear in legal principle, morality and the authorities (…*Yorkshire Railway Wagon Co v Maclure and Stoneleigh Finance Ltd v Phillips*) that for acts or documents to be a "sham" with whatever legal consequence follow from this, all the parties thereto must have a common intention that the acts or document are not to create the legal rights and obligations which they given the appearance of creating. No unexpressed intentions of a "shammer" affect the rights of a party whom he deceived…."

192. While Russell LJ did not use the term sham he considered the question of what it took to enable a court to hold that a transaction was intended to mask a loan noting (at pg 804D) "the court must find that both parties to the transaction so intended".

193. As the county court judge had made an express finding that the defendants were not parties to the sham the majority's view was accordingly that Mr Snook's contention of sham failed. Denning MR's dissented on the basis although the defendants were not party to the sham, Auto Finance acted as their agents and the defendants were accordingly answerable as principal to the conduct of their agents.

194. In *Antoniades v Villiers and another* [1990] 1 AC 417 the question before the House of Lords was whether agreements were a lease or a license (which was relevant to whether the young unmarried couple were tenants and entitled to protection under the Rent Acts). The landlord, Mr Antoniades, had let the flat to them on two contemporaneous and identical agreements termed licenses. The agreements emphasised the lack of exclusive possession and that Mr Antoniades was entitled to use the rooms together with the licensee or permit others to use the rooms too. The flat had one bedroom, a sitting room with a bed-settee, a fold-up bed table, a kitchen and bathroom. The House of Lords reversed the Court of Appeal's decision (Bingham and Mann LJJ) that the agreements were licenses.

195. Lord Bridge's view (pg 454 E-F) was that the clause:

> "…could be seen in all the relevant circumstances to be repugnant to the true purpose of the agreement. No-one could have supposed those provisions were ever intended to be acted on. They were introduced into the agreement for no other purpose than as an attempt to disguise the true character of the agreement which it was hoped would deceive the court and prevent the appellants enjoying the protection of the Rent Acts…"

196. In his judgment Lord Templeman noted the background to the Rent Acts, the significance of whether something was a lease or license and that the parties could not contract out of the Acts. In his view (pg 458 at G):

> "…the court must consider the surrounding circumstances, including any relationship between the prospective occupiers, the course of the negotiations and the nature and extent of the accommodation and the intended and actual mode of occupation of the accommodation."

197. He went on to find that the clause in issue was not a genuine reservation – Mr Antoniades did not genuinely intend to exercise the powers – it was only intended to deprive the cohabitees of the protection of the Acts. The facts had to prevail over language in order that the parties could not contract out of Rent Acts. It was apparent that the clause was a pretence from its terms and negotiations.

198. Lord Ackner's judgment summarised the issue as being: What was the substance and reality of the transaction? In reality the agreements created a tenancy although the landlord sought "vigorously to disguise them as mere licences to occupy the flat".

199. Lord Oliver prefaced his speech with commentary around reconciling the objective of keeping property gainfully occupied and avoiding application of Rent Acts. The critical question was not how the arrangement was presented in documents but what is the true nature of the arrangement. In his view (at Pg 467H) was there was an "air of total unreality about these documents…" The clauses could not:

> "…be considered as seriously intended to have any practical operation or to serve any purpose apart from the purely technical one of seeking to avoid the ordinary legal consequences attendant upon letting the appellants into possession at a monthly rent".

200. He read the first instance judge's find that the licenses were artificial transactions designed to evade the Rent Acts as "a finding that they were sham documents designed to conceal the true nature of the transaction."

201. Lord Jauncey's judgment (at pg 475E-F) set out that it was permissible to look at how the parties acted after the agreement:

> "for the purposes of determining whether or not part of the agreement are a sham in the sense that they were intended merely as "dressing up" and not as provisions to which any effect would be given."

202. Having examined the factual circumstances of the flat and how it was used he was – driven to conclusion that:

> "parties never intended that [relevant clause] should operate and that it was mere dressing up in endeavour to clothe the agreement with a legal character which it would not otherwise have possessed".

203. In *Autoclenz Ltd v Belcher and others* the question before the Supreme Court was whether car valeters fell within the definition of "worker" for the purposes of National Minimum Wage Regulations 1999. This issue depended in part on whether the agreement between the car valeter and Autoclenz was a contract of employment.

204. Lord Clarke who gave the court's decision – with which the other JJSC, (Lord Hope, Lord Walker, Lord Collins, and Lord Wilson) agreed, identified the issue at [17] as involving:

> "consideration of whether and in what circumstances the ET may disregard terms which were included in a written agreement between parties and instead base its decision on a finding that the documents did not reflect what was actually agreed between the parties or the true intentions or expectations of the parties"

205. He regarded the essential question as being what were the terms of the agreement. The position under the ordinary law of contract was in his view correctly summarised by Aiken LJ's decision in the Court of Appeal's decision in the matter. That summary noted that once it was established the written terms of a contract were agreed the only way to argue a contract contained a term inconsistent with the express terms was to allege the written terms did not accurately reflect true agreement of the parties – generally the allegation would be that there was a continuing common intention to agree another term, which intention was outwardly manifested but because of a mistake (common or unilateral), the contract inaccurately recorded what was agreed. If such a case was made out the court could grant rectification.

206.Lord Clarke then highlighted at [21] and [22] of the decision that there was a body of case law in which a different approach was taken in the context of employment law contracts where the focus was on reality and where written documentation may not reflect reality of the relationship. Referring in particular to the EAT's decision in *Consistent Group v Kalwak* [2007] IRLR 560, the Court of Appeal's decisions in *Firthglow Ltd v Szilagyi* [2009] ICR 835 and *Autoclenz* and noting at [23] that the historical context in which those decisions were set included *Snook* (he sets out Lord Diplock's definition of sham quoted above at [191]), he said:

> "I would accept the submission made on behalf of the claimants that, although the case [*Snook*] is authority for the proposition that if two parties conspire to misrepresent their true contract to a third party, the court is free to disregard the false arrangement, it is not authority for the proposition that this form of misrepresentation is the only circumstance in which the court may disregard a written term which is not part of the true agreement. That can be seen in the context of landlord and tenant from *Street v Mountford* [1985] AC 809 and *Antoniades v Villiers* [1990] 1 AC 417, especially per Lord Bridge at p 454, Lord Ackner at p 466, Lord Oliver at p 467 and Lord Jauncey at p 477. See also in the housing context *Bankway Properties Ltd v Pensfold-Dunsford* [2001] 1 WLR 1369 per Arden LJ at paras 42 to 44."

207.Having identified at [28] that as regards *Kalwak* that the reasoning of Rimer LJ in the Court of Appeal and Elias J (as he then was) who was sitting in the EAT, was inconsistent he rejected the application of the approach of Diplock LJ in *Snook* (that to find a contract was in a part a sham required a finding that both parties intended to paint a false picture as to the true nature of the obligations). In Lord Clarke's view this was "too narrow an approach to an employment relationship of this kind". Instead he "unhesitatingly" preferred the approaches of Elias J in *Kalwak,* and the Court of Appeal (Smith and Sedley LJJ) in *Szilagyi* and Aikens LJ in *Autoclenz.*

208.I do not quote all of the numerous extracts referred to from those decisions; the common thread in each of those endorsed approaches, and in the context of landlord and tenant (*Antoniades v Villiers*) is that the wider basis for disregarding written terms emerges from the task of establishing what the true agreement was, and to discover what the actual legal obligations of the parties were. In this regard he specifically agreed with Aikens LJ's warning against focussing on the parties' "true intentions" or "true expectations" and Sedley LJ's recognition that "the factual matrix in which the [employment] contract is cast is not ordinarily the same as that of an arm's length commercial contract". Contrasting the type of case that *Autoclenz* was and the ordinary commercial dispute he quoted at [34] Aikens LJ's acceptance that those offering work or services were frequently able to dictate the written terms which the other party has to accept and that:

> "…In practice, in this area of law, it may be more common for a court or tribunal to have to investigate allegations that the written contract does not represent the actual terms agreed and the court or tribunal must be realistic and worldly wise when it does so."

209.He concluded at [35]:

> "So the relative bargaining power of the parties must be taken into account in deciding whether the terms of any written agreement in truth represent what was agreed and the true agreement will often have to be gleaned from all the circumstances of the case, of which the written agreement is only a part. This may be described as a purposive approach to the problem. If so, I am content with that description."

Disputed issues

210.Returning to the matters in contention and in particular whether there was a basis to disregard written terms that was no dependent on showing an intention to deceive or mislead, according to the appellant, what the cases revealed, was a three-fold classification 1) cases of sham in the *Snook* sense – i.e. conspiracy between parties to a bi-lateral or multi-lateral document to deceive other as to their true relationship 2) cases such as *Antoniades* and *Autoclenz* where one of the parties includes terms or provisions with the effect of deceiving third parties as to true legal effect of document and 3) cases where the terms of document and effect were respected but the label of document or relationship created is wrong (resulting in a labelling issue) e.g. cases on whether an agreement is a lease or a license or on whether a charge is fixed or floating. These are cases where the document does precisely effect true agreement but where language of document superficially indicates falls into one legal category but when properly analysed falls into another. In the appellant's submission only the third category was available as an argument to HMRC but their case is not borne out on the facts. (The trustee knew the difference between the trusts here and bare trusts. Parties understood the concept of lending money. The fact the trustee was unlikely to recall loans unless this was in the interests of beneficiaries nothing more than them complying with the terms of the trust).

211.In my judgment the cases relied on by HMRC do confirm that there exists, in principle, a means by which written terms of an agreement may be disregarded

without having to show an intention to mislead or deceive by both or even one of the parties.

212. While I agree with the appellant that the speeches in *Antoniades* are replete with references to pretence and disguise, the decision must viewed in the light of the Supreme Court's decision in *Autoclenz* which makes it abundantly clear that it is not necessarily the case that parties must have an intention to deceive / mask in order to disregard a term in a written contract and that certain terms may fall by the wayside if on an enquiry as to what the true agreement was they are not included in that true agreement. In reply the appellants refined their case; what needed to be shown was some kind of subjective element to the effect that the term was not intended to apply (which might or might not be dishonest). But, as pointed out in the passage from Aikens LJ's judgment which Lord Clarke quoted and endorsed, what the parties privately intended or expected may be evidence of what objectively, was agreed. Ultimately though what matters is what was agreed. (That observation must also be heeded in relation to the ways in which HMRC has, at some points, put its case. They argue for instance that it was the intention and understanding of all concerned that payments to the EBT, or the application of payments on the terms of the sub-funds would be applied as directed by the relevant directors and that it is therefore permissible to find an implied agreement. Again that might be relevant to establishing, objectively, that there was an agreement but it is not enough by itself).

213. In any case the parties disagree on whether the approach advocated by Lord Clarke of seeking to ascertain the true agreement has a restrictive application. The appellant suggests, contrary to HMRC's view, that the approach is only relevant in fields where there is unequal bargaining power such as certain landlord and tenant or employment situations. There is some support for this submission. See for instance Lord Clarke's reference (at [28] of his decision set out at [207] above) which refers to the approach being too narrow an approach "to an employment relationship of this kind", his endorsement at [33] of Sedley LJ's agreement of what Aikens LJ said about the different context of employment, and at [34] where he highlighted Aikens LJ's agreement with Smith and Sedley LJ's view that the circumstances in which contracts relating to work or services are concluded are often different from those in which commercial contracts are concluded).

214. However Lord Clarke's conclusion at [35] (that bargaining power had to be "taken into account") clearly indicates to me that inequality of bargaining power is not a precondition to embarking on the task of ascertaining the true agreement but a factor to be considered "in deciding whether the terms of any written agreement in truth represent what was agreed…". So, a court will look at what the true agreement is; but where there is unequal bargaining power a court will be wary of not necessarily regarding the written agreement as conclusive of the true agreement reached.

215. HMRC further argue that the principle does not only apply where there is unequal bargaining power. The essence is that where documentation which is produced which is not the product of arm's length commercial negotiation but is the product of lawyers or accountants designed to take the benefit or avoid the burden of statutory

provisions the court must be astute to ascertain whether the written documents represent the true agreement.

216.It is correct that one of the paragraphs of Elias J's decision in *Kalwak* that Lord Clarke found "considerable force in" stated:

> "57. The concern to which tribunals must be alive is that armies of lawyers will simply place substitution clauses, or clauses denying any obligation to accept or provide work, in employment contracts, as a matter of form, even where such terms do not begin to reflect the real relationship…."

217. But, I cannot glean from this or from any of the other cases I was referred to any principle that special rules will apply to agreements drafted by lawyers or accountants with a particular aim in mind. The task will remain ascertaining what the true agreement is between the parties in question. As explained in *Autoclenz*, once a contract is agreed the only way to argue the terms are different are the avenues set out in Aikens LJ's summary (see [205] above). Under the normal rules relating to formation of contact whether it is in writing, oral or implied from conduct and on interpretation of contracts it will not matter what one party thought they agreed to if the other party did not agree too.

218.In their skeleton argument HMRC also referred to the judgment of Arden LJ's statement in *Bankway Properties Ltd v Pensfold-Dunsford & another* [2001] EWCA Civ 528 where, following her consideration of *Snook* sham she stated:

> "However… there is a variant …where a question arises whether an agreement is not intended to have the effect stated but is intended to evade the operation of a statute out of which the parties cannot contract"

219.I note this case was described in Lord Clarke's judgment in *Autoclenz* as a case arising out of the housing context but in so far as it is relied on by HMRC to evince a wider principle this was not elaborated on and it was not clear to me in any event that the variant referred to encompassed all statutes or to particular statutes in which case it was then not then clear to me that ITEPA, as regards tax, or SSCBA, as regards NICs, were statutes which the parties were unable to contract out of.

220.Summarising the relevant legal propositions to be applied I conclude:

> (1) It is possible to disregard the terms of a written agreement following an analysis of what the true agreement is.
>
> (2) In so doing it is not necessary to establish dishonesty, an intention to deceive or disguise, or a subjective intention that the term was not intended to apply for the provision to be disregarded (although those matters may be relevant); the task is one of identifying what the true agreement is.

(3) The principle is not restricted to employment or landlord and tenant situations but does not affect the construction of arms' length commercial contracts.

(4) The tribunal should take inequality of bargaining power into account. The greater the disparity, the more astute the tribunal should be in investigating whether the written contract represents the actual terms agreed.

(5) There are no special rules for agreements drafted by lawyers or accountants.

3) The Ramsay approach

221. HMRC's next line of attack rests on the *Ramsay* approach which is set out in more detail in the section below. The essence of *Ramsay* as described in later cases and as HMRC point out is to apply a purposive construction of the statutory provision in question to a realistic view of the facts.

222. HMRC's submission is that even if the payments to the EBTs were not payments to the director, and even if the powers conferred on the trustees of the EBT were discretionary, nevertheless construing the word "earnings" in the legislation purposively, payments to the EBT or the application of monies to sub-trusts were earnings because on the facts there was no realistic prospect of the discretion being exercised other than at the direction of the relevant director. Referring to *UBS/Deutsche Bank* - a realistic view of the facts may where appropriate require the tribunal to disregard elements that have been inserted into a transaction without any business or commercial purpose. Referring to *Scottish Provident* their submission is that, at most the risk the discretion would not be exercised towards the director was a low one and is to be disregarded. Further or alternatively, given the trustees invariably followed the relevant directors' instructions the payment of money into the EBTs and/or sub funds should be viewed as a payment to the directors (by analogy with *Aberdeen Asset Management Plc* a case which is discussed later). HMRC argue the above principles apply equally to terms of the loan agreements purporting to confer on trustees a right to demand repayment on one month's written notice.

223. It did not appear to me that the appellants took issue with the general principles underlying the *Ramsay* approach, rather their case was that the approach did not work in the way HMRC suggested it when applied to the facts of these appeals, and that the cases where the approach was applied successfully by HMRC could be distinguished on the facts.

Ramsay, UBS and BMBF

224. The so-called *Ramsay* approach was most recently discussed in the Supreme Court's decision in *UBS and Deutsche Bank v RCC* [2016] UKSC 13. The judgment was given by Lord Reed JSC with whom Lord Neuberger PSC and Lord Mance, Lord Carnwarth and Lodge Hodge JJSC agreed.

225. At the section [61] to [68] dealing with *The Ramsay approach* Lord Reed set out the evolution of the approach in the *Ramsay* decision and in subsequent House of Lords decisions. He noted the significance of *Ramsay* being in firstly its extension of a purposive approach to statutory construction to tax cases and secondly in establishing that the analysis of the facts depended on that purposive construction of the statute.

226. In *BMBF* the House of Lords summarised the position at [32] as:

> "…to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description…"

227. As regards statutory construction, Lord Reed noted at [64] a statement of Carnwath LJ in the Court of Appeal in *BMBF* that taxing statutes "generally draw their life-blood from real world transactions with real world economic effects". He went on to say:

> "Where an enactment is of that character, and a transaction, or an element of a composite transaction, has no purpose other than tax avoidance, it can usually be said, as Carnwath LJ stated, that "to allow tax treatment to be governed by transactions which have no real world purpose of any kind is inconsistent with that fundamental characteristic." Accordingly, as Ribeiro PJ said in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46; (2003) 6 ITLR 454, para 35, where schemes involve intermediate transactions inserted for the sole purpose of tax avoidance, it is quite likely that a purposive interpretation will result in such steps being disregarded for fiscal purposes. But not always."

228. At [65] he noted various examples of authorities where:

> "…the court considered the overall effect of the composite transaction, and concluded that, on the true construction of the relevant statute, the elements which had been inserted without any purpose other than tax avoidance were of no significance. But it all depends on the construction of the provision in question. Some enactments, properly construed, confer relief from taxation even where the transaction in question forms part of a wider arrangement undertaken solely for the purpose of obtaining the relief. The point is illustrated by the decisions in *MacNiven v Westmoreland Investments Ltd* [2001] UKHL 6; [2003] 1 AC 311 and *Barclays Mercantile* itself."

229. As regards the edict to view transactions realistically, Lord Reed clarified this had nothing to do with concept of sham as explained in *Snook* at [68]. He emphasised the task was to analyse the facts in the light of the statutory provision being applied:

> "If a fact is of no relevance to the application of the statute, then it can be disregarded for that purpose. If, as in *Ramsay*, the relevant fact is the overall economic outcome of a series of commercially linked

> transactions, then that is the fact upon which it is necessary to focus. If, on the other hand, the legislation requires the court to focus on a specific transaction, as in *MacNiven* and *Barclays Mercantile*, then other transactions, although related, are unlikely to have any bearing on its application."

230. At [69] onwards Lord Reed discussed *Scottish Provident* (which HMRC refer to and which the appellant seeks to distinguish), quoting the House of Lords' decision (Lord Nicholls) regarding the situation where the effect of a composite transaction was to be disregarded where parties had deliberately included a commercial irrelevant contingency, creating an acceptable risk that the scheme might not work as planned :

> "…We would be back in the world of artificial tax schemes, now equipped with anti-*Ramsay* devices. The composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties, it might not work as planned."

231. From the above I draw the following issues to consider:

(1) Is the enactment concerned with "real world transactions with real world economic effects" – if so if a transaction or element of transaction has no purpose other than tax avoidance then it will be inconsistent with that fundamental characteristic.

(2) A linked question is whether the legislation requires the court to focus on the overall outcome of a series of commercially linked transactions or on a specific transaction.

(3) It should be considered how the scheme was intended to operate. Commercially irrelevant contingencies should be disregarded.

(4) The question is ultimately whether the scheme answers the statutory description.

Was there a Payment of earnings for PAYE purposes?

232. HMRC say that if there were "earnings" on a Ramsay approach then there was clearly a payment for PAYE purposes. Arguing by analogy to *Aberdeen Asset Management plc v HMRC* [2013] CSIH 84 [2014] STC 438 the trustees invariably followed the relevant directors' instructions the payment of money into the EBTs and/or sub-funds should be viewed as a payment to the directors.

233. The appellant relying on *DTE Financial Services v Wilson* [2001] STC 777 argues the term "payment" ordinarily means an actual payment i.e. a transfer of cash or its equivalent, not simply the discharge of an employer's obligation to the employee. That case concerned a scheme to avoid liability for NICs and to defer the operation of PAYE in respect of bonuses using the transfer to directors of a contingent reversionary interest under a settlement. In discussing the application of the *Ramsay* approach to payment Jonathan Parker LJ stated:

> "the concept of payment is a practical, commercial concept. In some statutory contexts the concept of payment may (as Lord Hoffmann pointed out in *MacNiven*) include the discharge of the employer's obligation to the employee, but for the purposes of the PAYE system payment in my judgment ordinarily means actual payment: ie a transfer of cash or its equivalent."

234. *Garforth v Newsmith Stainless Steel Ltd* [1979] STC 129, was a decision of the High Court which the appellants referred to for the proposition that when money is placed unreservedly at the disposal of an employee, that is equivalent to payment (and conversely therefore that when money is not unreservedly at his disposal that is not a payment). The decision concerned two directors of a taxpayer company who were voted bonuses. The bonuses were credited to the directors in the directors' loan accounts and the question was whether there had been a payment of those bonuses for PAYE purposes by the company. Walton J's decision explained:

> "…The argument really is, on the one hand, that all that happened was that the balances in the directors' loan accounts with the Company were increased without them getting anything out of it unless and until they withdrew their money from the Company and, on the other hand, that the money was placed unreservedly at their disposal, they could have had it at any moment they chose, and that amounts to payment. As between those two contrasting views, I have no hesitation at all in saying that, in my judgment, when money is placed unreservedly at the disposal of directors by a company that is equivalent to payment"
>
> …
>
> If moneys are placed by one person unreservedly (and I think that for present purposes I do not have to go very deeply into that qualification, for the simple reason that, as has already been noted, it was found as a fact by the Special Commissioners that payment of the sums standing to the credit of the current accounts would have been made had the direct demanded payment from the Company, so there is no question here of any fetter whatsoever) at the disposal of any other person, that, I think, must be equivalent to payment. Mr. Koenigsberger has said: But supposing, before the directors actually chose to draw their money out, the Company had gone into liquidation, what would the position be then? It seems to me that the answer to that is really the same answer as would be given in the case of a director taking the money out and putting it into a bank which later went into liquidation. Where a director chooses to leave his money seems to me to be a matter entirely of his own choice. If, of course, it is not a matter entirely of his own choice - if for some reason, the money was not placed unreservedly at his disposal - then I think that very different considerations would arise. After all, if the company were to put money into the account with a note on it saying that it is to be paid out only as and when the board of directors decide, or as and when the company in general meeting passes a resolution to that effect, or some other qualification of that nature, then the money would not be reservedly at the disposal of the director, he could not do with it what he liked and we would be a long way away from payment"

235.The appellants also referred to the Special Commissioners' decision in *Sempra Metals Ltd v HMRC* [2008] STC (SCD) as a case where the proposition of amounts having to be placed at the employee's unreserved disposal was applied in the context of discretionary trusts. The Special Commissioners rejected HMRC's contention that the payments to the trusts were placed unreservedly at the disposal of the employees on the basis this ignored the existence of the trusts (it was accepted the trustee was likely to comply with reasonable requests but the trustee was not a cipher who did what it was told). The appellants argue that unless and until the step of the trustee for example appointing out money to the employee absolutely the money was not at the beneficiary's disposal.

236. As mentioned above HMRC refer to *Aberdeen Asset Management plc v RCC.* The case involved a composite scheme culminating in transfer of shares into a "money box" company to employees. The Court of Session (Outer House) held the transfer to the employee of shares was a payment for PAYE purposes. The Lord President (Gill) held the Upper Tribunal had erred by deciding the question on the basis of the formal legal rights that flowed from the interposition of the company.

237.Lord Drummond Young's judgment considered *Garforth* and *DTE* at [38] which in his view read the word "payment" too narrowly concentrating on strict legal form whereas under the *Ramsay* approach the transaction had to be viewed realistically as a commercial whole. His interpretation of *Garforth* was that Walton J considered it was the practical ability to make use of funds that was important.

238.At [34] he stated:

> "In considering what amounts to payment for the purposes of the PAYE legislation, it is important in my opinion to bear in mind that money is a medium of exchange. In practical terms, therefore, the crucial question is whether funds have been placed in a position where as a practical matter they may be spent by the employee as he wishes; it is at that point that the employee can be said to obtain the benefit of those funds. If the PAYE legislation is construed purposively it is in my view obvious that it is such a benefit that is to be taxed. For this purpose it is not appropriate to deconstruct the precise legal nature of the employee's rights, drawing fine distinctions according to the methods that he must adopt in order to use the funds for his benefit. The fact that the employee has practical control over the disposal of the funds is sufficient to constitute a payment for the purposes of the legislation."

239.Lord Glennie agreed with the reasons of the other judges on the panel.

240.As with *Murray* the decision in *Aberdeen Asset Management* is not strictly binding on this tribunal but in my judgment its treatment of the relevant legislation and the test it puts forward of whether the employee has practical control over the funds is correct and should be followed.

241.As regards *Garforth,* as Lord Drummond Young explained the judge in *Garforth* could be understood as being concerned with the practical ability to use funds. As

regards the example given by Walton J of a sum being paid out only as and when a board of directors or subject to some other qualification of that nature not being unreservedly at the director's disposal to do with as he liked and thus being a "long way away from payment" I note this was in an obiter section of the judgment as on the facts of that case there was no question of a fetter arising. I note *Garforth* does not deal with the situation where the board of directors, would be likely to comply with the director's wishes, and that as regards the particular facts it was found that payment from the company would have been made to the director if payment had been demanded. The term "unreservedly" is to be understood in a practical non-technical way (i.e. it was good enough that the director could have demanded it if he or she wanted it).

242. As regards *DTE,* rather than construing payment too narrowly it appears to me that in deciding that the concept of payment was a practical commercial concept the Court of Appeal was not seeking to restrict the term but to make it clear it was susceptible to a *Ramsay* approach (under the distinction between legal concepts and practical and commercial concepts which was being applied at the time under the law post *McNiven v Westmoreland*). It followed that a conclusion that there was an actual transfer of cash or its equivalent could be reached even though there was for instance a composite transaction so long as when it was realistically appraised it was viewed as a payment of cash or its equivalent. On that view there is no conflict between the view that payment means a transfer of cash or its equivalent and facts which disclose that an employee has practical control of the funds (because in having such control they will, realistically appraising the fact of practical control have been transferred cash or its equivalent).

243. *Sempra* was a decision of the Special Comissioners and as such is of persuasive authority but was not dealt with *Aberdeen Asset Management.* However I note that *Sempra* did not deal with the issue of whether in circumstances where the trustee was likely to exercise their discretion a certain way (and whether the fact there was a small chance trustee would not comply could be disregarded) there could be considered to be a payment for PAYE purposes.

(1) Application to facts: Redirection

244. In HMRC's submission, when the evidence is evaluated, the various board minutes and the answers given by the appellant's witnesses it is clear there was a redirection of earnings and that the facts of the case fall on the *Smyth v Stretton* side of the line. The directors determined the payments that were to be made, the payments were in respect of their services qua directors and the directors agreed to payment being made to the EBTs. In essence they argue the directors awarded themselves bonuses and redirected those bonuses to the trust structure.

245. HMRC refer in particular to the following:

> (1) The appellants viewed EBT as "an employee bonus arrangement" as can be seen for instance from the board minutes of the OCO board meeting 13 June 2005 (at [21] above).

(2) Requests were made by the appellants to the trustees to establish sub-funds "in respect of the services of" the relevant directors (for instance as set out in Toughglaze's board minute of 13 July 2004 (referred to at [67]).

(3) The witnesses were clear the sums paid into the EBTs derived from director's employment. Mr Harrison in his evidence-in-chief stated the "proposed awards intended to be in recognition of the services provided by key employees and their contribution towards success of the company during the period 30 June 2005" and Mr Varsani in his that the sums were "to reward key management…"

(4) Mr Brice's report characterised the contributions to the EBT a being in respect of past service.

(5) There was no real doubt as to proportions in which contributions would be allocated to each director. Board minutes referring to no final decision being made to allocation of bonus were not realistic or accurate – there was no evidence of real consideration to dividing the bonus pool differently: As regards OCO, HMRC refer to Mr Harrison's answers in cross-examination: In relation to 2005 he agreed the directors were to be treated equally and that £100,000 was the appropriate bonus for each of the directors, and that there was never any intention of the any benefit going to anyone other than the key employees (the directors). Mr Varsani's evidence in chef was explicit about the directors being rewarded equally.

(6) It was clear the directors agreed to their bonuses being paid into EBTs, recipients were the only directors and controlling shareholders of company - it was their decision to use the EBT scheme determining the amount the company could afford to pay them.

(7) Further Mr Harrison agreed that if the four directors had not agreed to do the scheme his understanding was they would get £100,000 each, and that controlling the company could have procured a direct payment. The position was no different for 2006. Similarly Mr Varsani's answers indicated he accepted the sum could have been paid directly and would have been paid that way were it not for the scheme.

246. The appellants' response is that none of these matters assist in showing how the directors received an entitlement to money or money's worth: as regards to the board minutes – setting aside a pool of money without awarding it to anyone or providing anyone with a right to that money does not give rise to a payment of earnings. Regarding Mr Brices's report it was not clear how the ex post facto report could impact on what according to HMRC is a matter of fact but in any case it did not advance their case. The EBT trustees were conferred with discretionary powers. Unless and until appointment made to an employee absolutely the most the employee had as a member of a class of beneficiaries was a right to be considered for benefit by the trustees. The EBT contributions were akin to *Edwards v Roberts* contributions to conditional / contingent fund (and the sub-fund appointments did not alter that). As regards receipt, neither the contribution, appointment to the sub-fund or making of loans or investments from sub-fund gave rise to actual money payments, benefits in kind capable of being turned into money. HMRC submission ignored the appellant

companies were separate legal persons. It was of course the case that as directors / shareholders they could vote them themselves more but the tax is not charged on what they could have received, or would have received but on what they did receive.

Tribunal views

247. It is clear that many of the points raised by HMRC ([245] (1) to (4)) miss their mark given the conclusions reached in the legal discussion above (that the source of any payment as is a necessary but not a sufficient condition for the amount to be taxable as earnings, and that is not enough to show that the amount would otherwise have been paid as earnings). The board minutes and witness evidence relied on as showing the payments were linked to the directors' service and that payments would have been paid as bonus do not necessarily mean sums were paid as redirected earnings.

248. Similarly as explained in the legal discussion section some of the appellant's submissions on the contingent nature of the director's interest in the sums once in the EBT are not directly on point. The focus of the question of redirection concerns whether at or before the payment was made to the EBT the directors the directors had some form of rights or call in relation to the sums such that the sums amounted to earnings capable of being redirected in the first place. If the sum was earnings when paid into the EBT then as HMRC point out it is irrelevant what the nature was of what the directors chose to invest their earnings in. (Also in so far as the appellant's submissions are predicated on it being necessary to show either physical receipt or an entitlement that may be as discussed in the legal discussion section be too restrictive a test.)

249. The question is whether there is sufficient evidence to sustain a conclusion that the sums were subject to some kind or right or interest of the directors whether through entitlement, allocation, earmarking, or some such other means and that the directors agreed or acquiesced to these sums being directed somewhere apart from to themselves.

250. There was no evidence or any suggestion the directors were legally entitled to the sums, furthermore there was insufficient evidence that the directors had some other interest whether through the sums being earmarked or allocated to the directors.

251. The clear intention of the appellants was to put an amount of money into the EBT. I am unable to find from the evidence that the company signalled in any way to directors that they had any rights or interest over a specific sum of money such that it then became relevant to seek each of the relevant directors' agreement to putting sums into the scheme.

252. The directors may have individually thought they deserved an equal share – but that is not the same as the company agreeing they were to receive an equal share. And in any case this does not overcome the fact the evidence shows it was the company who made the decisions and that the decision the company made was to use a scheme to "pass value" to the directors. This was not a case where the company set aside

sums for the directors who then agreed that something which could sensibly be thought of as theirs (the named director's) then agreed for such sums to be put into the scheme.

253. As HMRC point out whether a redirection has occurred will depend on the facts. In *Murray Group* a similar scheme was used but the facts indicated that for instance side letters were involved at the same time as salary was negotiated which determined the amount to be contributed to the sub-trust and the terms of the trust. Although these were not specifically considered by the Court of Session in its decision it is possible to see how the amounts were viewed as part of the employee's remuneration package at the outset.

254. My conclusion is that HMRC's argument on the redirection issue fails.

(2) Application to facts: Antoniades / Autoclenz argument in relation to trusts

255. As indicated by the legal discussion above I reject the appellant's argument that it is not open to HMRC, as a matter of law to make the argument that documents may be disregarded even where it has not been shown that one or both of the parties had an intention to mislead as to the true nature of the document or that there was some kind of subjective element on their part to the effect that the term was not intended to apply (whether that was dishonest or not).

256.Having said that when it comes to the application of the *Autoclenz/ Antoniades* approach to disregarding the terms of the trust document that was executed, I agree with the appellant it cannot been be assumed, that that approach may be applied at least on the face of it, to a document which is unilaterally executed such as a trust. Both *Autoclenz / Antoniades* and the cases referred to in them are grounded in situations where the terms within a bilateral agreement were in issue. Neither the approach of searching for a true agreement nor taking into account equality or otherwise of bargaining power makes sense in the context of a trust. I was not referred to any authority which suggested the approach could be so extended and in my view therefore HMRC's challenge based on *Autoclenz / Antoniades* (where it was made clear no allegation of pretence of deceit was made) falls at this hurdle.

257.The following analysis in relation to the question of whether the terms of the trust document relating to discretion or the trust document may be disregarded, and instead the conclusion reached that the sums were held on a bare trust for each of the directors assumes I am wrong in that conclusion and it is possible to apply the approach to the trust document.

258.If it is, then the consideration of bargaining power may, as the appellants suggest, be put to one side as irrelevant. Also, instead of looking to see what the true agreement was, the task would presumably need to be adapted to looking to see what the true intention was on the part of those executing the document.

259.HMRC invite the tribunal to make findings of fact that each of the directors of the appellants, were told and understood EBT and sub-trusts would operate as bare trusts

notwithstanding the documents, and that the trustee shared the directors' understanding on all these points.

260. In furtherance of their submission they also highlight a number of points to do with the way the trust was administered and say the behaviour was inconsistent with any intention to exercise an independent discretion. This is discussed in more detail below at [281].

261. I consider the directors' and trustees' understanding in turn.

Mr Harrison's understanding

262. The answers Mr Harrison gave in cross-examination, which HMRC refer to, reveal Mr Harrison appreciated that even though he accepted the list of beneficiaries in the trust was not limited to the four directors, his understanding of the scheme was that £400,000 was going to four key employees and/or would end up in their family trusts. He agreed the trustee would not do anything unless they asked Mr Harrison what his wishes were. It was not his understanding for instance that the trustee could give money to any charitable body without his knowledge but he accepted this might be technically possible. He did regard the money within the sub-trust as his and his family's which he could "take" if he wished. Contrary to his denial he was informed by PSL that he and the adult beneficiaries would have de facto control (as set out in PSL's letter of 21 June 2005). Mr Harrison's evidence was that he was happy with paying PSL's 12% fee because he knew he would get an interest-free loan.

263. Having considered the totality of Mr Harris' evidence, and the terms of the documents he signed, I am not satisfied however that his understanding could be straightforwardly be summed up, as HMRC submit, being that the trustee had to follow whatever instructions were given. While Mr Harrison did not necessarily understand what a discretionary trust was, he did in my view appreciate that there was an intermediate step of the trustee having to consider the request made and the possibility, albeit technical, of the trustee not acceding to the request. There is nothing to suggest he had taken on board the breadth of the class of beneficiaries and therefore he did not have any concern the money technically might be appointed elsewhere. In my view Mr Harris' answers, and the terms of the documents that were produced for him to consider and sign which emphasised the decision was for the trustees, are more consistent with him accepting that there was formally a request and consideration process to go through, that it was technically open to the trustees to reject his wishes but that there was no serious risk of the request not being complied with than that his understanding was that the trustee had to comply with his instructions.

264. I do not read the reference in the letter of 21 June 2015 to being informed he and the beneficiaries would have "de facto" control as being inconsistent. Rather the term "de facto" is consistent with view that under the law the situation was different, (although the term "de facto" assumed and was consistent with the fact that in all practical likelihood the trustee's discretion would be exercised in the favour of beneficiaries).

265. There being no evidence Mr Harris or the directors were told the EBT would operate as a bare trust notwithstanding the documents I cannot make this finding of fact as HMRC invite me to do so.

Mr Varsani's understanding

266. Although Mr Varsani's evidence indicated that he understood the scheme to involve a trust, and a sub-trust I accept his evidence that he and the other directors were simply following the advice of PSL who they regarded as the experts and they did not understand the purpose of the trusts or sub-trusts. In particular while he appreciated that professional trustees in the Isle of Man were involved he did not know what a trust was or what the obligations of a trustee were. In relation to the sub-trust his expectation was the money would be kept for his benefit but that he would have to request it before he could get it. He did not appear familiar with the breadth of the class of beneficiaries and consequently did not have any expectation that anyone other than the directors, children or spouses would benefit.

267. There is nothing on the evidence or the answers given to me which suggests that the directors of Toughglaze were told or understood that notwithstanding the trust documents they had control over the funds and the trustees were obliged to comply with their instructions (as distinct from an understanding that the trusts / sub-trusts were ultimately for the benefit of them and their families and that the trustees would be likely to comply with their requests). I therefore reject HMRC's submission to that effect.

Operation of trust and trustee's understanding

268. Mr Schofield's evidence covered both his role as a trustee, what happened generally at various stages of the scheme as well what happened in relation to the EBTs and sub-funds as regards the particular appellants in this appeal.

The declaration of sub-trusts

269. Mr Schofield's evidence explained that a request to the trustees to consider allocating certain amounts to sub-funds was given "some consideration" by the trustees. Further to the Tribunal's question he elaborated on this further as follows:

> "By consideration I think we knew who the key directors were, so the consideration was basically: is this what they expected? Are these people key employees? Is in accordance with the settlor's wishes? Basically does everything appear as it should be?"

270. The trustee recognised that the Settlor had created the EBT as part of its wider reward strategy for their employees and that the EBT was only part of that strategy as other employees would have rewards delivered in different ways. Mr Schofield could not identify a situation where the trustee did not comply with the company's wishes. He understood the trustee had the same fiduciary duties in respect of all beneficiaries and that these duties were not solely derived from the trust deed, but were duties such as to act in the best interest of beneficiaries derived from trust law. The trustees did

not regard each of the directors as a Settlor. If the trustee had any questions or needed further clarity in respect of any recommendations made, the trustee referred solely to the settlor company who was the UK company that created the EBT.The trustees saw no reason not to comply with reasonable requests made by the settlor of the EBT. As the trustee, Mr Schofield accepted the appropriateness of the recommendation; it came from the Settlor.

271.The trustees were typically already familiar with who the beneficiaries were, typically being the directors, as a result of their due diligence process. Following the execution of the Deed of Appointment which resulted in the creation of the sub-fund, a new bank account was opened for the sub-fund. From the trustees' point of view this was both administratively a lot easier and also seemed appropriate. This was, therefore, part of the process of creating the sub-funds and the result was that the cash appointed to the subfund was transferred to and held in the sub-fund's own bank account. At the time, the trustee's principal bankers in relation to this type of EBT planning were the Royal Bank of Scotland International and that was generally where the sub-fund accounts were opened. In certain cases, the Settlor had decided to use a different bank when opening its bank account and expressed a view that any further bank accounts opened in relation to the trust should be opened with the same bank. This did present its administrative challenges to the trustee but generally, the trustee would try to comply with the expressed wish of the Settlor.

The loans which were made to beneficiaries

272.Loan were generally but not always made from a particular sub-fund immediately. In some cases, (as was the case for some of the directors in the current appeals) the money was held in a bank account for a period of time and in other cases, the money was invested. There were differences in the amount of input from the settlor or beneficiaries. If any beneficiary wanted a loan it was rare for there to be a dialogue between the beneficiary and the trustee by way of persuasion. Rather, the trustee received a request for a loan from the beneficiary which it then considered independently. In response to the Tribunal's question as to what the independent question involved, Mr Schofield elaborated on the questions he posed himself as follows:

> "– is the beneficiary a beneficiary of that particular sub-fund? Are they entitled to an interest-free loan? I think that's probably as far as the consideration went"

273.Mr Schofield's evidence was that repayment of the loans or the situations that might give rise to repayment of the loans were not generally discussed with the beneficiaries at the time of making the loans. His mind set when a beneficiary asked for a loan was not to look at it as a bank manager might. His view was that as a trustee, he did not necessarily want security and he was not overly concerned at the beneficiary's ability to repay; if he had a request from the principal beneficiary of the sub-fund for a loan, this would confer tax efficient benefits for the rest of the beneficial class of the sub-fund as they would generally be family or dependants of the principal beneficiary. He could not recall anyone other than the principal beneficiary requesting a benefit such as a loan.

What happened to loans thereafter, including payment of interest by beneficiaries

274.All of the loans were month-demand loans. Most had not as at the date of the hearing been repaid, although a number of loans were repaid prior to 5 April 2012. None of the loans for the appellants and years at issue in the current appeals had been repaid. There was no evidence as to the circumstances of the loans which had been repaid to suggest the action had been initiated by the trustees or someone other than the borrower. For those loans that have not been repaid, Mr Schofield's view was that they remained repayable. The trusts were ongoing as at the date of the hearing save for a few that had settled with HMRC.

Benefits arising otherwise than by way of loan

275.The trustees also received requests to benefit beneficiaries otherwise than through interest free loans. For example, OCO requested on 28 February 2008 that the trustee consider an award for the staff party in lieu of the annual Christmas party. A further example of such a circumstance was on 27 October 2004 when the directors of Toughglaze requested that a loan of £48,000 to be paid into Circle Investments Limited in order to invest in commercial properties, mainly located in Germany.

276.Although as indicated above the repayment of loans or the situations that might give rise to repayment were not generally discussed there was more dialogue when beneficiaries wanted to leave some or all of the money in the trust and invest through the trust structure rather than borrow the money from the trustees. For example, in the case of OCO as detailed above at [58] on 23 March 2009, one of the directors of OCO requested that the trustee consider making an investment of £58,500 into the Aria Absolute Income Protected Fund as he did not require further loans and as Mr Schofield put it "he chose to leave the rest of the funds in his family trust". Another example concerned a beneficiary of a trust, who lived in Scotland and who worked in the offshore oil industry who Mr Schofield had met on a trip to Scotland. They discussed various scenarios and eventually, a company was created underneath the sub-fund. This company was funded by the sub-trust and commissioned the construction of two special purpose boats to be built to support diving operations. The boats were rented on a bare boat charter to a business owned by the beneficiary who ran a separate business in the UK renting out the boats to end users. Other examples include investments in residential or commercial property, typically in the UK, which are normally structured through a special purpose vehicle owned by the sub-fund. As trustees, they had also seen more "vanilla" investments into share portfolios and similar.

277.Although Mr Schofield's evidence mentioned that if requested to make an investment the trustees did their own research where that was required it appears this was not directed to gaging the soundness of the investment from a financial or credit risk point of view but was motivated more through a desire to minimise reputational or money laundering regulation non-compliance risk.

278.In another case, the directors wanted money to be loaned back to the company and therefore, terms had to be negotiated as the trust deed specifically excluded the Settlor from receiving benefits from the trust. Any loan made by the trustees to the employer

company therefore needed to be made on commercial terms. The trustee took advice from local banks and concluded that an appropriate interest rate for an unsecured loan at that time would be 4% over the then Bank of England base rate. These were the terms negotiated with the employer company. Subsequently, the company offered a second charge over various properties as security for the loan. The trustee took the security and in recognition of the additional security, reduced the interest rate to 2% above the Bank of England base rate. In around 3% of cases, loans were made to Settlors or other entities other than the beneficiaries.

279. Mr Schofield accepted that the trustee was likely to comply with both reasonable requests made by the Settlor in relation to benefits and the reasonable requests of the beneficiaries in relation to the delivery of those benefits. He could not give any examples of what would constitute an unreasonable request.

280. In cross-examination Mr Schofield was probed on his understanding of the differences between a bare trust and the trust set out in the documents. He identified that in contrast to a bare trust, the trustee in the trust operated under the documents had the power not to comply with requests from beneficiaries. He thought it correct to consult with the director as "principal beneficiary" on the basis of his view that the sub-funds had been created specifically for the principal beneficiary and families as part of the reward strategy.

HMRC's criticisms in relation to administration of trusts

281. HMRC make a number of criticisms about how the trust was administered. They submit that it was operated in a highly mechanical way and argue that for a variety of reasons the trustees' behaviour was inconsistent with any intention to exercise an independent discretion: (i) there was no evidence sought to ascertain the size, nature and class of objects of EBTs or sub-funds in general terms still less to enquire of factors that might make some employees or family members more deserving of benefit than others, ii) the trustees followed settlor recommendations and principal beneficiary requests without question, iii) the speed with which decisions were made was inconsistent with genuine reflection, and iv) the trustees were not troubled by steps that contravened the terms of trust. Mr Schofield, HMRC submit, gave frank written and oral evidence: it was clear he was a mere cipher, that his role was to facilitate remuneration strategies and follow requests of "principal beneficiary" and that he had no real appreciation of the role of a trustee of a discretionary trust.

Trusts law on discretionary powers

282. Before determining whether the shortcomings HMRC allege against the trustee which point to the trust being a bare trust rather than a trust where discretionary powers of appointment were conferred, it is necessary to take a detour into the case law around discretionary powers. Both parties referred the tribunal to various cases and textbook extracts. HMRC were at pains to clarify that they were not alleging the trustees had acted in breach of trust, rather that the behaviour in not considering a discretion reflected the fact that the trustees were acting in accordance with the true

terms of the trust upon which the assets were held namely a bare trust for the relevant directors.

283.HMRC argue the trustee's behaviour was inconsistent with any intention to exercise an independent discretion. Per *Thomas and Hudson: the Law of Powers (2nd Ed 2010) at 11.06-11.07* the duty of a donee of a fiduciary power is to consider its exercise, even if it is a mere power, and involves at least an attempt to identify the object of the power and the considerations that might make it appropriate to make appointments to some individuals rather than others. Also, pointing to an extract from *Lewin on Trusts*, they argue the duty cannot be discharged by simply doing as asked by settlor (or anyone else) – (*Turner v Turner* [1984] Ch 100). HMRC submit the trustees simply accepted requests made to them without question.

284.The appellants referred to various other excerpts from *Thomas and Hudson* which referred to various extracts from the case law: *Re Hay* (VC Meggary), *Re Manisty's Settlement* (Templeman J) and *Re Gestetner* (Harman J) which put the obligation of the donee in a more nuanced way as follows:

> "…there is no obligation on the trustees to do more than consider…from time to time, I suppose the merits of such person of the specified class as are known to them and if they think fit to give them something….I cannot see here that there is such a duty as makes it essential for these trustees before parting with any income or capital, to survey the whole field, and to consider whether A is more deserving of bounty than B."

285.The appellant also submitted by reference to *Gestetner* the trustees are only obliged to consider such requests as are actually made by the objects.

Principles to be derived from trust cases:

286.It is clear from the face of the trust document that the power to appoint it conferred on the trustees was discretionary.

287.As set out in the *Law of Trusts 2nd Edition*: 11.03:

> "Powers of appointment…conferred on trustees *qua* trustees…carry with a duty to consider periodically whether or not the power should be exercised."

288.As regards the nature of the duty to consider this was explained as follows by Megarry VC in *Re Hay's Settlement Trusts* [1982] 1 WLR 202 pg 210 (extracted at 11.04 :

> "He must first consider what persons or classes of persons are objects of the power within the definition in the settlement or will. In doing this, there is no need to compile a complete list of the objects, or even to make an accurate assessment of the numbers of them: what is needed is an appreciation of the width of the field…Only when the trustee has applied his mind to "the size of the problem" should he then consider in individual cases whether, in relation to other possible

> claimants, a particular grant is appropriate. In doing this, no doubt he should not prefer the underserving to the deserving; but he is not required to make an exact calculation whether, as between deserving claimants A is more deserving that B…"

289. At 11.08 the text mentions that:

> "The nature and extent of the trustee's "duty to consider" in relation to a power of appointment conferred on him *qua* trustee clearly varies with the circumstances of each case and with the nature of the power (be it special, hybrid or general). Every power must be exercised only for the purpose for which it is conferred, or at least, in accordance with what the trustees honestly considered to have been the purpose…".

290. At 11.10 it is explained that :

> "Even where the class of objects is large and comprises different categories, the terms of the power may sometimes imply an order of priority or preference, as was the case in ***Re Gulbenkian's Settlement,*** for example, where it was clear that the trustees were expected to have regard to the best interests of one named beneficiary…In yet other cases the relevant purpose may be ascertainable only be a process of construction. As Templeman J pointed out in ***Re Manisty's Settlement,*** the trustees will endeavour to give effect to the wishes and intentions of the donor, and they "will derived that intention not from the terms of the power necessarily or exclusively, but from all the terms of the settlement, the surrounding circumstances and their individual knowledge acquired or inherited". Thus in many instances, the trustees may have to rely on knowledge acquired by them outside the trust instrument (for example changes in the circumstances of the family) or even on the consent of a third party, such as the settlor himself…"

Was the trustee's behaviour consistent with law in relation to consideration and exercise of discretionary powers?

291. It follows from the above that any obligation to survey the field, consider who was deserving or undeserving, were not tasks to be viewed in isolation, or done by an exact calculation but to be done by taking into account the particular terms and nature of trust. Further the purpose of the trust may be derived from looking further than simply what is in the document.

292. As to the terms of the trust and sub-trust both included a wider class of beneficiaries that the directors. The beneficiaries included wife, children, remoter issue, parents, any other person financially dependent and "any body which is charitable". It is correct that although Mr Schofield's evidence referred to the "principal beneficiary" there was no such term defined tin the trust documents. The recitals to the trust deed mentioned the Settlor wished to "establish a trust fund for the benefit of its employees and dependants and the employees and dependants of any Group Company". The trust and sub-trust deeds mentioned the wish to exercise power of appointment "for the benefit of [named director]". The recommendation to the

trustee stated, "It is our wish that the following benefits be provided to the following employees", and then in the next paragraph, which suggested the use of revocable sub-trusts for the benefit of certain employees and their respective families, mentioned an amount and then referred to "[named director] and Family".

293. With those terms in the documents and surrounding circumstances in mind it appears to me that several of HMRC's criticisms do not get off the ground.

294. As to surveying the field, considering who was deserving / undeserving: there was no material deficiency in the trustees' survey of the relevant field when setting up the sub-trust, or once the sub-trust was set up. Given their terms and genesis, regard was duly paid to the settlor's wish to set up a sub-trust for particular named directors and their families and similarly in relation to considering the named directors' wishes for interest free loans.

295. In response to a question in cross-examination as to whether enquiries of any of the other potential beneficiaries under the EBT were made to see if a payment should be made for their benefit Mr Schofield replied:

> "…no, because by the time we were appointed as trustee the [settlor] company itself, as far as we were concerned, had considered its overall remuneration strategy, and we were---and the---it had chosen to reward its key employees, particularly its directors, by appointment of assets on to a sub-fund. So what I'm trying to say is at the time we got involved with it, it had effectively been earmarked as to what the --- certain the settlor company decided what they would like to see happen."

296. The trustees' obligations against this backdrop would not, in my view, extend to examining what other employees might be deserving of an award, or in the context of the sub-trust having to ascertain who the family /other members of the director were to see whether an appointment should be made to them. The clear purpose of the trust was to provide a means to benefit certain individuals connected through employment or persons connected to such individuals. Given that connection it was also not unreasonable for the trustee to take account of the views of the settlor.

297. As to HMRC's submission that Mr Schofield who followed the recommendations put to him without question this was not borne out by the evidence. Mr Schofield explained in answer a question in cross-examination as to his understanding of the difference between a bare trust and a discretionary power of appointment that as regards the latter"…the trustees had the power not to comply with a request received from the beneficiary". Taking account of Mr Schofield's professional experience I find that he held this understanding at the relevant time and I accept that Mr Schofield did appreciate the difference between bare trusts and discretionary powers of appointment.

298. When challenged in cross-examination that in every case the request was complied with he explained that it needed to be looked at as part of the bigger picture of the particular settlor's reward strategy.

> "everything that went on was what we expected to go on. But we didn't receive unreasonable requests, and given the trusts had been created to reward key employees, I think the trustee acted reasonably in following the requests of individuals".

299. It is correct no enquiries were made of other beneficiaries and the other beneficiaries were not informed, but these facts, following on from the discussion of the relevant obligations under trusts law above, did not necessarily point against the existence of a discretionary power of appointment.

300. While there might well be a variety of things the trustees could have done or further enquiries they could have made they did in my view he comply with the basic minimum of what was required of them as regards discretionary powers of appointment. Once the circumstances surrounding the power as taken into account, as highlighted by dicta of Templeman J in *Manisty*, it does not seem surprising that the trustees acceded to the setting up of sub-trusts or the loan requests. It was legitimate for the trustee to have regard to intention of providing benefit to named directors and setting up sub-trust (given the intention expressed was to provide benefit to employees). Once that intention had been expressed it was also reasonable to accede to the loan and other investment requests – given the sub-trust was expressed to be for the director's benefit. Mr Schofield did give due consideration to the exercise of the power in the sense of not feeling bound to make a decision which complied with the request but in positively deciding to grant the request given it was consistent with his understanding of the purpose of the trust. There was nothing in what he did which was inconsistent with the kind of discretionary power of appointment or which pointed to there being a bare trust for the directors.

301. HMRC submit the trustees' meetings and minutes were all a pretence and the suggestion that the trustees might not comply with requests is equivalent to suggestion that the landlord in *Antoniades v Villiers* might move into and share the flat the couple occupied or that the valet cleaners in *Autoclenz* might be allowed to substitute someone else. Putting aside the concerns over extending the approach suggested by *Autoclenz* and *Antoniades* to trust documents such an analogy does not hold good in my view. The trust provision did not necessitate refusal of requests but due consideration of the power; the proper question is not to ask whether the trustee would refuse to comply with the request but whether the trustee would, as the trust document and the general law required, consider the exercise of the discretion.

302. While it is accepted that there are no instances of requests not being followed that is not inconsistent with there being appropriate consideration and the trustees acceding to recommendations if it were thought they were reasonable. Just because Mr Schofield was not able to articulate what would be an unreasonable request that did not mean there was not a discretionary power of or that the trustee was not intended go through the exercise of considering exercise of discretion each time appreciating he was not required to accede to the request.

303. As to HMRC's point the trustee was not worried about contravening the terms of the trust that is not applicable in the current cases and in any case is not inconsistent with the trustees considering the exercise of the discretionary power.

304. In relation to HMRC's criticism as to the lack of due diligence performed, and the trustees' lack of concern about borrowers' ability to repay loans, given the background to the trust it is not surprising those matters did not feature in the trustees'analysis. What was important was that the trustees considered the request and saw no reason not to comply (as distinct from feeling bound to comply with it). As the appellants point out Mr Schofield's evidence was the settlor's wishes were clearly expressed to him, and that the trustees were willing to comply with their expressions of reasonable wishes; he was mindful of settlor's wishes and mindful of the purpose of the trust.

305. Regarding the argument that the speed and mechanical nature were inconsistent with any real exercise of discretion it is correct the trustees' decisions were turned around quickly and that processes funnelling the recommendations, and actioning them once a decision was made were set up to deal with high volumes. But the nature of the exercise of discretion did not require much (in that the way it was carried out – asking such questions as to whether the persons entitled, were the requests reasonable / in line with what the trustees reasonably expected). The consideration could be done relatively speedily.

306. As regards directors' understanding, as explained above, I have rejected the finding that they understood the trust to be a bare trust, however even if they had had that understanding I agree with the appellants that that fact would be of little relevance; the terms of documents such as trusts may be complicated to a lay person or settlor but they are not disregarded for that reason. In any case, here there is no evidence there was a different intention on the part of those executing the document other than to execute what they were advised to execute. The trust was professionally drafted by a firm of solicitors. The board minutes of the appellants would have clearly signalled to the directors the discretionary nature of the power of appointment which was then carried through to the terms of the trust.

307. In conclusion I reject HMRC's argument that the allocation of money to the sub-funds was earnings because at that point the money was under the director's control as a result of it being subject to the bare trusts in the director's favour.

HMRC's submission that adverse inference should be drawn from lack of documents / failure to call certain witnesses

308. It is convenient at this point to deal with the oral submissions made by HMRC which prefaced their contentions on the facts. They say there was a failure on the appellants' part to call a number of highly significant witnesses and invite the tribunal to draw adverse inferences as a result.

309. HMRC submits that once the redirection issue was raised it was for the appellant to show the sums were not directors' earnings which they directed to be declared on trust. As confirmed in *Ingenious Games v HMRC* [2015] UKUT 105 (TCC) which in turn referred to the High Court's decision in *Brady v Group Lotus Car Companies Plc* [1987] STC 635 (CA) the burden is on the appellant taxpayer to show the assessment or amendment is incorrect.

310.HMRC contended it was agreed expressly or implicitly that the Tenon Isle of Man trustees would act as ciphers and each of the directors would have control of the assets. The expectation in such circumstances would be that the relevant person or persons from PSL would be called to give evidence (using Tribunal's power to compel if they refused). Mr Richard Coombs could have been called, as could the external accountants who were at the original meetings, and each of the appellant's directors (although sadly Mr Vohra (Mr V Shah had changed his name to Mr Vohra) had died shortly before the hearing there was no reason he could not have provided a statement at a much earlier stage). As regards the adverse inferences that could be drawn HMRC referred to the judgment of Flaux J in *Boreh v Republic of Djibouti* [2015] EWHC 405 (Comm) which cited the following passage from Brooke LJ in *Wisniewski v Central Manchester Health Authority* [1998] Lloyds LR (Medical) 223 at 227*:*

> "…In certain circumstance a court may be entitled to draw adverse inferences from the absence or silence of a witness who might be expected to have material evidence to give on an issue in an action".

311.There was an exception per Lord Sumption in the *Prest v Prest* case [2013] 2 AC 415 at [44]::

> "If the silent party's failure to give evidence or the necessary evidence can be credibly explained, even if not entirely justified, the effect of his silence in favour of the other party may be either reduced or nullified."

312. HMRC say the appellant does not want the circumstances in which the scheme was presented and explored to be subject to scrutiny and that a deliberate tactic was adopted by PSL to make sure there were no written notes ever taken of meetings.

313.The appellant says the circumstance underlying *Republic of Djibouti* were some way from those in the present case. The witness (the President of the republic) who did not attend and who did not give an adequate explanation for his attendance was a critical witness (the defendant's case was the president had personally agreed to the defendant taking the action which the claimant complained of.) As regards Mr Vohra he was seriously ill and battling cancer, and as regards PSL they went into liquidation in 2013 and it was difficult to get documentation from them. No indication was given what material evidence was lacking and if it was so critical why HMRC could not have compelled their attendance. As to the allegation PSL deliberately did not take notes the appellant says this is unfounded and questions why in any case a failure to take notes of a meeting is objectionable or should result in an adverse inference.

314. Having reflected on the parties' submissions I do not accept the submission that an adverse inference should be drawn in the circumstances of this case. In the context of the redirection argument, given my conclusion above that there is a lack of evidence of redirection, HMRC would no doubt say the fault for the lack of evidence lies with the appellants and submit that the appellants have not demonstrated there was *not* an agreement between the company and the directors to the effect that the directors were to be paid the sums as earnings. This concern can however be sidestepped: HMRC's assessment and amended Statement of Case proceeded on an assumption that the sums paid by the appellants into the EBT were earnings of the

directors' employment "in that they were paid in respect of work done *qua* directors". But as identified in the legal discussion above something akin to receipt / allocation by the sum of the directors must be established. HMRC's case has not got off the ground on that aspect (because they did not think it necessary) such that it then becomes necessary for the appellant to disprove it.

315. In relation to the *Antoniades/Autoclenz* arguments HMRC's case was that the intention of all the relevant parties as evidenced by their conduct was that the trust property and/or the sub-fund property should be at the absolute disposal of the directors and that in short what purported to be discretionary trusts for a number of different beneficiaries were in reality intended to be, and operated as bare trusts. The evidence upon which such arguments might be founded would include that of the directors of the company and of the trustees. In respect of each of the appellants a director and a trustee who were present at the relevant meetings were called and at the very least each of the directors who were called were able to speak to how they had understood their own relationships with the company and with the trustees. There was no evidence before me to enable a finding that PSL adopted a deliberate tactic of not recording conversations and while on the face of it, it might appear odd that professional trustees who were rigorous in recording their own board meeting minutes did not leave a documentary audit trail of their telephone discussions, that seems less untoward in the context of a relationship where the trustees were in close and regular day to day contact with PSL.

(3) Application to facts: Ramsay approach in relation to appointment to sub-trusts

316. The starting point, as indicated by the relevant case law, is to consider a purposive construction of the relevant statutory provisions in this case s 62 ITEPA which contains the relevant definition of "earnings". While I did not receive any specific submissions addressing the underlying purpose of the provision various observations may be noted from the drafting of the section and the judicial consideration which the section and its predecessors have been subjected to as outlined in the legal discussion sections above.

317. In terms of the statutory drafting it is to be noted that the term "earnings" is not understood in the abstract but in relation to an employment. This is stated explicitly in s 62(2), and the contents of that subsection further serve to show the link with an employment speaking of items which are inherently defined by reference to employment such as salary or wage or in relation to other profits by reference to what is "obtained by the employee" and referring also to an "emolument of the employment". The outer limits having been set by a relationship to employment the definition of what it is that is captured is wide and inclusive covering e.g. "any…other profit or incidental benefit of any kind.." and in (c) "anything else that constitutes an emolument…".

318. Going back to the more general questions posed in the case-law as regards the application of a *Ramsay* approach (as set out at [231] above) there can be no doubt in my view the provision is concerned with "real world transactions with real world

economic effects." (Were the position otherwise the depictions drawn in the case-law referring to real word concepts and effects e.g. Lord Reid's summary in *Heaton v Bell* of a person being chargeable on what goes into his pocket would not resonate in the way they do.) Further the broad and inclusive nature of the provision does not suggest it is one which requires the tribunal to focus on a specific transaction but admits the possibility that the tribunal may have regard to a composite transaction.

319. In terms of the specific concerns underlying the provision, as considered in the legal discussion sections above, it is clear that as well as the need to establish that the source of the amount is from an employment, it is also necessary that the amount is received (acknowledging receipt can be interpreted more broadly to take account of cases of redirection) as money or money's worth.

320. The features of the legislation which therefore illuminate the relevant realistic facts to be considered are accordingly a relationship to employment, a concern with receipt of money and money's worth, a concern with real world economic effects and being ready where appropriate to look at linked transactions as a composite whole.

Realistic appraisal of facts

321. HMRC's submission in relation to the application of the *Ramsay* approach on the facts is that even if legally there was a discretion then as the trustee was a cipher who simply followed instructions there was a practical inevitability, if not a legal inevitability that what the directors wanted to do with their earmarked funds would be done. That, they submit, is a realistic view of facts and given purposive construction that results in sums held in a structure such as this being as much earnings as if they had in fact been held on bare trusts.

322. The appellants' response to HMRC's argument is that what was received cannot be viewed as a payment of money or money's worth. In contrast to the facts of *Aberdeen Asset Management* (referred to at [236] above) which concerned a money box company and where the employee effectively had the keys to the box, here the beneficiaries had at most an expectation of benefit. They expected that if they made requests to trustees their wishes would be met, but that was not an absolute right to money.

323. Turning then to the tribunal's realistic appraisal of the relevant facts the backdrop is a scheme involving a serious steps which are in essence those set out in PSL's explanatory document of 21 June 2005 (at [22] above). The steps envisaged and which were followed through with no practical likelihood of them being departed from were for a trust to be declared by the employer over funds set aside for the benefit of the directors, the appointment of professional trustees who later became the sole trustees, and the creation of sub-trusts for the benefit of the directors which the directors would control.

324. There was nothing to suggest the driver for setting up the EBT in each of the relevant financial years was anything other than to create a mechanism to reward the directors in a way which sought to avoid sums being charged to income tax and NICs.

It is not in dispute that the appellants used a scheme which had been put together by PSL and there is nothing on the facts which suggests to me there was any commercial driver other than the avoidance of tax and NICs for embarking on the scheme. That factor is of course not conclusive of the issues before the tribunal and the question remains as to whether the scheme was effective in its objective.

325. The centrepiece of the appellant's argument as to why the sums were not chargeable to tax and NICs in essence rests on the idea that the discretionary power of appointment acted as a sort of circuit-breaker to any assumption the directors could get their hands on the amounts appointed under the sub-trusts. They argue that under the terms of the trust they had no means of ensuring that they received the benefit, and they were not in receipt of cash or the means of accessing cash.

326. While that follows as a matter of trusts law, the focus of analysis at this point is to appraise the facts realistically. For the reasons set out below it was in my judgment clearly envisaged that the directors would be able to access the funds in the sub-trust as they wished. There was no practical likelihood that that the trustees would not accede to the director's requests (and no practical likelihood that anyone other than the directors would make requests to the trustees):

(1) Although as discussed above in the context of the *Antoniades / Autoclenz* issue the trustees were not ciphers, the terms in which the trust had been set up and the way in which the purpose had been expressed by the employer settlor meant there was no real risk that the trustees would, having duly considered the exercise of their powers, refuse to follow the director's recommendation. It was known the trustees would grant requests which were aligned to the remuneration purpose of the trust. Any requests that appeared to be for the named director's benefit would pass muster.

(2) There was no real risk the trustees would exercise their discretion in the favour of someone other than the named director or someone the named director wanted funds to go to. At the outset in relation to the initial set up of the EBT the instructions to publicise it to other employees were tokenistic. Even if the notices had been properly publicised to all eligible beneficiaries, under their terms the company would still effectively remain as a gatekeeper to the requests which went to the trustees. The employees, or indeed other family beneficiaries had no means of approaching the trustees direct to make their own case for an award, and even if they had done it is likely, given the reasons for setting up the trust, that the request would be put back to the settlor company for its views in relation to the EBT and in relation to the named director, who the trustee regarded as a principal beneficiary in relation to the sub-trusts.

(3) The fact the directors agreed to undertake the scheme in the first place indicates they fully expected the trustees to agree to the recommendations made to them (although they understood the trustees were not necessarily obliged to follow the decision as discussed above). It is inconceivable that having built up large sums within the company through their hard work that they would have been comfortable with a scheme which allowed those

funds to slip away to someone else due to the trustee making appointment decisions at their own initiative. I note in this regard Mr Harrison's evidence:

> [15]: "We understood the sub-funds to be family trusts which were created for the benefit of the key employees and their families. It was meant to be an incentive…we still have roughly £54,000 in my family trust [*emphasis* added] that remains untouched…" [16] "The EBT constituted recognition for the hard work we had undertaken and incentive to maintain performance in the future."

327. The scheme would not serve the purpose intended by the company and directors if there was any real question of the trustees acting in a way which was contrary to the director's wishes and e.g. refusing the director's request or appointing to another beneficiary such as a charity. The directors' behaviour in terms of their compliance with the scheme instructions, the extent of follow up queries made and reassurances and comfort sought, would be markedly different if there had been any genuine worry that the money appointed to the sub-fund could not be dealt with as the director wished.

328. The appellant takes issue however with viewing the trustees' discretion as a commercially irrelevant contingency as referred to in Lord Nicholls' opinion in *Scottish Provident.* Whereas in that case which involved an artificial scheme where the strike price on an option had been set so as to deliberately create an acceptable risk the scheme might not work as planned the appellant argues that here the trustee's discretion was the very essence of the trusts and powers the parties intended to create. I do not accept this is a good ground of distinction. There is nothing to suggest the parties in *Scottish Provident* did not fully intend their strike price provisions to take effect; the point was that the likelihood of an adverse effect on the operation of the scheme was set an acceptable level. Similarly, although there is no question that the trust arrangements created by the parties here were intended to involve discretionary powers of appointment, the way in which the arrangements were set up meant that any risk that the trustees would not follow the directors' requests was set at an acceptably low level. The point remains that in such circumstances the low risk of the contingency adverse to operation of the scheme may be disregarded when appraising the facts realistically.

329. There is no dispute that it is correct that at law a discretionary beneficiary has no absolute current right to direct the trustees to pay him or her an ascertainable part of the income – all that he or she has is a hope of receiving a distribution. But, on the *Ramsay* approach the facts must be realistically appraised. The analysis does not end with a description of the legal nature of the rights of the beneficiaries but must pay due regard to the factual environment in which those rights were cultivated.

330. A realistic appraisal of facts entails recognising that the trustees would comply with requests to do what the beneficiary wanted given the trust's remuneration context. There was, as explained above, no concern that others would apply independently or that assets would be leaked away to others. Even if requests were made it was inevitable, given the terms of the sub-trust, that trustees would not do

anything without consulting the named director who they viewed as the intended beneficiary. In my judgment the sub-trust (and the particular way in which it was set up which included the communications of purpose to the trustees) was on a realistic appraisal of facts a money box which the named director could access as they wished.

331. While the appellants sought to emphasise that receipt, not inevitability, was the touchstone – e.g. an ICI employee who was paid in arrears would inevitably get paid the following month but would not be taxed on the sum until he or she received the payment, in my view this argument misconstrues the relevance of inevitability. It does not serve as a principle by which to establish whether and when earnings are paid, rather it is a possible implement that may be used in carrying out a realistic appraisal of the facts in that if one outcome inevitably follows from another then it may be unrealistic to disregard that fact depending on how the relevant legislation is purposively construed.

332. In relation to the appellant's submission that as regards the Toughglaze restricted trust deed cases the trustees would not be able to pay remuneration out I disagree with the suggestion that the deed presents any obstacle in that the inclusion of such deeds was clearly an inserted step with no purpose other than the avoidance of tax and may be disregarded. When it is, it was practically inevitable the trustees would comply with a request for sums to be appointed in the way the director wished given that would clearly be a reasonable request in the context of the purpose of the EBT sub-trust. In any case as discussed later, the trustees would clearly have tools at their disposal to provide the employee with money / money's worth in the form of an interest free loan, (payment of which would never realistically be demanded) which from the trustee's point of view would not be considered by the trustee as breaching the "no remuneration" provision in the deed.

333. I conclude therefore that in each of the relevant years that when the sums were appointed to the sub-trusts, taking account of the particular environment that was constructed around the discretionary power of appointment which informed the trustees' understanding of the purpose of the trust and sub-trust, there was no realistic possibility that the trustee's discretion in relation to the money in the sub-trust would not be exercised in whichever way the relevant director asked for it to be exercised. The facts when viewed realistically disclose that the sums derived from the director's employment were received by the director as money or money's worth and therefore amounted to earnings chargeable to income tax.

Payment for PAYE purposes?

334. As discussed above at [240] the test is one of practical control. When the funds were paid to the sub-funds the directors had practical control over them and could use them as they liked (given the way the EBT had been set up and the framework within which the discretionary power of appointment resided). There was therefore a payment for PAYE purposes when the sums were appointed to the sub-trust.

NICS

335. Both parties agree that whatever the analysis on "earnings" the same result will follow for NICs. For the same reasons there were earnings for tax purposes, there were earnings for NICs purposes. (As set out in *Forde* the NICs definition of earnings wider than that that for tax so if something is "earnings" for tax purposes then it must be earnings for NICs purposes). There is nothing in the purpose underlying "earnings" in SSCBA 1992 that suggests the purpose would also not, in a similar way to tax, also cover effects in the real world and also encompass composite transactions.

336. The analysis up to this point is sufficient to dispose of the issue before the tribunal in these appeals. The Regulation 80 determinations in respect of PAYE and the s8 decisions in respect of NICS are upheld in principle. The rest of this decision provides observations on the legal arguments relating to the issues that would remain for determination if I were wrong on the above conclusion together with the findings of fact relevant to those further issues.

Antoniades / Autoclenz – loans not real loans? Ramsay approach to loans?

337. If my conclusion above on the application of the *Ramsay* approach were wrong then HMRC's focus of attack shifts to a submission that the loans made were not real loans applying the *Antoniades / Autoclenz* case-law, rather the amounts purported to be lent were intended to be and were in fact unconditional payments. If the tribunal does not accept that then HMRC further invite it to apply the *Ramsay* approach and find that on a realistic view of the facts and a purposive construction of the statutory provision on earnings it was never intended that the trustee would exercise their right to demand repayment of the sums and the sums advanced were earnings.

338. As far as the loan agreement is concerned the approach taken in *Antoniades / Autoclenz* can in principle apply to analysing whether the loan agreements, being bilateral contractual agreements were truly loans (there is no issue as with the trust document of the document being unilaterally executed). The question then is whether the true agreement was that the loan was not really a loan or that if there was repayment condition the true agreement was that repayment would never be demanded unless the borrower wanted this.

339. Mr Harrison's and Mr Varsani's evidence suggested that they and their co-directors were aware the loans would become due and payable one month after any written demand by the lender in accordance with the loan agreements and that in that event they would have alternative sources of finance to repay the loans. Mr Schofield's evidence was that he was not overly concerned with the directors' ability to repay –as a trustee his view was the loan would confer benefits on the director along with the rest of the beneficial sub-class – who were general family dependants.

340. HMRC highlight the answers given in cross-examination in particular that Mr Harrison could not give any example of when the trustee might request payment, that Mr Varsani's only example was if the money was needed to pay the trustees' fees and that Mr Schofield had conceded it was difficult to imagine circumstances when the

loan would be repaid but that it might when it was to the benefit of the class of beneficiaries that the particular sub-fund be repaid.

341. I am not satisfied however there is sufficient evidence that the true agreement between the trustees and the directors was that there was not a loan or that there was any agreement not to trigger the repayment provision. I accept the directors' evidence that they understood there was a term in the agreement stipulating a right for the money to be repaid. As to their ability to repay I accept their evidence that they thought repayment would be possible but had insufficient evidence before me to make the finding that that was in fact the case throughout the currency of the loan. There was also insufficient evidence to make the finding HMRC sought that the directors were told and understood that the purported loans would never be called in without their consent and that the trustees shared the directors' understanding on this.

342. However, the fact the directors or Mr Schofield could not coherently articulate what circumstances the loan might be repaid does not make it any the less possible that the repayment provision was not part of the agreement. While it might, all other things being equal, point against a conclusion that repayment was part of the true agreement but it would certainly not be conclusive. There are, no doubt, any number of provisions appearing in a legally drafted agreement which parties when probed are not clearly able to articulate their motivations or rationale for but that does not mean they have not agreed to or are not bound by the terms. (HMRC refer to the fact none of the 400 or so loans were called in and also to the fact that no assessment was made by the trustee of ability to repay. However in my view, although both of these features point towards a conclusion that realistically the loans would not be repaid neither of those features mean the repayment provision was not part of the parties' true agreement between each other. When Mr Schofield acknowledged that trustees would not recall loans unless it was in the interests of beneficiaries to do so I understood that to refer to the interests of the beneficiary who had borrowed the sum as there was no suggestion that if one of the other beneficiaries e.g. one of director's dependents had suggested repayment that the trustees would then have acceded to that. Again this points to the parties' intention being that the repayment clause could be exercised rather than it meaning nothing. While it is insufficient to infer that there was an agreement not to seek repayment it is consistent with a finding that there was no realistic prospect of the loans being triggered. It seems clear to me that if a repayment demand was made under the agreement and the loan was not repaid there would be no issue with enforcement of the loan.

343. The loan was accordingly a true loan. But the lack of exercise in the multitude of cases, and in particular the lack of due diligence into the ability of the borrower to repay, are consistent with an understanding on the part of the parties that it was highly unlikely the trustee would make a request not be repaid unless the borrower wanted this.

344. As regards a realistic appraisal of the facts under a *Ramsay* approach, the situation is essentially one where A transfers money to B on the basis that B will be liable to pay the money if B determines it is in B's interest to pay the money. In such a situation B is in control over when the money is repaid and it remains open for B to

decide that it will never be in B' interests to transfer the money back. In circumstances such as these the money is for all practical purposes money which is at B's disposal.

345. Also taking into account 1) the purpose of the scheme, and the fact that the money built up in the appellants was viewed by them as arising from their hard work, 2) the fact the appellants were charged a significant fee by the scheme devisers of 12% of the amount sought to be put into the scheme, 3) the fact the directors thought they had sufficiently liquid assets to meet the repayment of the loan should a repayment demand be made, it seems unlikely to me that the directors would enter into the arrangements with a view to simply obtaining interest free loans. The scheme only made sense if the loans were ones in respect of which repayment would not be demanded – simply making loans of interest free loans was not commensurate with the objective of rewarding the directors' hard work and the evidence the amounts would have been paid as salary if they had not gone into the scheme. It appears far more likely to me that, the directors agreed to have the sum loaned to them but understanding that while it could be enforced, it was highly unlikely that it would be enforced.

346. So, if following from the above, it was not enough from a money / money's worth point of view that directors ended up with amounts in the sub-trust – and those amounts did not count as earnings) then the amounts loaned when viewed realistically under a *Ramsay* approach would nevertheless be earnings, there being no realistic possibility the money lent would ever need to be repaid.

Section 201 ITEPA benefits?

347. HMRC argue that even if the sums were not earnings then they are still charged to tax under particular provisions found within the benefits code, namely ss 201 and 203 ITEPA. Under these provisions, the cash equivalent of an "employment-related benefit" is treated as earnings from the employment for the tax year in which it is provided (s.203(1), ITEPA). For these purposes a "benefit" means "a benefit or facility of any kind." (s.201(2), ITEPA) and an "employment-related benefit" means (s.201(2), ITEPA):

> "a benefit, other than an excluded benefit, which is provided in a tax year—
>
> (a) for an employee, or
>
> (b) for a member of an employee's family or household,
>
> by reason of the employment."

348. In essence the appellant's argument is that there is no benefit under s201 because no benefit was made or received. They argue the principle was established in *Templeton v Jacobs* [1996] STC 991 and was reflected in *Dextra* which concerned similar facts and where the Special Commissioners did not find s201 was satisfied. The appellant says this tribunal should reach same conclusion here noting 1) that the Revenue did not appeal the point, 2) the outcome was consistent with the binding authority of *Templeton v Jacobs* 3) a conclusion that the charge is applicable would

be inconsistent with the receipt principle and 4) the conclusion gives rise to difficulties of how to value the potential benefits.

349. I can deal with this issue briefly as HMRC did not seek to run any different arguments to those run in *Dextra* or to persuade the tribunal that it should not follow it (they do however reserve the right to argue the point at a higher level). Given my decision above that the sums appointed to the sub-trust were earnings subject to income tax and PAYE it is not necessary to reach a decision on the issue but even if it were given HMRC's position, and given Special Commissioners' decisions, although not binding, are of persuasive authority, HMRC's arguments that the benefits codes provisions applied would not have been successful before this tribunal.

Corporation Tax issues

350. This decision does not make any determination on the corporation tax issues because it was accepted that if the HMRC succeeded on their income tax / NICs issues the deductions for corporation tax the appellants sought would be allowed. The following section records the arguments made and offers observations on what I would have decided if HMRC had been unsuccessful on their earnings / NICs argument setting out the findings of fact made which are relevant to the arguments. The corporation tax issues were:

(1) If and to the extent that the Sums did not constitute "earnings" for PAYE income tax purposes:

(a) Did the Sums represent money wholly and exclusively laid out or expended for the purposes of the Appellant's trade?

(b) Did the costs of establishing the trust constitute capital (rather than revenue) expenditure? (It was confirmed at the hearing that this argument was not being pursued by HMRC in the particular lead cases before the tribunal and I accordingly do not deal with it.)

(c) Does s.43 of the FA 1989 apply so as to disallow a corporation tax deduction in the accounting period in which it was claimed? This raises two sub-issues:

(i) Did the Sums represent "amount[s] for which provision is made in the accounts";

(ii) Were the Sums held by the trustees "with a view to [their] becoming employee's remuneration"?

(d) Does Schedule 24, FA 2003 apply so as to disallow a corporation tax deduction in the accounting period in which it was claimed? In particular:

(i) did the declarations of trust over the Sums (either in isolation or viewed together with the appointment of Tenon

(IOM) Ltd and Tenon (IOM) Nominees Ltd as trustees) constitute either

(a) a payment of money to another person or

(b) a transfer of an asset to another person within the meaning of para 1(2)(a), Schedule 24, FA 2003, with the result that the provisions of that schedule operate so as to disallow a corporation tax deduction in the accounting period in which it was claimed in respect of the Sums?

351. For Corporation Tax purposes there were three principal factual variations as between the various appeals:

(1) Unrestricted Trust Deed Cases being cases where the EBT deed did not contain a restriction expressly prohibiting payments of remuneration out of capital or income of the trust. The appeals in this category are:

a) OCO's appeals in relation to the EBTs established in the years ending 30 June 2005 and 30 June 2006; and

b) Toughglaze's appeals in relation to the EBTs established in the years ending 31 May 2004.

(2) Restricted Trust Deed Cases being cases where the EBT did contain an express prohibition on the trustees making payments of remuneration (whether out of the trust capital or the trust income). The appeals in this category are: Toughglaze's appeals in relation to the EBTs established in the years ending 31 May 2005 and 31 May 2006.

(3) In Year Cases being cases where the EBT in question was created (and a trust declared of all relevant funds) in the same accounting period in which the appellant recognised an expense in its profit and loss account. The only appeal in this category is OCO's appeal in relation to the EBT established in the year ending 30 June 2006.

352. As was helpfully set on the appellants' skeleton argument the different types of case now before the tribunal can therefore be shown as follows:

	Year Ended	**Restricted/Unrestricted**	**In Year/Not In Year**
OCO	30 June 2005	Unrestricted	Not In Year
	30 June 2006	Unrestricted	In Year
Toughglaze	31 May 2004	Unrestricted	Not In Year
	31 May 2005	Restricted	Not In Year
	31 May 2006	Restricted	Not In Year

353. The appellants submit that, irrespective of these variations, on a proper analysis the deduction which was recognised in the appellants' profit and loss account is an allowable deduction for corporation tax purposes in the accounting period in which it was recognised.

Relevant Corporation Tax legislation

354. Again I gratefully adopt the summary set out in the appellant's skeleton argument. For corporation tax purposes, each Appellant carries on a trade. The profits of those trades have to be computed in accordance with generally accepted accounting practice (GAAP), subject to any adjustment required or authorised by law in computing profits for those purposes (s 42, Finance Act 1998).

355. One provision which may require such an adjustment to be made is s 74 of the Income and Corporation Taxes Act 1988 (ICTA), which, so far as is relevant to the issues in dispute, provides:

> "(1) Subject to the provisions of the Corporation Tax Acts, in computing the amount of the profits to be charged to corporation tax under Case I or Case II of Schedule D, no sum shall be deducted in respect of-
>
> (a) any disbursements or expenses, not being money wholly and exclusively laid
>
> out or expended for the purposes of the trade or profession;
>
> …
>
> (f) any capital withdrawn from, or any sum employed or intended to be employed as capital in, the trade or profession, but so that this paragraph shall not be treated as disallowing the deduction of any interest."

356. Two further provisions can result in adjustments being made to the profits computed in accordance with GAAP: (1) s 43, Finance Act 1989 (FA 1989); and (2) Schedule 24 to the Finance Act 2003 (FA 2003).

(1) Section 43 Finance Act 1989

357. The provisions of s 43, FA 1989 which were in force at the material times were those which had been substituted, with effect for accounting periods after 5 April 2003, by s 722, ITEPA and paras 156 and 157, Schedule 6 to ITEPA. That version of s 43, FA 1989 provides:

> "43 Schedule D: computation
>
> (1) In calculating profits or gains to be charged under Schedule D for a period of account, no deduction is allowed for an amount charged in the accounts in respect of employees' remuneration, unless the remuneration is paid before the end of the period of 9 months immediately following the end of the period of account.

(2) For the purposes of subsection (1) above an amount charged in the accounts in respect of employees' remuneration includes an amount for which provision is made in the accounts with a view to its becoming employees' remuneration.

(3) Subsection (1) above applies whether the amount is in respect of particular employments or in respect of employments generally.

(4) If the remuneration is paid after the end of the period of 9 months mentioned in subsection (1) above, any deduction allowed in respect of it is allowed for the period of account in which it is paid and not for any other period of account.

(5) If the profits are calculated before the end of the period of 9 months mentioned in subsection (1) above—

(a) it must be assumed, in making the calculation, that any remuneration which is unpaid when the calculation is made will not be paid before the end of that period, but

(b) if the remuneration is subsequently paid before the end of that period, the calculation is adjusted if a claim to adjust it is made to an officer of the Board within 2 years beginning with the end of the period of account.

(6) For the purposes of this section, remuneration is paid when it—

(a) is treated as received by an employee for the purposes of the Income Tax (Earnings and Pensions) Act 2003 by section 18, 19, 31 or 32 of that Act (receipt of money and non-money earnings), or

(b) would be so treated if it were not exempt income.

(7) In this section—

"employee" includes an office-holder and "employment" correspondingly includes an office, and

"remuneration" means an amount which is or is treated as earnings for the purposes of the Income Tax (Earnings and Pensions) Act 2003."

(2) Schedule 24 to the Finance Act 2003

358. Paragraph 1 of Schedule 24 provides:

"(1) This Schedule applies where—

(a) a calculation is required to be made for [corporation tax purposes] of a person's profits for any period, and

(b) a deduction would (but for this Schedule) be allowed for that period in respect of employee benefit contributions made, or to be made, by that person ("the employer").

But it does not apply to a deduction of a kind mentioned in paragraph 8.

(2) For the purposes of this Schedule an employer makes an "employee benefit contribution" if—

(a) the employer pays money or transfers an asset to another person

("the third party"), and

(b) the third party is entitled or required, under the terms of an employee benefit scheme, to hold or use the money or asset for or in connection with the provision of benefits to or in respect of present or former employees of the employer.

(3) The deduction in respect of employee benefit contributions mentioned in sub-paragraph (1) is allowed only to the extent that—

(a) during the period in question or within nine months from the end of it

-

(i) qualifying benefits are provided out of the contributions, or

(ii) qualifying expenses are paid out of the contributions, or

(b) where the making of the contributions is itself the provision of qualifying benefits, the contributions are made during that period or within those nine months.

(4) An amount disallowed under sub-paragraph (3) is allowed as a deduction for a subsequent period to the extent that—

(a) qualifying benefits are provided out of the employee benefit contributions in question before the end of that subsequent period, or

(b) where the making of the contributions is itself the provision of qualifying benefits, the contributions are made before the end of that subsequent period.

359. An "employee benefit scheme" was defined in para 9(1) of Schedule 24, FA 2003 as "a trust, scheme or other arrangement for the benefit of persons who are, or include employees of the employer".

1a) Did sums represent money wholly and exclusively laid out or expended for the purposes of appellant's trade?

Wholly and Exclusively

360. HMRC assert in each case that the expense was not incurred wholly and exclusively for the purposes of the appellant's trade. HMRC invite the tribunal take the approach taken by the FTT in *Scotts Atlantic Management Ltd v RCC* [2013] UKFTT 299 (TC); there the artificial steps in first making a declaration of trust before appointing professional trustees then retiring as trustees were found to be part of a pre-planned scheme designed to avoid the operation of Schedule 24 – and it was found that was not merely incidental but an all-pervading object.

361. The appellant argues however the expense was incurred, in each case, as a means of incentivising the key employees of the appellants (this was something which was clearly wholly and exclusively for the purposes of the appellant's trade: see *E Bott Ltd*

v Price (Inspector of Taxes) [1986] STC 100, at 106; and *Sempra Metals Ltd v HMRC* [2008] STC (SCD) 1062, at [74]-[79]).

362. As regards *Scotts Atlantic* the appellants reserve right to argue the case wrongly decided but for present purposes point to the room left in that case by UT for someone to choose one method over another and not be found to have a dual purpose [55]: if that is to mean anything they say it would apply in a situation such as the one here where there is a comparison between two simple methods – one being a contribution to a third party to be held on trust the other being a declaration of trust. There are not all of the "fancy intricate steps" that there were in *Scotts Atlantic.*

363. It appears clear to me that if the contribution made had not had the hoped for effect of avoiding Schedule 24 the appellants would not have made the contribution in the way they did. However the means by which the contribution were made is not conclusive – the question is not why did appellants make the contribution in the way that they did but why did they make the contribution? In my view the clear purpose of the contribution was to remunerate the directors; it was not made to avoid corporation tax.

1c) s43 FA 1989

364. The appellant argues s43(1) is not triggered as no cost is recorded in the accounts in respect of the employee's remuneration.

i) sums represent "amount[s] for which provision is made in the accounts?

365. As regards s43(2) the appellant argues that "provision" means provision in the ordinary accounting sense (a provision, or where there is more certainty an accrual, interpreted in line with GAAP). This particular argument is, given the facts, only relevant to OCO Ltd for y/e 2006.

Findings of fact in relation to accounts:

366. Details of how the sums were treated in the accounts for the various years are set out as follows:

OCO Ltd

367. OCO y/e 30 June 2005: A sum of £400,000 was recognised as an expense in OCO's profit and loss account for the year ending 30 June 2005 and recorded in the notes to the accounts under the heading "Director's emoluments" (note 6).

368. OCO y/e 30 June 2006: £416,000 was recognised by OCO as an expense in the profit and loss account for the year ending 30 June 2006 and recorded in the notes to the accounts under the heading "Directors' emoluments" (note 8). The remaining £4000 was included as a "current investment" in OCO's balance sheet (note 15).

369. Under the heading "Administrative expenses for the year ended 20 June 2006" a figure of £1,002,872 appears in respect of "Directors' remuneration". An amount of £1,027.371 appeared against "Remuneration and other emoluments" in the financial statements under the heading "Directors' emoluments".

Toughglaze Ltd

370. Toughglaze: £1m was recognised in Toughglaze's profit and loss account as an expense for the year ending 31 May 2004 and recorded in the notes to the accounts under the heading "Directors' emolument" (note 17). The sums of £1m and £1.5m were similarly recognised and recorded in respective profit and loss accounts and notes for the accounting periods ending 31 May 2005 and 31 May 2006.

371. The financial statements of both OCO and Toughglaze included the following accounting policy note:

> "The company has established trusts for the benefit of the employees and certain of their dependants. Monies held in these trusts are held by independent trustees and managed at their discretion.
>
> Where the company retains future economic benefit from, and has de facto control of the assets and liabilities of the trust, they are accounted for as assets and liabilities of the company until the earlier of the date that an allocation of trust funds to employees in respect of past services is declared and the date that assets of the trust vest in identified individuals.
>
> Where monies held in trust are determined by the company on the basis of employees' past services to the business and the company can obtain no future economic benefit from those monies, such monies, whether in the trust or accrued for by the company are charged to the profit and loss account in the period to which they relate."

372. The tribunal received expert evidence which was not challenged by HMRC, in the form of a written report from Mr Steven Brice. Mr Brice is a Chartered Accountant and Fellow (FCA) of the Institute of Chartered Accountants in England and Wales (ICAEW) and a Partner in the Financial Reporting Advisory Group at Mazars LLP who has specialised for the last 20 years in financial reporting and who has held a number of offices with various accounting and financial reporting bodies and technical committees. He was instructed by the appellants to consider, against the backdrop of the facts that had been agreed between the parties, whether in relation to each of the years the expenses recognised in the appellants' financial statements, and in relation to UK GAAP (Generally Accepted Accounting Practice) applicable at the time were 1) properly taken, 2) if so what the expense was taken in respect of (the declaration of trust, the appointment of the sum to sub-trusts or in respect of something else) and 3) whether the expense could be said to have been in respect of a provision and if so what the provision was in respect of. Mr Brice's report explained the relevant statutory and accounting framework setting out that UK GAAP consisted of accounting standards and other guidance published by the UK's Financial Reporting Council and that the relevant standards were Financial Reporting Standards ("FRSs") and in particular FRS 5 ("Reporting the Substance of Transactions") FRS 12

("Provisions, Contingent Liabilities and Contingent Assets" and FRS 18 ("Accounting Policies"). His report considered the relevant accounting requirements in respect of accounting for the initial recognition of payments into an EBT and subsequently. For present purposes it is sufficient to note that Mr Brice set out the definition of "Provisions" as defined in FRS 12 as:

> "a liability of uncertain timing or amount". Under FRS 12 a provision should be recognised when: "a) an entity has a present obligation (legal or constructive) as a result of a past event; b) it is probable that a transfer of economic benefits will be required to settle the obligation; and c) a reliable estimate can be made of the amount of the obligation".

373. As to "accruals", FRS 12 went on to explain that:

> "accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example amounts relating to accrued holiday pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions. Accruals are often reported as part of trade and other creditors, whereas provisions are reported separately."

374. Mr Brice's conclusion was that no provisions had been recognised in any of the years for either of the appellants. There were however accruals in each of the years except as regards the accounts of OCO for 2006. (For that year the EBT was created, and amounts were allocated to the sub-trusts prior to the year end. In Mr Brice's opinion when the EBT was established this would have created an EBT asset for OCO but which then had to be de-recognised once sums were transferred to the sub-trusts because in substance OCO no longer had control of the rights or other access to any future economic benefit from those funds. Thus the expense was not recognised in respect of a provision but in respect of de-recognition of the EBT asset.

375. I accept Mr Brice's evidence that no provisions were made in accounting sense in any year, but that accruals were made in every year except OCO y/e 2006.

376. HMRC argue that if Parliament wanted the term "provision" to bear a technical accounting meaning then the wording would have referred to "a provision". They say "an amount for which provision is made" has the wider sense of "something provided for" and the question is simply whether accounts provide for something i.e. one should look at accounts and see whether a sum which has been deducted and charged, whether there is an amount which is there with a view to its becoming employee's remuneration.

377. As to the appellant's argument that a contribution to the EBT was not "employee's remuneration" HMRC says that doesn't matter – the section directs attention to what may become of the amount in the future not whether it is remuneration at the time it is entered into the accounts.

378. In my view when viewed in isolation there is nothing to suggest "provision" should have the restricted meaning the appellant suggests when read in its full context "provision made in the accounts with a view to its becoming employee's remuneration". However subsection 2) in contrast to subsection 1) does appear to be concerned with liabilities which are recognised but not paid. As regards OCO y/e 2006 the fact £1,027,371 appears as Directors' emoluments and within "administrative expenses" is not covered by the statutory words "provision is made in the accounts with a view to its becoming employee remuneration."

ii) Sums held by trustees with a view to [their] becoming employee's remuneration"?

379. HMRC's position is that following the House of Lords's decision in *Dextra* (Lord Hoffman at [17] to [18]) – the "with a view to" test is satisfied if funds were held "on terms which allowed a realistic possibility that they would become relevant emoluments. The Court of Appeal and House of Lords rejected the contention that it was necessary for the funds to held solely or even the principal or dominant intention of paying emoluments. The appellants point out that the House of Lord had a materially different version of s43 before it, and that the ordinary meaning of "with a view to" is a "principal or dominant intention that emoluments should be paid" (relying on the High Court's decision (Neuberger J as he then was) on the interpretation of "with a view to"). In the *Dextra* version the section was used to define the concept of "potential emoluments". The flavour of futurity was, the appellants argue, critical to Lord Hoffman's reasoning in that it resolved the term which was otherwise ambiguous. Also the concept of intermediary had been removed (ss 11 of the old s43) and the difficulty of imputing a dominant intention to a trustee (an objection to a motive test) did not apply in the new s43.

380. I agree with HMRC however that the version of s43(2) applicable to this case similarly connotes futurity and or potentiality. That is consistent with the conception of the subsection capturing liabilities which are likely to or will realistically arise in the future but which do not create a present payment obligation. The subsection fulfils a similar role of enlarging the definition of what is captured by reference to what is provided for in the accounts. While it is true subsection 11) is no longer included that fact does not in my view make a difference to reasoning as it was an additional reason. The House of Lords' point that the relevant term was left undefined still stands to be taken account of.

381. In each of the cases it was a realistic possibility that at time of contribution to EBT the sums would be allocated to sub-trusts and would be extracted. However it must be recalled that the scenario we are in in this section of the decision is one where the conclusion is that no earnings were paid (i.e. the employees were successful in accessing the money without it counting as earnings and being subject to PAYE and NICS). Taking that into account it is difficult then to see that even if the test were one of considering realistically what would happen to say that a payment of "earnings" (i.e. earnings subject to PAYE and NICs) would materialise. So although HMRC's conception of the legal test would be correct, on the facts the restriction on deduction in the legislation would not therefore be triggered.

Appellants' argument that even if contrary to their submissions "with a view to" means "realistic possibility" then that test is not met in the restricted deed case (OCO y/e 2006).

382. The following observations would only be applicable if I were wrong in my conclusion above. HMRC, in response to the appellant's argument above in relation to OCO y/e 2006 and the restricted trust deed say that the time at which the "with a view to" question is asked is when the resolution giving rise to the expense in the accounts was made or at the very least by the time of the financial year end. At those points the restricted trust deeds were not executed.

383. The appellants submit that on the facts the draft trust deed was available to directors before year end. The relevant board minute mentioned "Premier Strategies has advised that the attached deed would not allow the trust capital to be paid out a remuneration but would allow the capital to be used to provide benefits such as interest free loan." The minutes were dated 17 May 2006. HMRC say this is backdated because the letter enclosing the draft was only sent on 24 May 2006. They say this is all that happened before year end because the start of the round is a letter dated 6 June 2006 which encloses an application to open a bank account so no money has been transferred and the trust document is not executed until 29 September 2006. HMRC note no resolution was passed to go ahead with the trust deed, no declarations were made, there was an amount charged or deducted in the accounts with a view to it becoming remuneration under administrative expenses. The position was, HMRC submit, the same as the previous two OCO years.

384. The appellant notes that included in 24 May attachments was a draft deed so it would appear the draft trust deed was available before the year end (and they also highlight that the point about backdating was not put to Mr Varsani).

385. In my view the issue is resolved by construing the provisions purposively and viewing the facts realistically. It was clear the draft deed was available to the appellant before the year end and that it would in due course be executed. The trustees would realistically not pay sums out in breach of the restriction. However there was no evidence which suggested the provision had any business or commercial purpose other than the avoidance of the corporation tax provisions restricting the ability to deduct. The restricted deed provision may accordingly be disregarded for the purpose of applying the relevant statutory provision and does not affect the analysis.

2) Schedule 24 FA 2003 applies to disallow Corporation Tax – declarations of trust (individually or together with professional trustee appointment constitute a) payment or money to another person OR b) transfer of asset to another person

386. The appellant's case is the schedule is not engaged because no payment or transfer to another person has been made as required by paragraph 1(2) – the language did not, contrary to HMRC's view that a purposive interpretation should be adopted, capture a declaration of trust. The fact the company divested itself of a beneficial interest in the money was not relevant. Even if "another person payment or transfer of an asset to

another person" captured the situation of the employer wearing a different hat of being a trustee there was still no transfer or payment.

387.The appellant counters HMRC's argument that the subsequent appointment of new trustees involved a relevant transfer from the company as transferee to professional trustee because 1) on HMRC's own case the payment was not from the employer but rather on HMRC's case someone who was another person – the employer as trustee 2) s40 of the Trustee Act 1925 results in trust property vesting automatically in the new trustee without any conveyance or assignment 3) noting 2(b) the thing transferred must be the source of the employee benefits whereas here all that the employer as trustee could transfer would be the bare legal title. (HMRC's riposte is that the vesting is simply the means by which the asset (the chose in action represented by the bank account) is transferred.

388.HMRC argue in any case the declaration of trust and the appointment of professional trustee formed part of a pre-ordained composite transaction – in transferring from the employer to themselves as trustees and then to professional trustees a transfer to another person has taken place. As regards a *Ramsay* approach whereby the tribunal should view the facts realistically as being that that there had been a transfer from the appellant companies to the professional trustee from the outset, the appellant say there is no warrant for ignoring the declaration of trust and ignoring the trusteeship (because if they were not trustees then the trust did not exist).

389. Looking at section as a whole I do not accept declarations of trust by an employer are not caught. The schedule is concerned with profits and deduction for corporation taxes of the employer. It sets up a suite of anti-deduction rules clearly meant to apply to EBTs. Paragraph 2b) refers to "employee benefit scheme" which is defined in paragraph 9 as meaning "a trust, scheme or other arrangement for the benefit of persons". A payment or transfer to trustees is clearly caught. An employer who has declared a trust over a sum will be someone who is entitled or required to hold or use money or assets to provide benefits. Noting that there would be nothing for instance to prevent e.g. a corporate trustee who was a wholly owned subsidiary of the employer being caught I agree with HMRC, Parliament cannot have intended that a deduction would not be caught because the EBT was constituted through the employer's declaration of trust; there would not be any obvious rationale for drawing such a distinction. Read in their context the words payment or transfer are broad enough to capture the change in legal relationships that arise as between an asset and the changed status of a person when a declaration of trust is made over such assets.

390.Even if that is not correct then construing the purpose of the legislation, and viewing the facts in the light of that realistically, a scheme in relation to which the declaration and then appointment of new trustees are pre-planned and where the declaration by the employer is an inserted step with no purpose other than avoidance of Schedule 24 and which may therefore be disregarded does answer the relevant statutory description of a transfer of asset to another person.

Conclusion

391. For the reasons set out earlier the Regulation 80 PAYE determinations in respect of PAYE and the s8 SSCBA 1992 decisions in respect of NICs are upheld in principle. If the parties cannot settle the amount of the determinations and decisions they may revert to the tribunal.

392. The appellants' appeals are dismissed.

393. This document contains full findings of fact and reasons for the 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.

SWAMI RAGHAVAN
TRIBUNAL JUDGE

RELEASE DATE: 01 JULY 2017

Appendix

RULE 18(6)

COMMON OR RELATED ISSUES OF FACT OR LAW

Background

1. The appellant companies are employers who used a scheme promoted by Premier Strategies disclosed under DOTAS (No. 93756767) which included the following features :

(1) The appellant company declared a trust over sums.

(2) A professional trustee company was appointed to act as trustee with the appellant.

(3) Sums were appointed to subtrusts.

(4) Sums were advanced under agreements ("Loan Agreements") by the trustees of the subtrust to individual employees.

(5) Sums were recognised as an expense in the appellant company's profit and loss account.

2. In respect of each of the sums of money to which these appeals relate (the "Sums") the issues of law are as follows:

(1) PAYE

1. Were the Sums earnings in respect of which the Appellant was under an obligation to account for income tax through the PAYE system at any of the points below, or otherwise:

(1) The declaration of trust made by the Appellant over the Sums - **NO**

(2) The appointment of the Sums to a subtrust. - **YES**

(3) The advance of the Sums by the trustees of that subtrust under Loan Agreements to individual employees.

(2) National insurance contributions

2. There are two sub-issues:[1]

[1] The Rule 18 related appellants may wonder why the issues put before the tribunal in relation to NICs in this case (OCO Ltd and Toughglaze Ltd) differed slightly from the way the issues were put in the Rule 18 direction the related appellants will have seen. In the lead cases the NICs issue were put in the same form as the tax cases whereas in the Rule 18 direction the issues included an additional and alternative argument in respect of those Sums which were allocated to sub-trusts: "(i) Did the Sums constitute (a) amounts paid for the employee's benefit; and/or (b) any remuneration or profit? (ii) In the light of the answer to the foregoing issue, did allocation of those Sums to sub-trusts constitute a

(1) Were the Sums earnings in respect of which the Appellant was under an obligation to account for national insurance contributions at any of the points below, or otherwise:

(a) The declaration of trust made by the Appellant over the Sums. - **NO**

(b) The appointment of the Sums to a subtrust. - **YES**

(c) The advance of the Sums by the trustees of that subtrust under Loan Agreements to individual employees.

(2) Alternatively, in respect of those Sums which were allocated to subtrusts:

(a) Did the Sums constitute (i) amounts paid for the employee's benefit; and/or (ii) any remuneration or profit?

(b) In the light of the answer to question 2(2)(a) above, did allocation of those Sums to subtrusts constitute a payment of earnings within the meaning of section 6(1) of the Social Security Contributions and Benefits Act 1992.

(3) Corporation tax issues

3. If and to the extent that the Sums did not constitute earnings for PAYE income tax purposes:

(1) Did the Sums represent money wholly and exclusively laid out or expended for the purposes of the Appellant's trade?

(2) Did the costs of establishing the Trust constitute capital (rather than revenue) expenditure?

(3) Does section 43 of the Finance Act 1989 apply so as to disallow a corporation tax deduction in the accounting period in which it was claimed? This raises two sub-issues:

(a) Did the Sums represent "amount[s] for which provision is made in the accounts"?

(b) Were the Sums held by the trustees "with a view to [their] becoming employee's remuneration"?

(4) Does FA 2003 Sch 24 apply so as to disallow a corporation tax deduction in the accounting period in which it was claimed?

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payment of "earnings" within the meaning of s.6(1) of the SSCBA". At the hearing it was explained to me by HMRC that this alternative formulation was based on the law as it stood after the Court of Appeal's decision in *Forde v McHugh* had been given but that it was no longer pursued by HMRC following the Supreme Court's decision in that case.