TC02235

Appeal number: TC/2009/15632

Corporation tax – discovery assessment – whether invalid – Appellant made contributions to an employee benefit trust (EBT) – following Dextra, FA 1989, s 43(11) applies - FA 1989, Sch 18, para 45 – whether the Appellant's company tax return for the year ended 30 April 2000 was in fact made on the basis or in accordance with the practice generally prevailing when it was made

FIRST-TIER TRIBUNAL
TAX CHAMBER

BOYER ALLAN INVESTMENT SERVICES LIMITED **Appellant**
(formerly BOYER ALLAN INVESTMENT MANAGEMENT LIMITED)

- and -

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

TRIBUNAL: JUDGE ROGER BERNER
TYM MARSH

Sitting in public at 45 Bedford Square, London WC1 on 23 – 24 January 2012, 6 – 10 February 2012 and 10 July 2012

Kevin Prosser QC and Jonathan Bremner, instructed by Farrer & Co LLP, for the Appellant

Christopher Tidmarsh QC and James Rivett, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. The Appellant, Boyer Allan Investment Services Limited ("Boyer Allan") appeals against discovery assessments made by HMRC under paragraph 41 of Schedule 18 to the Finance Act 1998 ("FA 1998") in relation to two accounting periods ended 30 April 2000 ("the 2000 assessment") and 30 April 2001 ("the 2001 assessment").

2. The appeal arises out of a number of payments made by Boyer Allan to the trustees of a discretionary trust for the benefit of its employees ("the employee benefit trust" or "the EBT") in the accounting periods in question. In its corporation tax returns for those periods Boyer Allan deducted those payments in computing its trading profits under Schedule D, Case 1.

3. As has subsequently transpired, and it is common ground, these deductions were not due as a matter of law. This is the consequence of the judgment, first of all in the Court of Appeal, and later in the House of Lords, in *Macdonald v Dextra Accessories Ltd* [2004] STC 339 (CA); [2005] STC 1111 (HL). The trust deed of the EBT conferred on the trustees an absolute and uncontrolled discretionary power to make payments out of the trust fund to employees, which in most circumstances would be emoluments in the hands of the employees. Accordingly, Boyer Allan's payments to the EBT were held by the trustees on terms which allowed a realistic possibility that they would be paid out as emoluments to employees, and so the payments were "potential emoluments" within s 43(11) of the Finance Act 1989.

4. As potential emoluments, the payments to the EBT were not deductible in the period of account in which they were paid (or would otherwise have been deductible), unless payments were made as emoluments within nine months of the end of the period, or if not, unless and until payments of emoluments were made (s 43(1), (2)).

5. No enquiry was opened into Boyer Allan's returns for either of the accounting periods in question. Before July 2005 HMRC discovered that as regards each of those periods the amounts paid to the EBT had not been paid out in their entirety as emoluments before the expiry of the applicable nine-month period. On 22 July 2005, under FA 1998, Sch 18, para 41, HMRC issued the discovery assessment for each period on the basis that in each case an amount which ought to have been assessed to tax had not been assessed and/or an assessment to tax had become insufficient and/or a relief had been given which had become excessive.

The appeals

6. The sole issue on which we are asked to make a determination at this stage is whether the 2000 assessment is invalidated by the restriction contained in FA 1998, Sch 18, para 45, on the ground that (a) the insufficiency of Boyer Allan's self-assessment or the excessive relief given is attributable to a mistake in the 2000 return as to the basis on which Boyer Allan's liability ought to have been computed, and (b)

the return was in fact made on the basis or in accordance with the practice generally prevailing at the time when it was made.

7. Although that is the scope of this decision, it is not the only ground of appeal. There is also an issue as to the extent deductions should be allowed in respect of each of the periods by reference to payments that were made within the relevant nine-month period. This is a matter which might be resolved between the parties, but if it is not, then the parties are at liberty to return to the Tribunal for a determination. One particular issue is the extent to which, if at all, a deduction should be given for employer's national insurance contributions (NICs) in such a case. Other issues may also arise depending on our determination on the para 45 issue.

Background

8. By way of background, we set out below the statement of agreed facts helpfully provided to us by the parties.

Statement of Facts

1. The Company

1.1 Boyer Allan Investment Services Limited ("the Company") was incorporated on 20 February 1998 in England and Wales with company number 03514279 and with the name Boyer Allan Investment Management Limited. The business of the Company was to provide the service of investment fund management, in return for fees consisting of management fees and performance related fees.

1.2 The current sole shareholder of the Company is:

Boyer Allan Holding Company Limited

1.3 The shareholders of the Company at the time its Corporation Tax returns for the accounting periods ended 30 April 2000 and 2001 were submitted were:

2000 Nicholas Timothy Allan; and

Jonathan Mark Edward Boyer

2001 Nicholas Timothy Allan;

Jonathan Mark Edward Boyer;

Richard William Whittall;

Alexander Griffin;

Guy Commaille; and

Andrew Tay

1.4 The current directors of the Company are:

Nicholas Allan

Andrew Tay

1.5 The directors of the Company at the time its Corporation Tax returns for the accounting periods ended 30 April 2000 and 2001 were submitted were:

2000 Nicholas Allan;

Jonathan Mark Edward Boyer; and

Richard William Whittall

2001 Nicholas Allan;

Jonathan Mark Edward Boyer; and

Richard William Whittall

1.6 The Company's accounting periods end on 30 April in each year. In accordance with Schedule 18 Finance Act 1998 the Company is required to submit its Corporation Tax return for each accounting period within 12 months of the end of it and pay such tax as may be due.

2. The Employee Benefit Trust ("the Trust")

2.1 The Trust was settled by the Company on 28 January 2000, to be known as the "Boyer Allan Investment Management Limited Employee Benefit Trust". The trustees are Schroder Cayman Bank and Trust Company Limited, whose registered office is at PO Box 1020 GT, Harbour Centre, Grand Cayman, British West Indies and Schroder Trust A.G. of 8 Rue d'Italie, 1204 Geneva, Switzerland.

2.2 The sum contributed to the Trust on the date it was settled was One Hundred Pounds (£100).

2.3 The proper law of the Trust is that of the Cayman Islands (clause 13). The trustees have power to change the proper law of the settlement to that of any jurisdiction they see fit, so long as that jurisdiction recognises the validity of the trusts and the interests of the beneficiaries. The trustees have not to date exercised that power.

2.4 The Trust has a "trust period" defined as 150 years from the date of the settlement or ending on such earlier date as the trustees may specify by deed.

2.5 The trustees have the powers associated with a discretionary settlement: power to accumulate income, power to appoint capital and income for the benefit of any

beneficiary as they think fit and power to alter the class of beneficiaries. Subject thereto, the Trust Fund (as defined) is to be held for charitable purposes.

2.6 The beneficiaries of the Trust are defined as the employees of the company and the wives, husbands, widows, widowers, children or step-children and remoter issue of the employees.

2.7 Certain individuals are defined as being excluded from potential benefit by reference to the provisions in Section 13(2) and Section 13(3) Inheritance Tax Act 1984 ("Excluded Person").

3. Contributions to the Trust

Contributions to the Trust were made on the following dates in the following amounts:

Date	Amount	Relevant Accounting Period
31 January 2000	£23,172,000*	1999-2000
27 March 2001	£750,000	2000-2001

* This is the sterling amount at which a $38 million contribution on that day was recognised in the company's accounts.

4. Payments out of the Trust

4.1 The trustees of the Trust exercised their discretion to provide benefits for certain employee beneficiaries in 2000, 2001 and 2002 as follows.

Beneficiary	Date	Payment (net of PAYE/E'ees NI)
N Allan	26 October 2000	£1,200,000
Sarah J S Macaulay	2 February 2001	£2,100
R Usher Smith	2 February 2001	£1,587
Jacqueline Booker	2 February 2001	£18,000
Keiko Hesketh	2 February 2001	£22,800
G Commaille	2 February 2001	£60,000
A H H Griffin	2 February 2001	£90,000
Robbi Mathie	2 February 2001	£22,800
N Allan	28 June 2001	£450,000

N Allan	1 February 2002	£300,000
J Boyer	1 February 2002	£500,000
G Commaille	1 February 2002	£27,000
R Mathie	1 February 2002	£21,720
K Hesketh	1 February 2002	£12,600
J Booker	1 February 2002	£16,500
G Hunter	1 February 2002	£3,066

The parties' respective positions as to the accounting period in which the relevant emoluments paid are allowable deductions S43(1) and (2) FA 1989 and amount allowable are set out in the attached table [*Not included in present print*].

4.2 Income Tax and employer's and employees' National Insurance Contributions in relation to the payments were duly accounted for by the Company on the due dates under the Pay as You Earn Regulations.

4.3 The trustee[s] transferred funds to the Company to reimburse it for the Income Tax and employees' national insurance contribution liabilities of the Beneficiaries as well as the Company's employer's national insurance contribution liabilities, referred to in paragraph 4.2, as follows:

9 November 2000	£1,044,000
9 February 2001	£188,877
3 July 2001	£389,250
11 February 2002	£761,843

5. The Company's Corporation Tax Returns

5.1 The Company's corporation tax return for the accounting period ended on 30 April 2000 was signed and dated by the Company on 24 January 2001 and submitted to HM Revenue and Customs[1] by a firm known as RSM Robson Rhodes, the company's then auditors and tax advisers, together with a copy of the company's audited report and financial statements for the relevant period of account. Receipt of the return and accompanying documents was acknowledged by HM Revenue and Customs by letter dated 7 February 2001.

5.2 The submission of the Company's accounts with its corporation tax self assessment was in compliance with Paragraph 11 Schedule 18 Finance Act 1998. The due filing date for this return was 30 April 2001 (Paragraph 14 Schedule 18 Finance Act 1998). Note 2 to the accounts, at page 9, contains a list of the items charged in arriving at the company's operating profit, including "Contributions to employee benefit trust" amounting to £23,172,000. In the computation submitted with the Company's corporation tax return the contribution to the Trust was included in the sum of £24,298,177 listed as "Salaries" under "Administration Expenses". The

[1] "HM Revenue and Customs" includes its predecessor department, the Inland Revenue.

contribution to the Trust was treated as a deductible expense for corporation tax purposes.

5.3 The Company's corporation tax return for the accounting period ended on 30 April 2001 was submitted by Ernst & Young, the company's then auditors and tax advisers on 30 April 2002 together with a copy of the company's audited report and financial statements for the relevant period of account. The due filing date for this return was 30 April 2002. Note 3 to the accounts, at page 9, contains a list of the items charged in arriving at the company's operating profit, including "Contributions to employee benefit trust" amounting to £750,000. In the computation submitted with the Company's corporation tax return the contribution to the EBT was shown as a component of Staff costs.

5.4 Pursuant to Paragraph 24 Schedule 18 Finance Act 1998 HM Revenue and Customs may enquire into a company tax return on giving notice to the company of their intention to do so within the time allowed. At the material times the time allowed in that paragraph was 12 months from the filing date for the company tax return, provided that the return was submitted on or before the filing date. As such (1) HM Revenue and Customs were obliged to provide any notice of enquiry into the return for the accounting period ended on 30 April 2000 on or before 30 April 2002; and (2) HM Revenue and Customs were obliged to provide any notice of enquiry into the return for the accounting period ended on 30 April 2001 on or before 31 July 2003. No such notice was given to the Company in respect of those periods.

5.5 The Company's corporation tax return for the accounting period ended on 30 April 2002 was submitted by Ernst & Young on 15 April 2003 together with a copy of the company's audited report and financial statements for the relevant period of account. The due filing date for this return was 30 April 2003. Note 3 to the accounts, at page 9, contains a list of the items charged in arriving at the Company's operating profit, including "Contributions to employee benefit trust" amounting to £1,050,000.

5.6 By letter dated 29 January 2004 the Company's then Inspector of Taxes, a Mr D.D. Ryan, gave notice to the Company that he intended to enquire into its tax return for the accounting period ended on 30 April 2002. This notice was validly given in relation to the period of account in question, having been served within 12 months of the filing date for the tax return on 30 April 2003.

5.7 By a letter dated 16 March 2004 Ernst & Young wrote to HM Revenue and Customs enclosing details of certain payments that had been made by the trustees from the Trust. That letter was accompanied by a copy of the Trust Deed and certain board minutes recording the decision to establish the Trust.

5.8 By a letter dated 29 April 2004 HM Revenue and Customs wrote to Ernst & Young and commented that from the details provided by Ernst & Young on 16 March 2004 as follows:

> "I note that sums have been paid out and PAYE and NIC operated on these. The sums paid out in 2002 are in excess of the sums paid in, are

> the amounts paid in, in this period, the ones paid out and from which period would you say the balance came? There are significant amounts still held within the funds that are part of the EBT contributions. I think it is worth stating that if the *Dextra* decision is upheld ie that S43 always applied to such contributions, that the previous years in which contributions were made will have to take account of this. If S43 applies the accounts would be correct, but computational adjustment should have been made for any amount not paid within 9 months of the end of the accounting period and, in effect, the returns would be incorrect for those periods."

5.9 None of the accounts, computations or returns submitted to HM Revenue and Customs for any of the periods 30/4/00 or 30/04/01 disclosed amounts that had not been paid out of the EBT.

5.10 By a letter dated 22 July 2005 the Company's Inspector gave notice to it that he had completed his enquiries into the company's tax return for the period ended 30 April 2002. In relation to the company's claim to corporation tax relief in respect of its contribution to the Trust, he referred to the decision in *Macdonald v Dextra Accessories Limited* (decision of the House of Lords dated 7 July 2005, reported at [2005] 4 All ER 107) and suggested that deductions in respect of contributions to the Trust should be restricted. He also proposed to issue discovery assessments in relation to the accounting periods ended 30 April 2000 and 2001 under Paragraph 41(1) Schedule 18 Finance Act 1998.

5.11 An assessment was issued on 22 July 2005 by HM Revenue and Customs to recover tax of £8,439,315 and accrued interest of £2,423,461 in respect of the accounting period to 30 April 2000.

5.12 A further assessment was issued by HM Revenue and Customs on 22 July 2005 to recover tax of £515,837.10 and accrued interest of £67,697.02 in respect of the accounting period to 30 April 2001(…).

[*End of Statement of Facts*]

9. In addition to this agreed statement of facts, we heard evidence from a number of witnesses, primarily in relation to the question of what practice, if any, was, at the relevant time, adopted by taxpayers, on the one hand, and HMRC on the other, in relation to the deductibility of payments into employee benefit trusts of the nature of the EBT. We were also provided with a number of bundles of documents. From this evidence we shall make further findings of fact. But we turn first to the law and the issue of construction of the phrase "on the basis or in accordance with the practice generally prevailing", as it appears in FA 1998, Sch 18, para 45.

The law

10. Although this appeal is concerned with FA 1998, Sch 18, para 45, the underlying tax assessments were made by virtue of FA 1989, s 43, and we shall be referring to it throughout this decision. We therefore set that section out in full:

"**43 Schedule D: computation**

(1) Subsection (2) below applies where—

(a) a calculation is made of profits or gains which are to be charged under Schedule D and are for a period of account ending after 5th April 1989,

(b) relevant emoluments would (apart from that subsection) be deducted in making the calculation, and

(c) the emoluments are not paid before the end of the period of nine months beginning with the end of that period of account.

(2) The emoluments—

(a) shall not be deducted in making the calculation mentioned in subsection (1)(a) above, but

(b) shall be deducted in calculating profits or gains which are to be charged under Schedule D and are for the period of account in which the emoluments are paid.

(3) Subsections (4) and (5) below apply where—

(a) a calculation such as is mentioned in subsection (1)(a) above is made,

(b) the calculation is made before the end of the period of nine months beginning with the end of the period of account concerned,

(c) relevant emoluments would (apart from subsection (2) above) be deducted in making the calculation, and

(d) the emoluments have not been paid when the calculation is made.

(4) It shall be assumed for the purpose of making the calculation that the emoluments will not be paid before the end of that period of nine months.

(5) But the calculation shall be adjusted if—

(a) the emoluments are paid after the calculation is made but before the end of that period of nine months,

(b) a claim to adjust the calculation is made to the inspector, and

(c) the claim is made before the end of the period of two years beginning with the end of the period of account concerned.

...

(8) In a case where the period of account mentioned in subsection (1)(a) above begins before 6th April 1989 and ends before 6th April 1990, the references in subsections (1)(c), (3)(b), (4) and (5)(a) above to nine months shall be construed as references to eighteen months.

(9) In this section "period of account" means a period for which an account is made up.

(10) For the purposes of this section "relevant emoluments" are emoluments for a period after 5th April 1989 allocated either—

(a) in respect of particular offices or employments (or both), or

(b) generally in respect of offices or employments (or both).

(11) This section applies in relation to potential emoluments as it applies in relation to relevant emoluments, and for this purpose—

(a) potential emoluments are amounts or benefits reserved in the accounts of an employer, or held by an intermediary, with a view to their becoming relevant emoluments;

(b) potential emoluments are paid when they become relevant emoluments which are paid.

(12) In deciding for the purposes of this section whether emoluments are paid at any time after 5th April 1989, section 202B of the Taxes Act 1988 (time when emoluments are treated as received) shall apply as it applies for the purposes of section 202A(1)(a) of that Act, but reading "paid" for "received" throughout.

(13) In section 436(1)(b) of the Taxes Act 1988 (profits to be computed in accordance with provisions of that Act applicable to Case I of Schedule D) the reference to that Act shall be deemed to include a reference to this section."

11. There is no dispute that the discovery assessments were not validly made for any reason apart from the application of FA 1998, Sch 18, para 45. That paragraph provides as follows:

Return made in accordance with prevailing practice

45 No discovery assessment for an accounting period for which the company has delivered a company tax return, or discovery determination, may be made if—

(a) the situation mentioned in paragraph 41(1) or (2) is attributable to a mistake in the return as to the basis on which the company's liability ought to have been computed, and

(b) the return was in fact made on the basis or in accordance with the practice generally prevailing at the time when it was made.

12. There is no dispute on para (a) of para 45. It is common ground that Boyer Allan's return for the 2000 period was made on the footing of a mistake as to the legal basis on which the deductions for the payments to the EBT should properly be claimed. The dispute between the parties is solely concerned with para 45(b).

13. It is also common ground that the burden of proof that the return for the 2000 period was in fact made on the basis or in accordance with the practice generally prevailing at 24 January 2001 (the date of filing of the return) rests on Boyer Allan, to the usual standard of proof, namely the balance of probabilities.

14. Submissions by both parties focused on the meaning of the phrase "in accordance with the practice generally prevailing". It was recognised that para 45(b) contains two tests, the other being that the return is made "on the basis … generally prevailing". However, Mr Prosser submitted, and Mr Tidmarsh did not argue to the

contrary, that these are not alternative tests, but rather represent expressions of the same test. We accordingly confine our consideration to the question of what is meant by "practice generally prevailing".

15. We start with a case in the High Court which addresses this question in the very same context, namely the application of s 43 FA 1989 to an employee benefit trust. In *Revenue and Customs Commissioners v Household Estate Agents Ltd* [2008] STC 2045, the taxpayer company established an employee benefit trust in 1998. In 1999 a payment was made into the trust, and a deduction was claimed. On 23 November 2005 HMRC made a discovery assessment for the 1999 period disallowing the deduction.

16. The case went to the General Commissioners. So far as material, those commissioners decided that FA 1998, Sch 18, para 45 did not apply because HMRC had not satisfied them that the return was not made in accordance with a generally prevailing practice. In the High Court, Henderson J held that this was an error of law. The legal burden of establishing that para 45 applies rests on the taxpayer.

17. Before the General Commissioners the taxpayer had submitted that no published view of HMRC on the application of s 43 FA 1989 to contributions to an EBT had been found or drawn to the taxpayer's attention. For HMRC, it had also been submitted that, prior to *Dextra*, there was no prevailing practice such that HMRC and the accountancy profession were in agreement. However, neither party had been aware of guidance published in para 1049 of the Inspector's Manual, Sch D under the heading "Trade deductions: relevant/potential emoluments", the relevant part of which stated:

> "… payments made by a company to the trustees of an [EBT] to provide benefits in the form of cash or shares to employees of the company will often not constitute potential emoluments. But any case in which it appears that such a trust is being used by a company largely to channel emoluments to employees so as to obtain a deduction for the payments when charged whilst deferring the receipt of the emoluments in the hands of the employee should be submitted to Business Profits Division (Schedule D)."

18. In this connection, Henderson J observed (at [53]:

> "I observe at once that this guidance was at best inconclusive. It says only that payments made by a company to the trustees of an EBT to provide benefits to employees in the form of cash or shares will 'often' not constitute potential emoluments, which implies that s 43 will not apply in such cases. However, it does not disclose the relevant criterion for distinguishing those cases from ones where s 43 will apply. The guidance then goes on to say that cases where EBTs are used largely to 'channel' emoluments so as to obtain a timing disparity between deduction and receipt of the emoluments should be submitted to Business Profits Division, but again no clear criterion is stated for identifying such cases, and all that can safely be deduced is that the

> Revenue thought they needed to be carefully scrutinised because of the potential for tax avoidance."

19. The learned judge was then left with the question of what to do in the light of his conclusions. The alternatives were to remit the matter to the commissioners for them to reconsider the application of para 45 on the basis that the burden of proof lay on the taxpayer, or simply allow the appeal and affirm the assessment. The judge decided not to remit. After referring to a submission by counsel for the taxpayer that HMRC's representative had misrepresented HMRC's practice to the commissioners, Henderson J gave his reasons as follows (at [58] – [60]):

> "**[58]** In the first place, if one leaves aside the alleged misrepresentation, the position is in my view straightforward. If the company wished to rely on para 45 at the hearing before the commissioners, the burden was on the company to establish both an operative mistake in the return and the practice generally prevailing in August 2000. The company failed to adduce evidence on either of those questions, and relied only on the submissions recorded in para 6 of the case stated. Those submissions refer to what was alleged to be 'the profession's view' that s 43 of the Finance Act 1989 did not apply to contributions to EBTs. However, without any evidence to support that assertion, and without any evidence that the Revenue took the same view, there was no material before the commissioners which could support a conclusion that a settled practice existed, let alone a settled practice which could properly be described as 'the practice generally prevailing at the time'. Without attempting to give an exhaustive definition, it seems to me that a practice may be so described only if it is relatively long-established, readily ascertainable by interested parties, and accepted by HMRC and taxpayers' advisers alike: compare the decision of the Special Commissioners (Dr A N Brice and Mr John Walters QC) in *Rafferty v Revenue and Customs Comrs* [2005] STC (SCD) 484, para 114. Accordingly, on the basis of the material before them, and on the assumption that they had directed themselves correctly on the burden of proof, the commissioners could only have concluded that para 45 did not apply. There would therefore be no point in remitting the matter to them for reconsideration.
>
> **[59]** The next question is whether the alleged misrepresentation makes any difference to the above analysis. In my judgment it does not. Even if the commissioners had been informed of the relevant passage in the manual, its terms are far too vague and inconclusive to support the inference that the company made its return in accordance with the generally prevailing practice. I consider that the same is true of a short, anonymous article in *The Law Society Gazette* of 4 October 1989, upon which Mr Woolf also relied, which gave a brief indication of the Revenue's reported views on the application of s 43 to payments into non-statutory share ownership trusts. Thus the position would have been no different if this material had in fact been before the commissioners, and again there would be no point in remitting the matter to them for further consideration.
>
> **[60]** It was in recognition of this fact, I think, that Mr Woolf argued for a remitter with permission to adduce fresh evidence generally on the

> para 45 issue. However, such an order should only be made in exceptional circumstances, and I can see no good reason in the present case why the company should be given a second chance to adduce evidence which it could and should have adduced at the first hearing. HMRC cannot in any way be blamed for the company's failure to come to the hearing armed with such evidence. All that would be needed to remedy any prejudice to the company caused by Mrs Morris's failure to disclose the relevant extract from the manual would be for it to be looked at and taken into account; but as I have already said there would be no point in doing this, because it could not make any difference to the result."

20. Mr Prosser was content to accept that, for a practice to be one that was generally prevailing, it had to be relatively long-established and it had to be accepted by HMRC and taxpayers' advisers alike. However, he submitted that it was not necessary, despite what Henderson J had said, for the practice to be readily ascertainable by interested parties. Because we are bound by the ratio of *Household Estate Agents*, this submission necessarily includes an argument that this part of Henderson J's judgment is *obiter*. Mr Prosser says that the case was decided on the basis that the taxpayer had not produced any evidence of any settled practice, and that the remarks of the judge as to the attributes of a practice generally prevailing were not necessary to his conclusion.

21. We do not agree. Although the failure of the taxpayer in *Household Estate Agents* to adduce any evidence to support its assertions was enough for HMRC's appeal to be allowed, that was not the end of the matter. The next stage was to consider whether the case should be remitted. In order to decide that question, one of the issues was whether the alleged misrepresentation by HMRC at the original hearing would lead to a different conclusion than that the commissioners could only have concluded that para 45 did not apply. In deciding that it would not, Henderson J was drawing on his analysis of the meaning of "practice generally prevailing" in determining that the passage in the Inspector's Manual and the article in the *Law Society Gazette* of 4 October 1989, if they were made available to the commissioners, would not make any difference to the result.

22. That being so, we are bound by the judgment of Henderson J in this respect. We shall consider what that means in a moment. But before doing so we should consider what the position would have been had we agreed with Mr Prosser. In that case, of course, the remarks of Henderson J in *Household Estate Agents* would nevertheless have been persuasive. But Mr Prosser argued that we should not follow them. He referred us in this connection to similar wording to that in para 45, but in the opposite direction, namely where a taxpayer, in relation to income tax or capital gains tax, claims relief in respect of an excessive assessment by reason of an error or mistake in a return, in what was s 33 of the Taxes Management Act 1970 ("TMA"). Under that section relief was not available in respect of an error or mistake as to the basis on which the liability of the claimant ought to have been computed where the return was in fact made on the basis or in accordance with the practice generally prevailing at the time when it was made.

23. Until its recent repeal, the wording of s 33 had a long pedigree[2]. Mr Prosser referred us to *Rose Smith & Co Ltd v IRC* (1933) 17 TC 586 (Ch) where the High Court (Finlay J) dismissed an appeal by the taxpayer from the Special Commissioners who had held, in relation to a claim under s 24 of the Finance Act 1923 which, as the judge remarks (at p 591), had broken new ground in allowing a person who had been wrongly assessed by reason of a mistake in his return to be repaid, that the company's treatment had in fact followed the basis generally prevailing at the relevant time. The appeal was dismissed on the ground that there was no point of law in connection with the computation of profits or income, and that the finding of the commissioners was a finding of fact, so there is no discussion of the relevant wording in the High Court.

24. The case largely concerned the use by the taxpayer company of an "average" or "even spread" method of calculating costs under hire purchase agreements, instead of the "actuarial" method which would have given rise to greater deductions in the earlier years of the agreement. The company argued that this was an error or mistake which had led to excessive assessments and that there was no evidence of any practice generally prevailing which would disentitle the company from relief. The commissioners found, on the evidence, that the practice generally prevailing had been to deduct the "average" and not the "actuarial" hire. That finding was accepted by the High Court as a finding of fact.

25. Mr Prosser argued that the wording of what was s 33 is the same as that in para 45, and the two must be construed consistently with one another. That being so, it would be wrong to regard para 45(b) as some sort of estoppel defence, requiring the publication of a statement on which a taxpayer places reliance. In the converse case, such as under s 33, it is HMRC who are relying on the practice, and there can be no question of estoppel.

26. Pausing there, we agree. Indeed, in the course of his submissions, Mr Tidmarsh was disposed to accept that it was not necessary for the taxpayer to have relied upon the practice in order to seek the protection of para 45. We find that there is no such requirement. In their skeleton argument Mr Tidmarsh and Mr Rivett pointed out that para 45 requires that the return is made in accordance with the relevant practice, and, they said, not merely in accord with the practice. We do not consider that this means that there needs to be any reliance on the practice, nor indeed that it is necessary for the taxpayer, when making the return, to have been aware of the practice. The use of "made" in this context does not introduce any subjective requirement that implies a need for knowledge or reliance; para 45(b) will be satisfied if the return that is made is in accordance with the identified practice, irrespective of the state of mind of the taxpayer. That too was accepted by Mr Tidmarsh in the course of closing submissions.

27. By reference to the introduction of what became s 33 in 1923, Mr Prosser submitted that the reference to a practice generally prevailing could not be confined to publicly stated practices on the part of the Revenue. In 1923, although we had no

[2] Section 33 was replaced by TMA 1970, Sch 1AB with effect for claims made on or after 1 April 2010. See now Sch 1AB, para 2(8), (9).

direct evidence, we can accept that there was nothing like the current publicity of HMRC practice, from statements of practice and tax bulletins to internal guidance manuals. The former legislation, containing the same words as appear now in para 45(b), was dealing with Revenue practice, but not with a practice that had to be publicly stated. On this basis, Mr Prosser argued that, *pace* Henderson J in *Household Estate Agents*, there should be no requirement that the practice should be readily ascertainable by interested parties.

28. In his judgment in *Household Estate Agents*, Henderson J referred to an earlier decision of the Special Commissioners, *Rafferty v Revenue and Customs Commissioners* [2005] STC (SCD) 484, which had considered the issue of practice generally prevailing in the terms of the corresponding provision to para 45(b) in the case of individuals, namely s 29(2) TMA. The case concerned the sale of a business and the receipt by the seller of a lump sum as consideration for his right to receive commissions and fees after his retirement as well as goodwill. He made his return on the basis that the whole sum received was capital and not income.

29. The Special Commissioners allowed the taxpayer's appeal on the substantive question whether the relevant part of the lump sum could be taxed as a post-cessation receipt or not. They also considered the position had that not been the case, and whether, if there had been an error or mistake in the taxpayer's return, the return had been made on the basis or in accordance with the practice generally prevailing when it was made. On the facts they concluded that there was no evidence of such a practice. They said (at [114]:

> "… We construe s 29(2) as a protection to the taxpayer from an assessment where the Revenue have changed their mind on a doubtful point in a sense adverse to the taxpayer. It would in our judgment go too far to construe it, as Mr Goldberg urged us to do, as a bar on the Revenue from raising a discovery assessment in particular circumstances where they had not publicly adopted a practice. We agree that a practice generally prevailing has to be a practice, or agreement, or acceptance over a long period whereby the Revenue agreed or accepted a certain treatment of sums in particular circumstances. In the circumstances of this case, for there to have been such a practice, the Revenue would have had to have agreed or accepted that a consideration such as that received by the appellant from Fortuna was to be treated for tax purposes as having been capital and not income. There was no evidence of such a practice."

30. Although the Special Commissioners rejected the argument for the taxpayer that the Revenue were barred from raising a discovery assessment purely on the basis that it was the practice in making returns, and that it was not necessary to consider the Revenue's practice, we do not read the commissioners' reference to public adoption of a practice as representing a view that there would have to be a published statement of HMRC. We agree with the Special Commissioners that the practice has to be one that is adopted by taxpayers and the Revenue alike.

31. We are, as we have determined earlier, bound by the description afforded by Henderson J in *Household Estate Agents* to the expression "practice generally

prevailing". But we do not consider that the issue depends upon any rule of precedent. In our view, the analysis is the same whether *Household Estate Agents* is binding on us or not.

32. In construing para 45(b) it is instructive, we think, to have regard to the context in which that provision falls to be considered. Under self-assessment, for companies as much as for individuals, the burden is placed on the taxpayer to make returns that calculate the tax payable. That burden is balanced by protections for taxpayers (see *Langham v Veltema* [2002] STC 1557, per Park J at [10]). As a general matter, where a company has made a return, if no notice of enquiry is given by HMRC within the relevant time limit, a discovery assessment or a discovery determination will only be capable of being made in defined circumstances. Furthermore, as is in issue in this appeal, even if those circumstances exist, the discovery assessment or determination will not be capable of being made if the return was made on the basis or in accordance with the practice generally prevailing at the time when it was made.

33. The corresponding provisions for individuals are those in s 29 TMA. In *Langham v Veltema* in the Court of Appeal [2004] STC 544, the issue concerned s 29(5), under which an inspector may make a discovery assessment if he could not have been reasonably expected, on the basis of certain specified information made available to him, to have been aware that there was an insufficiency of tax etc. The question of underlying purpose was considered. At [31], Auld LJ said:

> "… it may be helpful to consider first the underlying purpose of the new self-assessment scheme. It seems to me that its purpose is to simplify and bring about early finality of assessment to tax, based on an assumption of an honest and accurate return and accompanying documentation by the taxpayer."

34. The twin purposes of simplicity and finality, in our view, demand both certainty and clarity in the application of the relevant provisions. A practice within para 45(b) must be capable of being readily ascertained; otherwise it could not be one that was capable of general acceptance. And in order to be readily ascertainable, the practice must have substance (in the sense of not being inchoate), and be sufficiently precise and devoid of uncertainty as to its application. In particular, such a practice would not exist if it was equivocal or dependent on the ascertainment of facts, except where the criteria for its application by reference to the facts were themselves understood with a sufficient degree of precision so as the make the practice one that can be readily applied in any given case.

35. A practice of this nature will be readily ascertainable by interested parties in a number of possible ways. There may be a published statement of practice, concession or otherwise by HMRC. That process might be more or less formal. But publication is not a necessary ingredient. A practice, albeit unpublished, will be equally ascertainable if it can be readily discovered from enquiry of HMRC themselves or from advice sought from a practitioner in the field, particularly where the practice arises in a specialised area. Construed in this way, as we believe is right, there is in our view nothing between *Household Estate Agents*, *Rafferty* and *Rose* on this issue. Mr Tidmarsh accepted that, although the paradigm case of a practice would be a

statement of practice or an extra-statutory concession, it was possible for something to be identified as the practice if it were settled, defined and agreed between HMRC and taxpayers, or communicated between HMRC and taxpayers, or otherwise sufficiently identified to the outside world.

36. The requirement for a practice to be relatively long-standing emphasises, in our view, that such practice is not confined to published statements but extends to unpublished practices which are understood and accepted as a general matter. A new practice that is published will be unlikely, in our view, to require the same degree of longevity as might be required for an unpublished practice. Although each case will depend on its own facts we can envisage that an unpublished practice of the Revenue might take longer to seep into the collective consciousness of tax advisers generally. We believe that such a distinction was intended to be drawn in *Rafferty*, when the Special Commissioners spoke of a practice, without reference to any period of adoption, and separately of an "acceptance over a long period". It will be a matter of evidence in any particular case, but in our view a published practice is likely to be capable of being regarded as "generally prevailing" over a shorter period than one that merely becomes established through practice.

37. It is of course the case that, in order to be generally prevailing, the practice must have been capable of being identified by taxpayers when making their returns (although it is not necessary that a taxpayer has identified the practice). An internal practice adopted by HMRC, however precise in its terms, will not be generally prevailing until such time as it can be identified with sufficient precision by taxpayers and their advisers. We do not consider that communication as such is required. As custom can arise by usage, so too a practice can become generally prevailing merely by general adoption, irrespective of any actual communication. But there must still be the necessary quality of precision in the manner in which the practice is generally adopted and applied.

38. The same quality of clarity and precision must be present in the understanding of HMRC and taxpayers and their advisers alike. It is not enough that an interested party be able to ascertain from HMRC what its approach to a particular issue might be. It must be possible to demonstrate that the same answer to the enquiry would be given by the broad community of tax professionals engaged in a particular area.

39. In order that a practice may be regarded as generally prevailing, it must have been adopted by HMRC and generally, if not universally, by the taxpayer community. Furthermore, if a practice encompasses a number of aspects, or includes exceptions or caveats, all aspects of the practice must be so adopted and consistently applied. A practice will not be generally prevailing if it is not agreed, or respected, as a whole, either by HMRC failing to apply every element of the practice in every case where it should be applied, or by taxpayers adopting only those parts that are favourable to them, but disputing others that are not.

40. The practice must be settled. This will not be the case if it is articulated or applied otherwise than in a consistent manner. In *Household Estate Agents*, at [58], Henderson J refers to the need for there to be evidence of a "settled practice". In our

view, for there to be a practice of the nature envisaged by para 45(b), it must be on the basis of settled criteria. Those criteria must not be subject to change depending on the particular circumstances or the facts of a particular case. If the facts are relevant to the application of a practice, the relevant factors must themselves be clear and unequivocal. That is not to say that a practice must be immutable. It can of course be subject to change, but if it is changed, then the existence of the practice must be tested anew to ascertain if and when it can be regarded as generally prevailing.

41. We consider that mere inactivity can, in appropriate circumstances, give rise to a practice. This may be the product of a conscious response to a particular issue or a defined set of circumstances, or it may simply arise as a result of repetition of an omission to act in a different way, provided that the omission to act is based on a consideration of the issue, such as the applicability of a relevant statutory provision, or of the circumstances. But such an omission must also be capable of articulation in the same way as a positive act. It must have both clarity and substance. Its parameters must be clearly defined so that the general acceptance amounts to the same unequivocal understanding.

42. Mr Prosser argued that a distinction has to be drawn between something that is a shared view, which is applied in practice by taxpayers and HMRC alike, and the reasons why that view is adopted. We agree that if there is a sufficiently precise practice that is adopted and followed by both taxpayers as a general matter and HMRC, then the underlying rationale for any particular party deciding to adopt such a practice, or to act or omit to act, is not relevant. What matters is that there is a mutual understanding to proceed in a particular way in particular defined circumstances. There does not need to be an identical thought process on all sides in arriving at the settled practice. But in determining whether there is a practice at all, it will often be relevant to consider the underlying rationale for what has emerged.

The evidence

43. Having determined the nature of the practice which Boyer Allan must demonstrate is present to succeed in its appeal, we now turn to the evidence.

44. We had evidence from a number of witnesses, to whom we refer below, and a significant amount of documentary evidence. We have considered all of that in coming to our decision, but we shall refer in detail only to those parts we consider to have been most material to our determination.

45. The witnesses for Boyer Allan were:

(1) Robin Aitchison, a partner of Ernst & Young LLP, who provided a witness statement not in that capacity, but as an adviser to the asset management industry.

(2) Karen Doe, a Director in the Business Tax Group of Rawlinson & Hunter, an international group of professional firms, specialising in financial and taxation advice. Ms Doe gave evidence based on her experience, at the material time for this appeal, working for the accounting firm Grant Thornton.

(3) Nigel Eastaway, a partner in the Private Client Services London Tax Group at BDO LLP. Mr Eastaway has an array of professional qualifications and is well-known in the tax field as an active member of various tax committees and associations, and as the author of several books on taxation. Prior to it being acquired by BDO in October 2007, Mr Eastaway was a director of Chiltern plc.

(4) Ratan Engineer, a partner in Ernst & Young LLP. Mr Engineer provided a witness statement on the accounting treatment of the contributions made by Boyer Allan to the EBT. He had signed the auditors' report in the financial statements of Boyer Allan for the years ended 30 April 2001, 2002 and 2003. His evidence was unchallenged and we accept it. It is convenient to summarise the material points here.

For the years ended 30 April 2000 and 30 April 2001, the EBT was not shown on the balance sheet of Boyer Allan. This was the correct treatment at that time. The company did not have control of the EBT so UITF 13[3] did not apply to require the assets and liabilities of the EBT to be shown on the balance sheet of the company. Additionally, UITF 13 applied to employee share ownership plans ("ESOPs") rather than to EBTs.

UITF 32 was issued on 13 December 2001. This required companies to recognise the assets and liabilities of EBTs on their balance sheets, by reason of UITF 32 treating the companies as having control of the EBTs. Accordingly, the accounts of Boyer Allan for the period ended 30 April 2002 referred to this change of accounting policy and noted the inclusion of an asset within current and fixed assets and an equivalent liability as a provision for liabilities and charges.

From an accounting perspective, it was immaterial when considering the deductibility of a contribution to an EBT whether a payment had been made out of the EBT. The accounts showed a debit in the profit and loss account in relation to payments made into the EBT. There was never a persuasive argument made that this did not represent a debit to the profit and loss account for accounting purposes.

(5) Robert Field, a solicitor and partner at Farrer & Co, where he is the head of the firm's tax department. At the material time Mr Field was a partner in Lawrence Graham, and was involved in corporate tax work.

(6) Anthony Foreman, tax partner with PKF (UK) LLP from November 1988 until 31 March 2010, who is also the author of a number of tax books.

(7) Victoria Goode, a solicitor and partner in the Employee Incentives Department at Lewis Silkin LLP, whose evidence related to her work with Deloitte, implementing EBTs for clients and being used as an internal technical resource (drafting precedent documents etc) for EBTs.

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[3] Accounting Standards Board Urgent Issues Task Force Abstract 13 issued in June 1995: "Accounting for ESOP Trusts".

(8) Ian Grant, a Director of Smith & Williamson Limited in their private client tax group. He gave evidence based on his experience with WJB Chiltern Plc at the material time.

(9) Aidan Langley, a non-practising solicitor. Mr Langley's evidence concerned his experience with EBTs at PricewaterhouseCoopers ("PwC") between 1997 and 2001 and thereafter at Deloitte & Touche.

(10) Thomas Moore of Duncan & Toplis. Mr Moore's evidence related to his EBT experience when he was employed by PwC.

(11) Michael Sherry, a barrister at Temple Tax Chambers, specialising in taxation since 1985. Mr Sherry is the author of "Tax Planning for Family Shareholders" (1992).

(12) Andrew Thornhill QC, the renowned tax silk who appeared, as counsel for the taxpayer, in *Dextra*. One of the areas of Mr Thornhill's specialisation has been tax on employment income.

(13) Avril Whitfield, a former Inspector of Taxes until January 2001 when she joined KPMG. Ms Whitfield was a partner in Mazars LLP and with that firm head of tax in London until 31 August 2012.

(14) Francis Cochrane, a former partner of Latham Crossley and Davies (which became RSM Tenon), who now acts as a non-executive director and trustee, in most cases with particular responsibility for tax matters.

46. Apart from Mr Engineer, those witnesses for Boyer Allan referred to in the previous paragraph gave evidence in relation to the practice adopted in relation to the question of the deductibility of contributions to EBTs. In addition we had evidence from Nicholas Allan, a director and shareholder of Boyer Allan, and Gordon Matthew, chief executive of Schroder Trust AG, concerning the establishment and conduct of the EBT from January 2000 to April 2001.

47. The witnesses for HMRC were:

(1) Ronald Macdonald, currently a team leader in the HMRC Anti-Avoidance Group, who leads that group on employment income tax avoidance issues. Mr Macdonald commenced his role in August 1999. He was the named respondent in *Dextra*, and has since 1999 advised on most of the EBT litigation in which HMRC has been involved.

(2) Steven Terry, an aspect enquiry team leader within HMRC. Mr Terry provided a witness statement to explain the work carried out by HMRC in identifying documents disclosed for the purpose of these proceedings. His statement was not challenged, and we accordingly accept it.

(3) Desmond Ryan, an Inspector of Taxes who, up to 2008, was responsible within HMRC for the tax affairs of Boyer Allan. Mr Ryan provided a witness statement to explain the circumstances in which the discovery assessments at issue in this appeal were made by HMRC. His evidence was not challenged and we accept it.

Findings from the evidence

48. The primary question for us is the extent to which the evidence shows the existence of a generally prevailing practice in accordance with which the company tax returns submitted by Boyer Allan were made. This entails an examination of the relevant understandings of both taxpayers and their representatives and HMRC, to consider the extent to which this gave rise to a mutually accepted practice. This is not a case, as was *Household Estate Agents*, where there is a paucity of evidence.

Published HMRC statements

49. The natural starting point is to look at the material published by HMRC in this area.

50. During the consultations that took place during the passage of the Finance Bill which led to the enactment of s 43 FA 1989, the Law Society raised the question whether the rules restricting the deduction for Schedule D purposes of payments to intermediaries might prevent a deduction in respect of a company's contribution to a non-statutory ESOP. The *Law Society Gazette*, No 25, 4 October 1989 records that:

> "The Inland Revenue have considered this question and concluded that this will not generally be the case. This is because a payment to an ESOP by a company will not generally be made with a view to that payment becoming an emolument, given the variety of ways in which the trustees of non-statutory ESOPs may properly use the contributions they receive, for example, to pay expenses or interest on money they had borrowed.
>
> The Inland Revenue have said that they will keep the position under review and they would be glad to hear of any particular non-statutory ESOP where there appears to be a strong *prima facie* case that the s 43 rules about potential emoluments might apply."

51. Public guidance to Inland Revenue Inspectors in the relevant period also referred to s 43. Paragraph IM1049 of the Inspector's Manual (1995) refers to the definitions of "relevant emoluments" and potential emoluments" in s 43(10) and (11), and to cases where items in respect of emoluments would be properly deductible, on normal accounting principles. An example is then given of payments made by an employer to a third party to enable that third party to make payments to, or provide benefits for, employees which will constitute emoluments in the employees' hands at some future date, perhaps, on the occasion of the happening of some contingency. The paragraph then goes on to say:

> "In this context payments made by a company to the trustees of an employee benefit trust to provide benefits in the form of cash or shares to employees of the company will often not constitute potential emoluments. But in any case in which it appears that such a trust is being used by a company largely to channel emoluments to employees so as to obtain a deduction for the payments when charged whilst deferring the receipt of the emoluments in the hands of the employee should be submitted to Business Profits Division (Schedule D)."

52. The same theme appears in para IM689 of the Inspector's Manual. We were shown the version from April 2001. It describes the position as follows:

> "… payments made by the company to the trustees of an ESOT or other employee benefit trust to provide benefits in the form of cash or shares to employees of the company will not normally constitute potential emoluments for the purposes of Section 43(11) FA 1989. Any case in which it appears, however, that such a trust is being used by a company largely to channel emoluments to employees so as to obtain a deduction for the payments when charged whilst deferring the receipt of the emoluments in the hands of the employee should be referred to Business Profits Division, Schedule D, before the company payments are challenged as constituting potential emoluments within Section 43(11).
>
> Refer any points of difficulty arising in connection with such payments to Business Profits Division, Schedule D, for advice."

53. The Tax Bulletin issued by the Inland Revenue in February 1997 included an article on the tax treatment of an employer's contributions to an Employee Share Ownership Trust ("ESOT"). It focused on the case where the trust was not a statutory ESOT, the contributions were revenue in character and not capital, but where normal accounting practice required UITF 13 to be applied, with the result that the making of the contributions was treated as giving rise to an asset in the employer's accounts.

54. The article discusses the application of Case 1 computational principles in those circumstances. It makes the general point that the accounts are to be followed for tax purposes unless overridden by a specific tax rule. The question it poses is whether the time at which contributions to non-statutory ESOTs are charged against profits under UITF is overridden by some general tax principle. It concludes, based on relevant case law in this connection (*Threlfall v Jones*; *Gallagher v Jones* 66 TC 77 and *Johnston v Britannia Airways Ltd* 67 TC 99), that no general principle would override the accounting treatment required by UITF 13. The Tax Bulletin article does not refer to s 43. This is not surprising, because s 43 can only apply if the contributions would otherwise be deductible.

The advisers' evidence

55. We accept the evidence of all the advisers.

56. We accept the submissions of Mr Prosser and Mr Bremner in this respect that these advisers were well aware that trust deeds of EBTs conferred on trustees a broad power to make payments to employee-beneficiaries, but that those advisers were nevertheless advising their employer clients that payments into such a trust were in principle deductible. Those advisers did not advise that the payment was or might be a "potential emolument" within s 43(11) because of such a power. They consistently advised that the payment was deductible if it was revenue in nature, it was made wholly and exclusively for the purpose of the employer's trade and the employer's accounts were computed in accordance with GAAP. In some cases the advisers

would specify that the purpose must not be to "channel" emoluments from the employer to employees via trustees under their control.

57. The evidence of Ms Doe was that when giving advice she (and the rest of her team) focused primarily on the wholly and exclusively test, and on whether all the employees were benefiting, or were at least capable of benefiting, from the EBT. Although s 43 would occasionally be raised as part of her own, and others', technical analysis, it was always dismissed and not considered further. Nor was it included as a risk factor in Grant Thornton's standard advisory letter, or raised in relevant instructions to counsel.

58. The reason, as explained by Ms Doe, was that s 43 was not thought to apply to the type of circumstances she and her firm were envisaging when Grant Thornton's clients were setting up an EBT. The idea was not that the trust should be some sort of short term conduit for delivering cash to employees, but rather that it should be set up for longer-term planning to do with employee incentivisation and the possible provision of benefits other than cash payments.

59. Mr Eastaway's evidence was that, in connection with the obtaining of a corporation tax deduction, he and his firm would always advise the taxpayer company to ensure that a carefully drafted trust deed (settled by counsel) was in place. Advice was given on the importance of having fully independent trustees, and the need to identify all the beneficiaries of the EBT. Sometimes not all the employees would be included as beneficiaries (for example, administrative staff would sometimes be excluded). However, Mr Eastaway's firm always advised clients to make sure the benefit was spread to several employees, to ensure that the EBT was genuinely for the benefit of the trade generally.

60. Mr Eastaway and his firm also advised that there should be regularity of contributions into the EBT. Normally the company would start by making a small contribution that would be a capital payment, and so not deductible. This would then be followed by a larger contribution. Regular contributions would continue to be made after that, and the company would claim a deduction each year. At the material time Mr Eastaway and his firm did not consider s 43 a serious risk. Mr Eastaway did not recall even raising it with clients prior to the decision of the Special Commissioners in *Dextra*.

61. Mr Eastaway's evidence was that there was a widespread view amongst taxpayers' advisers the s 43 only applied if the EBT was an intermediary between the company and its employers. If an EBT was under the control of the trustees and if the trustees were doing their job properly, their sole duty was to the employees, who were the beneficiaries of the trust, and to their families and other members of the class depending on the terms of the individual trust deed. In those cases Chiltern simply did not consider that s 43 was in point.

62. Mr Eastaway's evidence was supported by a number of contemporaneous notes of advice and reports prepared by Chiltern plc. Those reports did not refer to s 43 as an obstacle to the obtaining of a corporation tax deduction.

63. Mr Field said that when advising clients in relation to EBTs in the relevant period he would routinely say that there should be no question whether a contribution to a trust was deductible for tax purposes. This would be the case so long as the payment was properly to be treated as being on revenue rather than capital account, that the payment was made to independent trustees for the purposes of the trade being carried on by the company and that it was appropriate for accounting purposes to deduct the payment in the profit and loss account.

64. Mr Foreman's evidence was that during the period 1995 to 2002 his firm encountered two main lines of enquiry into EBTs. One was whether the contributions were wholly and exclusively for the purposes of the trade. The other was in relation to the accounting treatment under UITF 13. He did not hear of a case in that period where the Revenue suggested that a deduction for a contribution should be disallowed because s 43 applied. Examples of compromises were not, in Mr Foreman's view, based on a s 43 argument.

65. In Mr Foreman's experience he did not see any Revenue enquiry, when considering the deductibility of a contribution to an EBT, into whether a payment had been made out of the EBT, except in relation to the issue of the accounting treatment, or where there was doubt whether the payment was wholly and exclusively for the purposes of the trade. He recalled that the first time he had heard of the Revenue raising the s 43 argument was when it was put before the Special Commissioners in *Dextra*. On the ground, in dealing with Inspectors of Taxes, it was raised as an issue only after the Court of Appeal judgment.

66. Ms Goode's evidence was that s 43, although given consideration, was not thought to be more than a theoretical risk. Her practice, and that of her colleague's was to put a recital in the trust instrument to the effect that it was not intended that the trust funds should be used to provide emoluments. This was also often made clear in the letter to the trustees asking them to establish the trust. However, there was no prohibition in the main body of the trust instruments she prepared against the payment of emoluments.

67. Mr Langley explained that the possible risks in relation to corporation tax were addressed in order of perceived importance. He considered the most important to be the question whether the contributions to the trust were wholly and exclusively for the purpose of a company's business, having regard to s 74 ICTA. He would then consider whether the payment was properly charged to the accounts as a revenue item. Only after that would he give consideration to s 43.

68. Mr Langley said that, although the public statement in the *Law Society Gazette* of 4 October 1989 was comforting, it was necessary to give s 43 consideration as nobody knew whether or not the view expressed in the *Gazette* would continue to be considered the correct position. The possible risk of s 43 applying was expressed so that clients were presented with the facts. However, during his time at Deloitte, until *Dextra* in the Special Commissioners, Mr Langley was not aware of any challenges by the Inland Revenue on the basis of s 43.

69. Mr Moore's evidence was that the view of his firm (at the time PwC) was that in order to claim a successful deduction for contributions to an EBT, the company needed to ensure, (a) that it was following the correct accounting treatment, namely that it came within UITF 13, and later UITF 32, (b) that there was an initial capital contribution to establish the trust and that further contributions were revenue in nature, (c) that the trust was not under the *de facto* control of the company, and (d) the contributions had to be for the benefit of the trade.

70. Mr Moore said that there was no concern about whether money had been paid out of the trust; questions raised by the Revenue about the purpose for which the funds had been used were, thought Mr Moore, directed towards whether the contributions had been made wholly and exclusively for the purposes of the trade. Mr Moore first became aware with any certainty of the Revenue's view that s 43 applied to EBT contributions when the point was put before the Special Commissioners in *Dextra*. He was however already aware, before the release of the Special Commissioners' decision on 3 September 2002, that the Revenue had a line of attack based on s 43. This came towards the end of 2001 or early 2002 from a former HMRC officer, Steve Bould, who had been involved at a high level in formulating the Revenue's response to the proliferation of EBTs, and who joined PwC at that time.

71. Mr Sherry gave evidence based on his experience of Revenue enquiries into company accounts and tax returns in the period from 1995 to the decision of the Special Commissioners in *Dextra*. On this basis he said that there were a few issues the taxpayer had to address in order to ensure a successful deduction. The accounting treatment, particularly after 1998, was often enquired into, with UITF 13 being referred to as a ground of challenge. The payments also had to be wholly and exclusively for the purposes of the trade, and revenue and not capital. The latter two factors were both of significance in the case of owner-managed businesses where there was a sole proprietor who was likely to be a significant beneficiary of the trust. It was not uncommon for the taxpayer company to be advised to take external advice as to the quantum of contributions and remuneration of all employees, including the owner-manager. This had another important aspect in establishing that the contributions were commercial and, therefore, could not be characterised as disguised distributions to the owner manager.

72. Mr Thornhill told us that he has over the years advised a large number of clients in relation to the establishment of EBTs. His view at the relevant time was that s 43 did not restrict deductibility if the intended benefits covered more than simply paying emoluments. Mr Thornhill produced a note of conference held on 2 July 1998, in which he expressed this view. He confirmed to those instructing him that the classification of future payments in the accounts of the sponsoring company as an accrual for remuneration would not necessarily mean that such payments would be treated as "potential emoluments" as defined in s 43(11) unless they were reserved in those accounts "with a view to their becoming relevant emoluments". He also advised that if the trustees of the trust had the discretion to make payments to persons other than members of the family of the participant or his household, as defined in s 168(4) ICTA, than that would help to reinforce the proposition that s 43 should not apply.

73. Mr Thornhill said that it did not occur to anyone present at the conference that s 43(11) applied to an EBT providing a wide range of benefits. He believed that in 1998 this represented the common view of taxpayers and HMRC alike. On the other hand, he advised at the conference that the Inland Revenue did not normally accept the comments made in the *Law Society Gazette*, 4 October 1989, and that reliance should not be placed on those comments. Similar advice had been given by Mr Thornhill at a conference on 29 November 1995 at which he said that the Inland Revenue would certainly not wish to extend its treatment of ESOPs to EBTs. Mr Thornhill also referred to a meeting at Somerset House between members of the Share Scheme Lawyers Group and Inland Revenue officials at which ways of restricting deductions for EBT contributions in cases where the contributions were not intended to be paid out for a considerable time had been discussed. The conclusion of the meeting was that UITF 13 was the key to the issue; s 43(11) was not mentioned by the Inland Revenue.

74. In cross-examination Mr Thornhill was shown a copy of an opinion he had given in November 2000 on a proposal to establish an EBT. In that opinion, which of course post-dated the January 2000 contribution by Boyer Allan but was before the date on which Boyer Allan submitted its tax return for the 1999-2000 period, Mr Thornhill had said:

> "The Revenue have become very much aware of EBTs and their usefulness in securing deductions for the employer and deferring tax for the employee. This has resulted in a considerable number of challenges to deductions claimed. It is very difficult to know what will happen here. In principle this seems to be a case where the EBT is a very commercial way of rewarding and retaining key employees."

In response to a presumption of instructing solicitors that any loans would need to be made within nine months of the end of the accounting period in which the relevant contributions were made in order to avoid relief being deferred by virtue of s 43, Mr Thornhill had said:

> "To assuage the Revenue, benefits of a taxable nature should be provided as soon as possible. However, in my view, this is not legally necessary."

75. At this time Mr Thornhill had been instructed for the taxpayer in *Dextra*. His evidence to us was that he would not have given advice of this nature in 1999, but that by November 2000 he had been aware of the school of thought that s 43 could possibly apply.

76. In their written closing submissions, Mr Tidmarsh and Mr Rivett submitted in this connection that the obvious inference to be drawn from MR Thornhill's advice was that in his view, absent payments of a taxable nature, HMRC would seek to challenge the availability of a deduction under s 43, albeit that Mr Thornhill's view was that they would have been wrong in law to seek to do so. We reject this submission. The fact that Mr Thornhill was aware of a school of thought that s 43 could possibly apply cannot give rise to an inference as to likely action by HMRC.

This possible inference was not put to Mr Thornhill, and we do not make such a finding.

77. Ms Whitfield gave evidence based on her experience as an Inspector of Taxes up to January 2001. She confirmed that one of the expense items from a company's accounts or return that would be reviewed was the level and appropriateness of contributions made into an EBT. Where the company was a close company, the position of the controlling shareholders would be reviewed. The main concerns were whether the contribution was revenue or capital in nature, whether the EBT had been correctly accounted for and whether the contribution was for the benefit of the trade or business.

78. Ms Whitfield confirmed that the first step in any examination of the accounts or return of a company would be to establish the facts. At that stage there would be no particular focus on any aspect, including s 43. The subsequent response would depend on the information provided, or not provided. This might require an examination in greater depth, and consideration of all the relevant statutory provisions, including s 43.

79. Except in limited circumstances, therefore, such as where the EBT was confined to the payment of emoluments or the purpose was the payment of emoluments, we find from all this evidence that the general view of advisers was that s 43 should not apply to an EBT. None of the witnesses had direct experience of s 43 being applied. However, apart from Mr Thornhill, none of the witnesses claimed any knowledge of whether HMRC accepted that s 43 did not apply, or did not apply in particular circumstances. Mr Sherry was the only witness to have referred expressly to the guidance in the Revenue Manuals, although we note that in advice given by Jeremy Woolf of counsel in June 1996, he also refers to that guidance, reading it as stating that s 43(11) does not apply to payments to an EBT unless the trust is being used for channelling purposes.

80. We have also noted, from materials produced of internal Revenue correspondence, that in 2000 Deloitte had raised IM680 and IM1049 as non-technical reasons why s 43 should not be applied to contributions to EBTs. We shall look more closely at the materials produced, which show the views being expressed by the Revenue officer, Mrs Linda Grant, who was in charge of policy in this area, but at this stage we note that Mrs Grant was of the view in this connection that those statements would not prevent the application of s 43 where it could be shown that the payments in question were of potential emoluments. Those statements were not regarded as concessionary.

HMRC evidence

81. Mr Macdonald's evidence was that, within the Anti-Avoidance Group at HMRC, he took over responsibility for EBTs in August 1999. Prior to that time it had often been the case that companies would claim a deduction for contributions to an EBT. But in Mr Macdonald's view it had not been until the late 1990s that EBTs became widely-used as vehicles for the avoidance of income tax and NICs. In his

witness statement Mr Macdonald sought to attribute this rise to the fact that other popular schemes for such avoidance had been circumscribed by legislation, and he referred in particular to the provisions of s 203F ICTA as having been introduced in April 1998 to close down schemes involving readily convertible assets. However, in cross-examination Mr Macdonald accepted that this had been an error: the relevant provisions had in fact been introduced in 1994.

82. In his role, Mr Macdonald acknowledged that he was dealing with the more aggressive end of the schemes for the establishment of EBTs. He referred in particular to schemes promoted by a firm of solicitors, Baxendale Walker. We were shown the minutes of a meeting with representatives of Baxendale Walker attended by Mr Macdonald and his predecessor, Winston Taylor, on 11 September 2000. Section 43 had been raised at that meeting, although the discussion as recorded appears to have been confined to s 43(10) (relevant emoluments). The point is made by Mr Macdonald, however, that s 43 would not have any bearing if the Revenue were to succeed on the UITF 13 point.

83. In his evidence Mr Macdonald referred to the HMRC Public Folder which is a method of information dissemination within HMRC. The folder in relation to EBTs held copies of presentations and speaking notes from head office specialists and advice on HMRC's views on EBTs. Mr Macdonald produced his slides and notes from one such presentation, in which he referred to s 43 in conjunction with UITF 13, capital and revenue, wholly and exclusively and *Ramsay*[4] and sham. His speaking notes indicate that s 43 would be dealt with by Linda Grant who, Mr Macdonald explained, was the person within the Revenue's head office who was responsible for policy in this area.

84. We had the slides of Linda Grant's own presentation. One slide deals with s 43, but only sets out the statutory language, and gives no indication of the Revenue's approach in practice.

85. We also had a copy of a presentation by Andrew Pickering of Special Compliance Office, Nottingham. In relation to s 43, and in the context of a slide entitled "Global Avoiders Ltd" and postulating a contribution to an EBT providing discretionary benefits and where the trustees are independent of the company and its directors, Mr Pickering's speaking notes state:

> "It is likely that we may not be able to apply the legislation at S 43 FA 1989 – the 9 month rule because:-
>
> The definition of "potential emoluments" within S 43 may not cover EBT payments, and
>
> The Revenue, for mainly technical reasons, advised that s 43 FA 1989 would not apply to payments made to employee share ownership trusts."

[4] *W T Ramsay Ltd v IRC* [1981] STC 174

86. Mr Macdonald could not recall Mr Pickering having said during this presentation that s 43 was not likely to apply. However, Mr Pickering had sent Mr Macdonald a copy of his speaking notes (including the passage quoted) prior to giving his talk, and Mr Macdonald had commented that he had himself been arguing that s 43 did apply to payments to EBTs because they were to remunerate employees (and were thus potential emoluments). Mr Pickering's reply had been that he was aware that "the door might be slightly open on S43", and that since Mr Macdonald would be covering that he would leave his own brief as it stood. We should also note that Mr Pickering prefaced his remarks generally by saying that he was speaking from an SCO perspective – namely the "dirtier end of the market", and that Linda Grant and others would be speaking about the "cleaner end".

87. Also from the Public Folders is a presentation from 30 November 2001, apparently by one Gary Clarkson, entitled "SCO Approach to EBTs – Some suggestions for tackling EBT arrangements". The speaking notes make the point that the author is not a technical specialist in the field of EBTs, and that appropriate advice should be sought on the issues if it is required. The notes to the slide on s 43 are as follows:

> "Section 43 may have application in cases where the money in the trust is put into sub-trusts for the benefit of named employees – you may be able to argue that, at that stage, the money becomes potential emoluments and subject to the 9 month time limit. The same could be said if you can link the monies paid into the trust to specific employees at any stage.
>
> However, this argument is far from certain and, if you think it is relevant, seek advice before running it.
>
> Note – point will shortly be litigated. A case involving allocation of trust funds into sub-trusts should, hopefully, be brought before the Special Commissioners early next year."

88. The practice within the Revenue was that an Inspector wishing to challenge the deductibility of a contribution to an EBT on the basis that the contribution was a "potential emolument" should first submit the case to Business Profits Division (Schedule D). We received in the course of the hearing a large number of such submissions and responses. Those responses were given by Linda Grant who, as we have described, was the Revenue's "policy holder" in this respect. Mr Prosser submitted, and we agree, that the views expressed by Mrs Grant are the most relevant in assessing the nature of the Revenue's practice (if any) in relation to the deductibility of contributions to EBTs. That is not to say that the activities of Mr Macdonald and other revenue officers are irrelevant, as we shall later describe.

89. In her responses, Mrs Grant advises that simply because tax planning might have been a factor in the setting up of an EBT, that does not mean that a deduction is not due for the contributions at the time of claim. To defer a deduction using s 43 or accountancy-based arguments would require evidence that the company has effective control over the trustees. The point is made that the Revenue have "so far shied away" from using s 43 other than in the clearest cases of avoidance.

90. Mrs Grant discusses the question whether trustees can be intermediaries. She says that whether the trustees are intermediaries for this purpose depends on how they act in practice, and whether they effectively act on the recommendations or instructions of the company on how and when they should use the company's contributions to make payments out of the trust to the employees who are beneficiaries of it. In certain cases Mrs Grant is able to point to features of the operation of the trust that would lend weight to the s 43 intermediaries argument.

91. The question of the level of practical control is a consistent theme. In one case Mrs Grant says that if all that the trustees have done, or will do, with the money contributed is to pay amounts (i.e. emoluments) to beneficiaries and invest the balance of the trust fund with a view to paying out further amounts to, or on behalf of, beneficiaries, then Mrs Grant could see no reason why the company's payment to the trustees would not be a payment of "potential emoluments" for s 43 purposes, unless the facts show that the trustees are not just acting as intermediaries of the company. In another case, although the amounts subject to s 43 would have been too small to justify action in that respect, Mrs Grant refers to evidence of trustees acting on the instructions of a company through statements of wishes provided by the company.

92. In another case, where the terms of the EBT allowed shares in the company to be acquired by the trustees and distributed to employees, Linda Grant referred to the difficulty in applying s 43 if there was no guarantee that the whole of the payment made by the company to the trustees would eventually find its way to the employees as emoluments. She gives as an example the case where the company's contribution might be partly used to meet the ordinary running costs of the trust. In the same context Mrs Grant refers to the comments in the *Law Society Gazette* concerning ESOTs as a possible stumbling block. However, she goes on to say that she does not think that any of these obstacles are insurmountable in a suitable case where there is factual evidence that the company intends a particular payment it makes (or, in the case of a provision, plans to make) to the trustees to be used to make payments to specific employees or to employees generally, and is in a position to ensure that the trustees act in accordance with its wishes.

93. It is apparent that in 1998, the question of the possible application of s 43 was still in the melting pot. In one letter to an Inspector, after referring to the fact that the Revenue have shied away from its use, Mrs Grant informs the inspector that:

> "I will keep you informed of developments on the s 43 front, the key to which is whether trustees of discretionary trusts can be considered to be 'intermediaries' for the purposes of section 43(11). But even if the Solicitor gives us support for arguing that that may be so in certain circumstances, it will be necessary to find out factual information how a particular trust is operated in practice and the relationship between the trustees and the company (acting through its directors)."

94. It also appears that there was some sensitivity to arguments on the possible application of the statement in the *Law Society Gazette* in 1989. In one exchange of correspondence Mrs Grant suggests that s 43 should not be mentioned at that stage in the process. She reasons (correctly, in the terms of s 43) that if a deduction can be

denied for accounting reasons there will be no need to refer to s 43. This, she says, would avoid the tricky issue of the commitment given in 1989 in relation to ESOTs, and the extent to which it might be argued to apply to EBTs more generally.

95. On 20 February 2001, Mrs Grant sent to Mr Macdonald a marked-up version of a letter intended to be sent out under Mr Macdonald's name which included the following observation, which must have been approved by Mrs Grant:

> "You have let me have a copy of counsel's opinion with regard to Employee Benefit Trusts. This is the standard opinion included with the 'Introducer's Pack' provided by Baxendale Walker. Included in that opinion is the view that Section 43 FA 1989 does not apply to Employee Benefit Trusts. Our view is that section 43 can apply to contributions to Employee Benefit Trusts. Whether it does, depends upon the facts of each particular case.
>
> The opinion says that this is because the sum paid into the trust will not be 'relevant emoluments' as there will not be a sum allocated in the accounts of the founder in respect of the emoluments of any particular office or employment, or in respect of offices or employments in general. It is a question of fact – ultimately for the Commissioners to decide if necessary – whether an employee has paid money into an Employee Benefit Trust with a view to it being allocated in respect of offices of employments (which, after all, is the common link between those eligible to be beneficiaries of Employee Benefit Trusts) or with a view to something else.
>
> The opinion goes on to claim that the contributions will not be 'potential emoluments' with[in] Section 43(11) as the trustees could not be correctly characterised as an intermediary of the founder. It is a question of fact – ultimately for the Commissioners to decide if necessary – whether the trustees of an Employee Benefit Trust do, in practice, act as intermediaries between the employer and those who benefit from the trust by virtue of their, or someone else's, office or employment."

96. On 2 March 2001 Mrs Grant wrote advising another Inspector:

> "Section 43 FA 1989
>
> 13. From the above [a discussion of UITF 13] you will gather that only if the trust is not under the 'de facto' control of the company might Section 43 FA 1989 be relevant. And because Section 43 only acts to defer a deduction for late-paid emoluments which are held by an intermediary (or are the subject of a provision in the employer's accounts in accordance with GAAP), it is likely to have little application. If the trustees are not under the control of the company I doubt if they could be considered to be intermediaries for the purpose of Section 43(11) FA 1989.
>
> 14. So, I suggest you leave any Section 43 arguments for the time being, and concentrate on the further fact-finding needed to consider the 'wholly and exclusively' question in more detail, and/or to support an accountancy-based timing argument."

97. In all of the evidence we have seen the position adopted has been that s 43 is a theoretical line to pursue in connection with denying deductibility for contributions to an EBT, but that it all depends on the facts. The view taken is that other avenues should first be pursued, which of course was entirely correct as a matter of law; s 43 could only apply if a deduction were otherwise available (s 43(1)(b)). Nevertheless, the facts should be examined to ascertain whether the trustees could be regarded as "intermediaries" within s 43(11); the focus prior to *Dextra* being on whether the trustees were under the effective control of the company in relation to the making of distributions out of the trust. Prior to *Dextra*, there was no indication that s 43 was engaged simply as a result of the terms of the trust deed.

98. The correspondence makes reference in many instances to Regional Technical Updates ("RTUs") produced by Mrs Grant. We were provided with two examples, the first from 1995 and the second from 1999. These repeat the perceived need that, to have any prospect of contending successfully that an employer's contribution to an EBT is a payment of potential emoluments, Inspectors had to obtain evidence to show that the trustees merely act as intermediaries of the employing company in making payments, or distributing benefits, to employees. In appropriate cases it is suggested that there be an examination of the level of discretion that the trustees actually have in practice.

99. In the first RTU (1995), after referring to the statement in the *Law Society Gazette*, Mrs Grant questions whether the approach adopted in that statement might be considered legalistic or artificial. She poses the rhetorical questions: Can it really be said that trustees have any real discretion? Is that not inconsistent with the employer's supposed object in making the contribution? In answer to those questions, Mrs Grant writes:

> "Inevitably employers are walking a tightrope. The trustees must have sufficient discretion so that S43 does not bite. But they cannot have a degree of discretion that might potentially defeat the overall objectives of the employer in making the contributions; that is to promote a greater degree of commitment by employees. Providing they have made a reasonable effort to walk that tightrope, we are content that they should secure relief without regard to FA89/S43. The cases that do concern us more, and where we will consider applying S43 are those –
>
> - strictly not ESOTs, where cash bonuses, deferred remuneration, etc schemes are wrapped up in this sort of form. In other words those in which the trustees are purported to have discretion which they don't in reality enjoy, because the employees['] title is clearly established, perhaps in the form of a written/verbal contract between employer/employee;
> - as above under 'ordinary principles' where the degree of discretion is such as to defeat the stated objective of the trust. In particular, where it appears that the real purpose is other than to encourage wider share ownership amon[g]st employees; or if it is unclear as to what the trust is in fact for."

100. The RTU goes on, under the heading "Advice" to say the following:

> "Although 'employee trusts' have been around for some time (the Heather[5] case was heard in 1972) there has been an upsurge in activity in recent years. In the main this is no doubt nothing other than a genuine desire to encourage employees to have a stake in the company for whom the[y] work. But, at the margin, there is no doubt that schemes are also being set up to counter the effects of FA89/S43; also, particularly for private companies, to operate as an off-shore money box as the more conventional ways of storing money are increasingly being attacked. This is a developing area and Business Profits Division 4 (Schedule D) would like to know of suspicious cases and to give advice. At the early stage of an enquiry a telephone call is sometimes helpful and the number is …"

101. In another RTU (1999), a number of practical examples are provided. One is of an EBT, expressed to have been set up as a bulwark against a takeover, with trustees consisting of two directors, two employees and one independent. The RTU makes the point that it is doubtful whether either UITF 13 or s 43 could apply. With the unusual constitution of the trustees it would be difficult, the note states, to contend that the company has control of the trust. In another case, the usual comments are made as to the difficulty in satisfying the potential emoluments definition if there is no guarantee that the payment to the trustees will find its way to the employees as emoluments, reference being made to the possibility that it might be used to meet ordinary running costs. But the point is once again made that s 43 might apply if there is factual evidence that the company intends a particular payment it makes (or, in the case of a provision, plans to make) to the trustees to be used to make payments to specific employees or to employees generally, and is in a position to ensure that the trustees act in accordance with its wishes.

102. The conclusion to be drawn from all of this material is that the Revenue regarded the possible application of s 43 as wholly dependent on the particular facts of each case. The Revenue regarded as particularly significant, firstly, whether it could be said that the trustees were acting on the instructions of the company, and secondly, whether there was factual evidence that the company intended a particular payment to be used to make payments to specific employees or employees generally, and was in a position to ensure that the trustees acted in accordance with its wishes. At no stage prior to *Dextra* in the High Court did the Revenue take the view that s 43 applied so as to delay the deductibility of a contribution to an EBT merely because the terms of the trust deed admitted of a realistic possibility that the funds could be used to pay emoluments.

HMRC enquiries

103. We received evidence from Mr Macdonald of EBT enquiries notified to SIS, together with enquiries where accountancy advice was sought by tax inspectors from HMRC accountants in connection with EBT enquiries and enquiries collated in the

[5] *Heather v P-E Consulting Group Ltd* (1972) 48 TC 293

mid-2000s by some HMRC regional offices where enquiries were made into EBTs. An analysis of this data shows the following:

Calendar year in which accounting period ended	**Number of referrals**
1992	1
1993	0
1994	4
1995	13
1996	32
1997	82
1998	201
1999	417
2000	445
2001	452
2002	169
2003	30
2004	16
2005	15
2006	5

104. The documents produced by HMRC of cases that were referred to Business Profits Division demonstrate that s 43 was being considered, and raised by the Revenue in a number of cases. However, we are unable to derive a clear factual finding on the enquiry position on the basis of this evidence. In his witness statement, Mr Terry, who was responsible for compiling these documents accepted that it was not possible for HMRC to identify instances where returns were submitted before January 2001 in which taxpayers making contributions to EBTs had made adjustments to their tax computations under s 43. Nor, except in cases where discovery assessments had been made and remained under appeal, had it been possible for HMRC to identify instances prior to 31 January 2001 where HMRC had failed to challenge the tax treatment of contributions to EBTs.

105. On the basis of the evidence before us we conclude that specific challenges under s 43 were the exception rather than the rule. In many cases, on the advice of Mrs Grant, s 43 was not specifically raised, because of the concomitant accounting issue that, if it could be sustained, would mean that s 43 would fall out of account altogether. In other cases its application was kept in reserve pending ascertainment of the full facts.

Discussion

106. It is clear, and there was common ground in this respect, that at the material time, and prior to *Dextra*, taxpayers' advisers generally and the Inland Revenue shared a common misunderstanding on the interpretation of s 43. Neither the advisers nor the Revenue considered that it applied merely because an EBT contained a discretionary power to provide emoluments to employees.

107. We do not consider that such a common misunderstanding is capable, of itself, of giving rise to a practice that s 43 would not be applied in those circumstances. There is a difference, in our view, between what simply happens in practice and the identification, or establishment, of a particular practice. The latter requires clarity and substance, as we have described. A practice not to take a particular point, therefore, must have as its foundation the identification of that issue before the practice is adopted. Merely failing to take a point is not enough, as the taxpaying community would not be able to discern anything as a matter of practice from such an omission. There is no evidence of the Inland Revenue having determined to adopt a practice in relation to this view of the law. Nor is there any evidence that the Revenue addressed the issue. The evidence is that the discretionary powers of the trustees were commonly argued by taxpayers to counter suggestions by the Revenue that the company had retained control over the contributed funds, and that the Revenue's response was to focus on the way the trustees had used those powers rather than on the powers themselves. Although it was the case that the Revenue did not attack EBT contributions on the basis subsequently revealed in *Dextra*, that was not in our view the result of any practice not to do so.

108. It is clear that the Revenue did not regard s 43 as its main weapon against tax avoidance in the form of EBTs. The main armoury consisted principally of the wholly and exclusively test, the capital and revenue distinction, and the accountancy arguments in relation to UITF 13. As we have described, the focus on those issues is perfectly understandable; s 43 is framed as a last resort, as it can only be applied where a payment would otherwise be deductible.

109. The focus on UITF 13 is instructive. Its focus was on control, and it accordingly overlapped to a considerable extent with the Revenue's then view as to the possible application of s 43. It was natural, therefore, for the Revenue to concentrate on UITF 13. If the "control" argument could prevail in that respect there would be no need to look at s 43.

110. That said, at no time was possible reliance on s 43 abandoned. It remained very much a part of the weaponry available to the Revenue. It was considered on a regular

basis by Inspectors enquiring into company tax returns, and was consistently referred to by Linda Grant in her advice and guidance to Inspectors, with the caution as to the perceived difficulties of applying it, and the need to ascertain the facts, particularly as to whether the trustees were acting on the instructions of the company, so as potential to render them "intermediaries", and whether a contribution was to be used to make payments to specific employees or employees generally (which could be regarded as "channelling").

111. The question we have to consider is whether the evidence shows that there was a practice generally prevailing and, if so, whether the return made by Boyer Allan on 24 January 2001 was in accordance with that practice.

112. Mr Tidmarsh submitted that any such practice as may be found in this case could not satisfy the test in *Household Estate Agents* that it be relatively long-established. He referred to the increase in the number of enquiries for accounting periods ended in 1998 and subsequent years. His argument was based on the time lag there would have been between the accounting year in question and the opening of an enquiry. We were referred to the law on this both pre- and post- self assessment, but we need not refer to that. On this basis, Mr Tidmarsh submitted that it was not until 1999/2000 that the Inland Revenue began to open a large number of enquiries into EBTs, and he relied also on evidence of those witnesses who said that EBTs were becoming more widely used in the late 1990s.

113. In his closing submissions Mr Tidmarsh was originally disposed to submit that nothing could be inferred from the fact that no enquiries were opened in some cases. If there was a practice generally prevailing, it could only be based on the opening of enquiries into EBTs and the closing of those enquiries without the s 43 point being pursued. We reject that submission, which cannot be right. The failure to open an enquiry can obviously be based on a settled practice; indeed that would be a most likely outcome of the application of such a practice.

114. On our raising this issue with Mr Tidmarsh, he accepted that the enquiry position was no more than evidential. It was directed at the issue whether there was a track record that could be regarded as relatively long-established.

115. We do not find this statistical evidence of any assistance. The evidence of what the Revenue were doing can be more readily discerned from the internal material with which we have been provided, as well as the evidence of the Revenue's external statements. Although it was in the context of ESOPs, there was a published view of the Revenue from as far back as 1989. The Inspectors' Manual of 1995 refers to s 43 in the context of EBTs, and the RTUs, including advice about s 43, commenced in 1995. We are in no doubt that, to the extent a practice can be identified for this purpose, it will not be prevented from being a generally prevailing practice by reason of any lack of longevity.

116. In our view, the essential question is whether the internal guidance within the Inland Revenue at the material time, and the way in which it was operated and applied, amounted to a settled practice accepted or adopted by taxpayers and their

advisers, such that it can be regarded as a generally prevailing practice on the basis of which Boyer Allan's January 2001 return was made. We accept that the primary evidence of such a practice is to be derived from the views expressed by Mrs Grant, as she was acknowledged to be the policy-holder within the Inland Revenue at the relevant time. But evidence of how others within the Revenue approached the issue is also relevant in assessing whether the views of Mrs Grant, and her internal advice and guidance, were translated into a settled practice.

117. As we have described, we have formed the view that, to be a practice for this purpose, it must be something capable of being clearly articulated, and articulated not just by the Revenue, or just by taxpayers' advisers, but by both, and by both in the same terms. An interested enquirer, seeking to establish whether there is a practice on a particular point, must be given the same answer, whomever he might turn to within those who have the relevant knowledge. The answer in each case must be clear and unequivocal, characteristics that follow from the context of providing certainty, for the Revenue and taxpayers alike, in which para 45(b) finds itself.

118. What this means is that the criteria for the application of the practice must be clearly identified. If the practice is dependent on the factual position, that factual position itself must be clearly expressed. There can be no lack of clarity as to which cases fall on which side of the factual dividing line.

119. Mr Prosser and Mr Bremner, in their closing written submissions, submitted that the evidence before us demonstrated unequivocally that there was a general, albeit not universal, acceptance by the Revenue and professional advisers alike that, firstly, payment by an employer to trustees of a discretionary trust for the benefit of employees was not "held by an intermediary with a view to … becoming … emoluments" and therefore was not a payment of "potential emoluments" within s 43(11), merely because the trust deed conferred an absolute and uncontrolled discretionary power on the trustees to make payments to employees, and secondly, that there was a payment of potential emoluments only where the facts of the particular case were that the trustees were under the control of the employer (and therefore an intermediary), and the payment to them was made with the intention that they should use it to pay emoluments to employees and for no other purpose (a "channelling case"). If those were not the facts, then it was appropriate to claim a deduction for corporation tax purposes in respect of the contributions.

120. We accept that the intermediary issue, the question of control and the intentions of the company as to the payments to employees were all aspects of the guidance provided to Inspectors by Linda Grant. But we are unable to discern in all of this the clarity and consistency of approach that could be regarded as translating into a practice, either to apply s 43 in a particular case or not to apply s 43 outside particular defined cases, on the part of the Inland Revenue at the material time. In this regard, we accept the submissions of Mr Tidmarsh that the Revenue had not formulated a practice; it had merely formulated internal practice guidance. It was advice to Inspectors as to avenues of enquiry to explore when investigating the facts, coupled with caveats on the view being taken as to the application of s 43. The doubts

expressed by Mrs Grant as to the applicability of s 43 cannot be regarded as constituting a settled practice not to apply that section.

121. We saw no consistent evidence of practitioners generally extolling any element of Revenue practice as regards the application or otherwise of s 43 except, and this was in limited circumstances only, by reference to the Revenue's own published materials. We do not believe that advisers would, in January 2001, have been able to articulate the Revenue's alleged practice in this respect in the manner in which we are now invited to find that such a practice existed and was generally prevailing. On this basis no such practice could in any event be regarded as "generally prevailing"

122. Although we have formed the view that it is not a necessary condition for there to be a practice that it be published, we also concluded that it is essential that, on enquiry, the same effective answer as to the position has to be capable of being given by the Revenue and the taxpayer or tax adviser community alike. In this case, we consider that the likely answer to the interested enquirer would have been to refer to the Revenue's Inspectors' Manual, and to the passages at paras IM689 and IM1049. Those statements are, as they were described by Henderson J in *Household Estate Agents*, inconclusive, and are not sufficient to amount to a practice generally prevailing for para 45(b) purposes. There is no evidence that either the Revenue or tax advisers generally would have identified a practice in the terms submitted by Mr Prosser and Mr Bremner.

123. On this basis we conclude that there was no practice generally prevailing with respect to the application or otherwise of s 43 FA 1989 to the deductibility of payments to trustees of EBTs. Accordingly we find that the return of Boyer Allan submitted on 24 January 2001 was not "on the basis or in accordance with the practice generally prevailing at the time when it was made."

Channelling

124. Our conclusion in that respect effectively disposes of that aspect of the appeal with which this decision is concerned. However, because we heard argument on it, we should also, if relatively briefly, comment on the issue of "channelling" in relation to this case.

125. What HMRC say in this respect is that, even if the published Revenue guidance could amount to a generally prevailing practice (which we have found that it cannot), the use of an EBT in this case in fact fell within the terms of para IM1049 of the Inspectors' Manual such that s 43 would apply.

126. The immediate point of this is that para IM1049 does not go that far. It simply requires channelling cases to be submitted to Business Profits Division. The argument of HMRC is effectively that even if there were a practice, Boyer Allan's tax return would not be in accordance with it because the practice not to apply s 43 as a matter of practice did not apply to channelling cases, each of which would have to be considered on its own merits. Essentially, what is said is that, even if there was a

general practice as regards the application, or non-application, of s 43, that practice did not extend to channelling cases.

127. The argument between the parties was whether this case was or was not a channelling case. The difficulty is that before we can address that question we effectively have to decide what a channelling case is. Where a company establishes an EBT with a view to benefitting its employees, where is the line to be drawn between cases that are channelling and cases that are not? Does this depend on whether the company has *de facto* control of the trustees, is it necessary for emoluments to have been earmarked for specific employees, or is it sufficient that the trustees simply adhere to a non-binding letter of wishes given by the company to the trustees? And these are all questions that have to be considered in the context of the position in January 2001.

128. The very fact that the answer to these questions is unclear lends weight to our conclusion that there was a lack of clarity and certainty as to the position that in turn negates any possible conclusion that there was, in these circumstances, a generally prevailing practice, or indeed any relevant practice at all. But on the assumption that there was a practice, we shall consider whether the circumstances of Boyer Allan's EBT would have taken the contributions to it outside that practice.

129. Some indication of what the Revenue, in January 2001, might have regarded as channelling may be gleaned from considering the basics facts of *Dextra*. There the various group companies that had made contributions to the EBT provided the trustees with schedules setting out the provision that those companies wished the trustees to make, expressed either as rewards for past performance (for three director-shareholders and certain relatives of two of them) or future performance (other employees). The relevant amounts were placed in sub-funds, and the beneficiaries were informed of the allocations and the future performance criteria, where relevant.

130. Mr Tidmarsh argued that Boyer Allan intended to use the EBT "largely to channel emoluments to employees so as to obtain a deduction for payments when charged whilst deferring the receipt of emoluments in the hands of the employee", and did in fact do so. He relies on the following factors.

(1) Mr Tidmarsh says that a primary concern on the part of Boyer Allan and its directors was to secure a deduction for corporation tax in circumstances where sums would be paid out as emoluments. We consider this to be irrelevant. It would be surprising indeed if a company did not consider the deductibility of a payment of this nature. The fact that it did can say nothing about whether this could be regarded as a case of channelling.

(2) Mr Tidmarsh relies upon the evidence of Mr Allan that the only payments that have been made from the EBT have been payments of cash, and that was the only way in which the payments were expected to have been made. Again, this does not in our view go to show the channelling of emoluments.

(3) Mr Tidmarsh refers to clause 11.1.1 of the trust deed which provides that benefits could be granted in favour of participants (as defined in s 13(2) of the

Inheritance Tax Act 1984, but excluding persons within s 13(3)) in Boyer Allan *only* by way of emoluments. On the basis that at all material times each of Mr Boyer and Mr Allan owned 50% and 44.5% of Boyer Allan's issued share capital, and so were participants, Mr Tidmarsh says that it follows that the *only* benefits that could be granted to them were emoluments. We agree, but we do not regard the terms of the trust deed itself as indicative of channelling, any more than in January 2001 the Revenue would have relied on those terms. The Revenue at that time were looking for evidence of what happened in practice, outside the terms of the trust.

(4) As we heard in evidence, the contribution to the Boyer Allan EBT made in the year ended 30 April 2000 was, from the moment of its receipt, notionally and informally "earmarked" for Mr Allan and Mr Boyer. This meant that they were presumptively entitled to the sums allocated, although Mr Matthew told us that the allocations were provisional and could increase or decrease by reference to discussions with the board of the company, investment performance and payments out to beneficiaries. It was at all times open to the trustees to apply the funds for the benefit of other beneficiaries of the EBT.

Mr Prosser argues in this connection that the earmarking of the funds did not mean that the funds somehow "belonged to" or were "destined for" Mr Boyer and/or Mr Allan. He submitted that this does not therefore mean that this is a case of channelling.

On analysis we believe that Mr Prosser may well be right. But whether he is or not is not the question we have to consider. We have to determine whether the circumstances of this case are likely to have fallen on the "channelling" side of the line as far as the Revenue were concerned in January 2001. We consider that it would, simply because of the allocations that had been made. Whether, absent what turned out to be the proper construction of *Dextra*, a court would have found that this was a case falling within s 43 is not to the point. We are satisfied that these circumstances would have taken the Boyer Allan EBT out of the normal case (to which the assumed practice would have applied), such that the assumed practice not to apply s 43 would not have operated in this case. A subsequent finding that this was not a channelling case would not have altered the position.

(5) For completeness, Mr Tidmarsh referred to the fact that from the inception of the EBT until 30 April 2002 the only benefits granted by the trustees were payments of emoluments. The sums paid out as emoluments in that period (including the payment of tax and employees' NICs on the relevant sums) were significant: £2m, £362,000, £750,000 and £1,468,000. We do not consider that this of itself would have led the Revenue to consider this to be a channelling case. However, we do consider that the payments to Mr Allan (on 26 October 2000 of £1,200,000, on 28 June 2001 of £450,000 and on 1 February 2002 of £300,000) would have contributed to the Revenue concluding at the relevant time that this was a channelling case.

131. For these reasons, therefore, we conclude that, if we had found that there was a generally prevailing practice with regard to s 43 and the deductibility of contributions,

we would nevertheless have found that in the circumstances of the Boyer Allan EBT that practice would not have applied. In our view, that would have been a case where it would have appeared to the Revenue that the trust was being used to channel emoluments to employees so as to obtain a deduction for the payments when charged whilst deferring the receipt of the emoluments in the hands of the employee.

Decision

132. For the reasons we have given we dismiss the appeal with respect to para 45, Sch 18, FA 1998.

133. The parties have liberty to apply in respect of the outstanding issues.

Costs

134. Any application for costs must be made within 28 days after the date of release of this decision. As any direction as to costs will be for detailed assessment, it will not be necessary for the application to be accompanied by a schedule of costs.

Application for permission to appeal

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.

ROGER BERNER
TRIBUNAL JUDGE

RELEASE DATE: 30 August 2012