[2019] UKFTT 389 (TC)

TC07204

Appeal number: TC/2017/01809

INCOME TAX – whether earnings of a diver within s15 ITTOIA 2005 can be regarded as earnings of a partnership – no – whether the diver was self-employed – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

JOSPEH PUTTNAM **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE FAIRPO

Sitting in public at Manchester on 3-4 October 2018

Mr Buchsbaum for the Appellant

Ms Poots, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal against a closure notice for the tax year 2014/15 issued on 20 September 2016 in the amount of £19.344.91.

2. The appeal was heard jointly with the appeal of another individual, Mr Green. As some of the facts of the appeals are slightly different, this decision deals only with the appellant's appeal. A separate decision was given in relation to Mr Green.

Background

3. The appellant is a mixed gas diver. In the relevant tax year the appellant treated the income from his engagement by Subsea 7 Crewing Services Pte Ltd (Subsea 7) as trading income of a partnership with his spouse. The appellant reported 50% of that income on his tax return as his share of the profits of the partnership.

4. HMRC opened enquiries into the return and issued closure notices giving effect to HMRC's conclusion that all of the income from Subsea 7 should be treated as income of the appellant.

5. It was agreed between the parties that, if the appellant is an employee, his income falls within the scope of s15 ITTOIA 2005.

6. The appellant noted, in opening, that HMRC had also enquired into another tax year but had withdrawn the assessment before that had proceeded to a hearing. It was submitted that HMRC had therefore accepted that for those years, the income should be regarded as income of a partnership. HMRC argued that the assessments had been withdrawn on a without prejudice basis and the withdrawals were not relevant to this matter.

7. Each case has to be considered on its own facts and, as the other assessments were withdrawn without prejudice, I do not consider that any inference can be drawn of relevance to this matter from those withdrawals.

8. The appellant also suggested in the hearing that HMRC should not be allowed to raise arguments that were not included in correspondence during the enquiry. HMRC noted that the arguments had been included in the statement of case some months earlier without objection. I do not consider that HMRC could be precluded from raising arguments that were set out in their statement of case, simply on the basis that the arguments had not been set out in earlier correspondence.

Whether s15 ITTOIA means that employment income of a diver can be regarded as trading income of a partnership

Appellant's case

9. The appellant argued s15 ITTOIA operates to reclassify the employment of a relevant diver as a trade and that the effect of s15 should be interpreted widely. In particular it was submitted that s15 should be interpreted as meaning that it is the owners of that trade who are subject to tax on the profits from the trade rather than the diver specifically.

10. The appellant argued that there are various differences between taxation of employment and taxation of a trade. It was submitted that a key difference is that in employment it is the person who performs the duties who is taxed whereas in the context of a trade, it is the owner or owners of the trade (including inactive owners) who are taxed on the income of the trade, regardless of who performed the duties which gave rise to that trade income. The appellant further argued that the decision as to who is the owner of a trade is one which made by the owners of that trade, as supported by the fact that partners can and do determine their profit sharing ratios.

11. In this case, it was argued that the appellant and his spouse had formed a partnership on 6 April 2009 and that it was this partnership which owned and carried on the diving trade that was created by s15. Accordingly, the appellant argued that it was this partnership that was subject to tax on the income derived from the duties performed by the appellant.

12. It was submitted that, if Parliament had not intended this broad interpretation to apply to s15 and to limit the statute so that the trade could only be a trade of the employee and not of a partnership, clear words would be required to limit the application of s15 accordingly. Further, if the intention of Parliament had been only to extend favourable expenses deductions to divers, as submitted by HMRC, the appellant argued that s15 would have drafted differently with specific reference to expenses deductions.

13. The appellant also submitted that, as HMRC allows wages paid to a spouse to be deducted in calculating the taxable income of the diver, this confirms that s15 does more than alter the way in which a diver is taxed.

HMRC's case

14. HMRC submitted that s15 applies only for tax purposes and has no wider deeming effect. The effect is that an individual employee's performance of their duties is treated for tax purposes as the carrying on of a trade.

15. It was submitted that, on a natural reading of s15, it is clear that the trade referred to is a trade of the employee only. The language does not support an extension of the meaning to encompass a trade owned by another person. It was submitted that there cannot be a separate owner of an employee's trade and further that a partnership cannot be an employee, as employment involves personal obligations.

16. HMRC argued that the purpose of this legislation was to change the timing of the tax payment and to provide more generous rules for the deduction of the expenses of divers. It was not to give effect to a wider purpose, which would allow for a different person to be taxed on the income.

17. HMRC submitted that express words would be required for s15 to operate to allow a change in the person subject to tax on the income.

Discussion

18. s15 ITTOIA states that in qualifying circumstances, the "performance of the duties of employment [of a relevant diver] is … treated for income tax purposes as the carrying on of a trade in the United Kingdom".

19. I note also that s15 has no effect for the purpose of National Insurance Contributions (NICs). Divers within the scope of s15 are not required to pay Class 4 NICs, which I consider adds to the conclusion that s15 does not create a trade for all purposes.

20. The wording of s15 is therefore clear that the provisions apply for income tax purposes only. In particular, s15 refers only to specific activities: "performance of the duties of employment" is deemed to be the "carrying on of a trade". It does not deem the employment generally to be a trade for all legal purposes, and so I find that it cannot be interpreted as meaning that the employment should be treated as a trade which is separate to the diver and capable of being owned and carried on by another person, or by persons in common under partnership law.

21. It is well established that employment is personal to an individual, involving personal obligations, such that the only person who can perform the duties of an employment is the individual employee. This is discussed further below.

22. Accordingly, I consider that the only person who can be regarded as "carrying on a trade" within the meaning of s15 is the individual "performing the duties of the employment".

23. I find that s15 cannot be interpreted as meaning that the employment income of an individual diver can be regarded for tax purposes as trading income of a partnership in which that individual is a member.

24. Indeed, if the intention of Parliament had been that s15 should be so broadly interpreted I consider that it would have required express wording to the effect that the deeming provisions applied to create a trade for all legal purposes.

25. At the time of the hearing, the Upper Tribunal decision in *Fowler* [2017] UKUT 219 (TCC) was being appealed to the Court of Appeal. The appellant had argued that the First Tier Tribunal [2016] UKFTT 0234 (TC) had found that the effect of s15 was to recharacterize the employment activities as activities of a trade (at §113) and that, as the Upper Tribunal had decided the matter on the definitions in the treaty, that decision had not altered the finding of the First Tier Tribunal.

26. It should be noted that the situation in *Fowler* was rather different to the situation in this case: Mr Fowler was not arguing that s15 created a trade which could be carried on by anyone other than himself, he was simply arguing that the deeming provisions of s15 applied in the interpretation of tax treaties.

27. The Court of Appeal ([2018] EWCA Civ 2544) subsequently restored the First Tier Tribunal decision, concluding that the deeming effect meant that Mr Fowler's income was trading income for the purpose of interpreting the relevant tax treaty.

28. However, I note that at §43 Henderson LJ (giving the majority decision) states that "The drafting technique employed in [the predecessor to s15, section 314(1) of the Income and Corporation Taxes Act 1988] is different from that of the "Tax Rewrite" project, **but in my view the substance is the same**. The Income Tax Acts are directed to have effect "as if" the performance by the relevant person of the specified duties of his employment "constituted the carrying on **by him** of a trade within Case I of Schedule D" (emphasis added).

29. There is, in my view, nothing in the Court of Appeal decision in *Fowler* which suggests that s15 should be interpreted as meaning that an actual trade, which may be carried on by persons other than the diver, is created. On the contrary, I consider that decision makes it clear that the effect of s15 is to deem a trade to be carried on by the diver only.

30. With regard to the appellant's submission that, in allowing a deduction for wages, s15 must be interpreted as being more than an alteration of the provisions under which the appellant is taxed, I consider that this is mistaken: the effect of s15 is clearly that a qualifying diver is to be taxed as if he were carrying on a trade. That is, he is taxed on the profits of that deemed trade, such that expenses incurred can be deducted if they meet the criteria to be deducted as expenses of the deemed trade. There is, in my view, no reason to extrapolate further and conclude that allowing the deduction of such expenses means that an actual trade capable of being carried on in partnership exists.

Whether the diver was employed or self-employed

Appellant's case

31. The appellant argued that, if s15 ITTOIA cannot be interpreted to mean that the income of his employment should be treated as income of a partnership, the reality of the relationship between the appellant and his engager, Subsea 7, was not one of employee and employer but was, instead, one of self-employment.

32. The appellant provided a witness statement and gave oral evidence at the hearing.

33. The appellant was engaged as a professional mixed gas diver under a "principal statement of employment" dated 1 January 2013, between Subsea 7 and the appellant, defined as "the Employee". The statement includes the following provisions:

> (1) The appellant's continuous service was deemed to have commenced on 1 April 2007.
>
> (2) The appellant was to carry out such duties as fell within his job description as a diver but was also required to be flexible and carry other duties from time to time. Subsea 7 had the right to amend the appellant's job title and description to meet the needs of the business.
>
> (3) The appellant was required to work at least 150 days per year, and Subsea 7 had the right to increase or reduce that number in future years (provided that reasonable notice was given). The appellant's working days were organised by Subsea 7, based on the needs of the business.
>
> (4) The appellant was paid a basic salary of £76,345.50 per annum, paid monthly in arrears. He was also entitled to be paid, at the same rate, an Excess Day Rate for days worked in excess of 150 days per year.
>
> (5) The appellant was required to work wherever he was assigned by Subsea 7.
>
> (6) The appellant was entitled to paid holiday leave.

34. The appellant's evidence was that his salary was approximately one third of what he might expect to earn if he was a day rate worker. There was no guarantee that Subsea 7 would offer any extra days, and so any additional opportunity to earn, in excess of those in the contract. He was aware of another individual who had been "frozen out" when an offshore manager had taken a dislike to him and so, although paid the basic salary, was not offered any additional work. The appellant was also aware that some divers had been threatened with recovery of the basic pay if they did not work their contracted days in a year.

35. The appellant confirmed that he was entitled to an additional "saturation bonus" paid under the Offshore Diving Industry Agreement (ODIA), which was paid for each day that he worked in a saturation chamber.

36. The appellant confirmed that he had not mentioned the partnership with his spouse to Subsea 7.

37. It was submitted that the contract did not actually set out the appellant's duties and that the nature of mixed gas diving was such that his activities could only be carried out in the saturation chamber, for which he would earn additional money. Accordingly, it was submitted that this relationship was at most employment in relation to the basic income only, and that income from the saturation bonus was self-employment income.

38. It was also submitted that Subsea 7 was not required to give the appellant any work and so there was no mutuality of obligation.

HMRC's case

39. HMRC submitted that the contract between the appellant and Subsea 7 was clearly one of employment and stated to be such.

40. The approach to determining whether an employment exist was set out in *Ready Mixed Concrete (SE) Ltd v Minister of Pensions and National Insurance* [1968] 2 QB 497and requires that there be mutuality of obligation, control by the engager and that the other provisions of the contract are consistent with it being a contract of service.

41. In the case of the appellant, HMRC submitted that there was mutuality of obligation in that Subsea 7 was obliged to pay the appellant his basic annual salary and also to pay additional amounts for work in excess of contractyal requirements. The appellant was obliged to work a specified number of days per year, and he was obliged to be available for work if not booked on annual leave. The number of days could be changed but only with effect from an anniversary of the contract.

42. HMRC submitted that there was also sufficient control by Subsea 7 over the appellant's work and, in particular the manner in which he undertook the work (in accordance with *Narich Pty Ltd v Commissioner of Pay-Roll Tax [1984] ICR 286*). In particular, Subsea 7 directed how the appellant's 150 contract days were to be organised, and could require him to work at any location in the world on such days and for such weeks as Subsea 7 may reasonably require. Subsea 7 had also confirmed to HMRC that the appellant's work was carried out under the full direction and control of Subsea 7\s diver supervisor and offshore manager.

43. Finally. HMRC submitted that the other conditions of the contract were consistent with the appellant being an employee, including provisions relating to performance management, employee disciplinary processes, and an entitlement to holiday and sick payThe appellant was also not permitted to work for anyone else without the consent of Subsea 7.

Discussion

44. The approach to determining whether an employment exist was, as both parties noted, set out in *Ready Mixed Concrete (SE) Ltd v Minister of Pensions and National Insurance* [1968] 2 QB 497: "A contract of service exists if these three conditions are fulfilled. (i) The servant agrees that, in consideration of a wage or other remuneration, he will provide his own work and skill in the performance of some service for his

master. (ii) He agrees, expressly or impliedly, that in the performance of that service he will be subject to the other's control in a sufficient degree to make that other master. (iii) The other provisions of the contract are consistent with its being a contract of service" (at 515).

45. Considering these points, therefore:

46. *Mutuality of obligation:* the principal submission made by the appellant was that there was no mutuality of obligation between himself and Subsea 7 because Subsea 7 were not obliged to give him work and therefore he could not be considered to be employed as part (i) of the test in *Ready Mixed Concrete* would not be met.

47. HMRC submitted that there was clear mutuality of obligations as Subsea 7 were obliged to pay the appellant and the appellant was obliged to work at least 150 days per year.

48. I agree with HMRC that both parties had obligations under the contract; the fact that Subsea 7 was able to choose to pay the appellant without making him work did not change that. I find therefore that there is mutuality of obligation during each assignment.

49. *Right of substitution*: the appellant argued there was no contract for personal service as his spouse provided back office services and so the services were not exclusively provided by him, and that the contract was for team services. HMRC submitted that the appellant was not allowed by Subsea 7 to provide a substitute to undertake activities on his behalf.

50. The principal statement of employment is specifically between Subsea 7 and the appellant. It makes no reference to partnership and was entered into three years before the partnership existed. There was no suggestion, or evidence, that the contract had been novated to the partnership. Subsea 7 stated in correspondence that they would not enter into diving contracts with partnerships. In my view, the contract is clearly personal to the appellant as "the Employee. I consider that there is no scope for interpreting the contract as being one for "team services".

51. The appellant's evidence was that his spouse dealt with administration whilst he was away on assignment with Subsea 7 and that she dealt with third party professionals and liaised with customers to find future work for the appellant.

52. In my view, none of these activities relate to the appellant's engagement by Subsea 7 and so the performance of such activities by the appellant's spouse cannot be regarded as being in substitution for the appellant in the Subsea 7 contract, even if such substitution was permitted.

53. *Control:* The appellant did not make particular submissions as to control, and HMRC stated that control was exercised by Subsea 7.

54. The contract between the appellant and Subsea 7 requires the appellant to "carry out such duties … as are issued to you from time to time. The contract also provides that Subsea 7 will direct how the contract working days are to be organised. Failure to comply or to make himself available would be regarded as a serious breach of contract by the appellant, liable to action under disciplinary provisions.

55. Correspondence between Subsea 7 and HMRC states that Subsea 7 consider that divers are under the full direction and control of dive supervisors and the offshore manager, and that they are required to follows Subsea 7 protocols for all activities. Any change from the protocols is subject to a management of change procedure and requires authorisation by Subsea 7. Subsea 7 also confirmed that the divers can be given extra tasks and can be moved from task to task and reassigned if necessary. This was not disputed by the appellant.

56. On the evidence provided, it is clear that it is Subsea 7 who has control over the work undertaken by the appellant. Subsea 7 can, and does, determine the tasks to be undertaken by the appellant and the hours to be worked on any given assignment.

57. *Other factors*: the appellant is entitled to paid leave and sick pay; the contract is stated to be one of employment. Although that need not be definitive, there is nothing in the contract which is inconsistent with the appellant being an employee of Subsea 7.

Conclusion as to employment status

58. I find, therefore, that there was mutuality of obligation in each of the assignments taken on by the appellant; that Subsea 7 had substantial control over the appellant's work (both as to what work was done and how it was done); and that the other factors raised are not inconsistent with a contract of service.

59. On that basis, the relationship between the appellant and Subsea 7 was one of employment and not a trade capable of being carried on in partnership (or, indeed, as a sole trader).

Whether there was a partnership

60. The appellant further argued that, even if he were regarded as employed, the case of *Newstead v Frost* 53 TC 525 made it clear that a partnership can exist to exploit the earnings of one partner and that the partners do not have to have the same role. The appellant acted as the diver, whilst his spouse provided administration functions.

61. The appellant also noted that, in the case of *Valantine* [2011] UKFTT 808, HMRC had argued that limited participation was not a bar to someone being a partner in a partnership.

62. The appellant's evidence was that he had entered into a partnership with his spouse on 6 April 2014, having previously been a sole trader. Although no partnership document was entered into, it was submitted that the partnership existed because it met the criteria in s1 Partnership Act 1890: "Partnership is the relation which subsists

between persons carrying on a business in common with a view of profit." s45 of the Partnership Act 1890 states that "The expression "business" includes every trade, occupation, or profession." It was submitted he Oxford English Dictionary (second edition) includes "employment" within the definition of each of those terms. In addition, s2 Partnership Act 1890 provides that "The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business".

63. It was submitted that the Partnership Act did not distinguish between employment and self-employed and that, as the definitions of trade, occupation, and profession each include employment, the employment of the diver could be carried on by the partnership.

64. The appellant submitted that he and his spouse considered that they were in partnership and that his income belonged to the partnership. Although Subsea 7 were not formally notified that the appellant had entered into a partnership with his spouse it was submitted that this did not affect the position. Subsea 7 had not told the appellant had he could not operate through a partnership. It was submitted that, even if Subsea 7 had told HMRC that they would not engage a partnership, they were referring to a partnership of two or more divers and not a partnership between a diver and a person providing administrative support.

65. It was further submitted that there are acknowledged situations where an employment can be carried out on behalf of a partnership. For example, there are tax concessions that apply where a partner of a firm acts as director of a client, which enable the income to be treated as income of the partnership for tax purposes rather than as employment income of the individual.

66. The appellant also argued that the decision in *Protectacoat Firthglow Ltd v Szilagyi* [2009] EWCA Civ 98 indicated, in paragraph 74, implied that it was possible to have a valid partnership in which the partners enter into employment contracts with a client. It was submitted that this supported the contention that the partnership could be employed by Subsea 7.

67. Finally, the appellant argued that if the engagement with Subsea 7 was not with the partnership then the appellant had entered into it without the consent of the other partner and so the appellant was required to account to the partnership for the profits made, under s30 Partnership Act 1890.

HMRC's case

68. HMRC submitted that no partnership existed as the appellant and his spouse did not carry on any business in common. In particular, the contract with Subsea 7 was not with a partnership and the work for Subsea 7 was not carried out by the partnership.

69. Therefore, even if the partnership existed, the income received from Subsea 7 was not income of a partnership. The contract was entered into between Subsea 7 and the appellant as an individual, not with the partnership. Subsea 7 confirmed to HMRC that they would not offer a contract for work through a partnership or a company.

Discussion

70. As already set out above, I have found that the appellant was an employee of Subsea 7 and that s15 does not operate to create a trade which can be carried on in partnership.

71. I do not agree with the appellant's submissions that the case should be equivalent to *Newstead v Frost*. The appellant's contract with Subsea 7 was entered into three years before the partnership was created, and was not novated to the partnership, and so the contract cannot have been entered into by the partnership in order to provide the services of the diver. The contract is, as set out above, clearly a contract of personal service between Subsea 7 and the appellant alone. It is not particularly surprising that Subsea 7 did not see any need to tell the appellant that he could not provide services through a partnership, as their contract was not with a partnership.

72. I also do not agree with the appellant's submissions that the partnership could be employed. As set out above, the partnership was not employed by Subsea 7 in any case. The decision in *Protectacoat* refers to the possibility of the partners in a partnership each being engaged as employees: it does not, even in obiter, find that the partnership itself can be engaged as an employee. It is well established that an employment requires personal service and so cannot be undertaken in partnership.

73. The reference to the tax concession for partners engaged as directors does not, in my view, assist: the earnings of a director are (in the absence of the concession) taxed as employment income because a director is an officeholder and statute defines income of officeholders as being within the scope of PAYE. This does not mean that the engagement of the partner as a director equates to employment of the partnership. Indeed, if a partnership could be employed, there would be no need for the concession.

74. The reference to s30 Partnership Act 1890 is also not of assistance: the obligation is on the partner to account for *profits* earned without consent in carrying on a business of the same nature. As already established, I find that the appellant was employed by Subsea 7 and so was not carrying on a business. As also established, s15 applies only for income tax purposes and so cannot be interpreted as meaning that the appellant was carrying on a business for the purposes of the Partnership Act 1890.

75. As such, I consider that the question whether there is a partnership is largely irrelevant: the appellant's activities in relation to the contract with Subsea 7 do not amount to a trade which could be carried on by that partnership and I find that there are no circumstances in which the appellant's employment could be regarded as giving rise to income which could be attributed to the partnership for tax purposes.

Decision

76. For the reasons set out above, I find that the appellant was an employee of Subsea 7; that the income from his contract was not income of a partnership but, instead, income of the appellant. The appeal is dismissed.

77. 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.

ANNE FAIRPO

TRIBUNAL JUDGE
RELEASE DATE: 17 June 2019