[2021] UKFTT 0304 (TC)

TC08246

Appeal number: TC/2018/01369

INCOME TAX – whether under the Income Tax (Pensions and Earnings) Act 2003 amounts paid under trust arrangements are taxable as earnings from employment – – or under Part 7 A of that Act – no – whether the Appellant can obtain a tax deduction for contributions to the trust in computing its profits for corporation tax purposes if the amounts are taxable under that Act – yes – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MARLBOROUGH DP LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE HARRIET MORGAN
MEMBER JOHN WOODMAN

The hearing took place of 16 to 20 November 2020 and written submissions were received on 20, 25 and 30 November 2020. With the consent of the parties, the form of the hearing was video on Tribunal Video Platform, due to Covid 19 restrictions. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

Mr Michael Firth, counsel, instructed by Morrisons Solicitors LLP, for the Appellant ("MDPL")

Mr Julian Gosh QC and Ms Barbara Belgrano, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents ("HMRC")

Decision

Part A - Overview

1. MDPL has appealed against various assessments, determinations and decisions issued by HMRC in which HMRC seek to impose taxes in respect of payments made under a "remuneration trust" structure which MDPL used for a number of years for the benefit of its sole shareholder and director, Dr Mathew Thomas. It appears the structure was devised and promoted by various persons and entities connected with Mr Paul Baxendale Walker (referred to together as "**BW**").

2. At all relevant times, MDPL operated a dental practice in which Dr Thomas provided his dental services. In summary, MDPL put in place the following arrangements ("**the RT arrangements**") which are under consideration in this appeal:

(1) MDPL established a trust ("**the RT**") which was stated to be for the benefit, broadly, of persons who had provided or might in the future provide services, custom or products to MDPL.

(2) MDPL made "contributions" to the RT ("**the contributions**") on the basis that, as stated in the relevant documents, the contributions "reflect part of the economic cost to [MDPL] of earning its profits". For each relevant accounting period, MDPL (a) deducted the contributions as business expenses in computing its profits for accounting purposes, and (b) claimed a deduction for them in computing its profits for corporation tax purposes.

(3) Acting on behalf of the trustee of the RT, a company controlled by Dr Thomas used the funds received as contributions, in each case very shortly after a contribution was made to the RT, to make "loans" to Dr Thomas ("**the loans**") of the same or very nearly the same amount as the relevant contribution.

3. There was no dispute that the sole purpose of the scheme was to extract MDPL's profits into the hands of Dr Thomas in a form which it was thought (a) did not attract any liability to tax (namely, as loans) but (b) did enable MDPL to obtain a tax deduction for the relevant sums in computing the profits of its dental trade for corporation tax purposes.

4. HMRC's view is that:

(1) For each relevant accounting period, MDPL is not entitled to a deduction for the contributions in computing its profits for corporation tax purposes (a) on the basis that they are not laid out, expended or incurred wholly and exclusively for the purposes of its trade under the general rules (in s 74(1) of the Income and Corporation Taxes Act 1988 ("**ICTA**") or s 54(1) of the Corporation Tax Act 2009 ("**CTA 2009**")) or, (b) if it is so entitled, it is nevertheless prevented from obtain a deduction under the rules relating to employee benefit schemes (in schedule 18 to the Finance Act 2003 or ss 1290 to 1296 CTA 2009).

(2) For each relevant tax year, under the Pay As You Earn System ("**PAYE**"), MDPL is liable to account for income tax and primary and secondary class 1 national insurance contributions ("**NICs**") in respect of the monies paid by MDPL as contributions which passed into the hands of Dr Thomas as loans ("**the relevant sums**") on the basis that they either:

(a) constitute "earnings from an employment" within the meaning of the general rules in the Income Tax (Employment and Pensions) Act 2003 ("**ITEPA**") and to NICs under corresponding provisions, or

(b) are taxable under the disguised remuneration provisions in chapter 2 of part 7A ITEPA ("**part 7A**"). Part 7A contains anti-avoidance provisions designed to bring certain payments made by third parties to or for the benefit of employees within the charge to income tax and NICs.

5. Accordingly, HMRC have sought to impose tax charges on MDPL as follows:

(1) As regards corporation tax:

(a) by making, on 2 November 2017, amendments to MDPL's corporation tax returns on closure of their enquiries into MDPL's tax returns for the accounting periods ending on 31 March in each of the years 2009 and 2012 to 2015, and

(b) by issuing, on 20 March 2014, corporation tax discovery assessments for the accounting periods ending on 31 March in each of the years 2008, 2010 and 2011 under para 41 of schedule 18 to the Finance Act 1998 ("**schedule 18**").

(2) As regards income tax due under the PAYE system, by issuing determinations under regulation 80 of the Income Tax (Pay As You Earn) Regulations 2003 ("**the Regulations**")) for (a) the 2010/11 tax year on 19 March 2015 (b) the 2011/12, 2012/13 and 2013/14 tax years on 19 February 2016, and (c) the 2014/15 tax year on 26 April 2016 ("**the determinations**").

(3) As regards NICs, by making decisions under s 8 of the Social Security (Transfer of Functions, etc.) Act 1999 for (a) the 2011/12 tax year on 19 February 2016 and (b) the 2014/15 tax year on 26 April 2016 respectively ("**the decisions**").

6. In outline, MDPL argues that:

(1) The determinations were not validly issued by HMRC as further explained in Part E.

(2) In any event, Dr Thomas is not taxable on the relevant sums as "earnings from employment" under the general rules in ITEPA (and, accordingly, is not subject to NICs) and MDPL is not, therefore, liable to account for sums in respect of income tax and NICs under the PAYE system. MDPL accepts, however, that the relevant sums are taxable as distributions and, on that basis, that it is not entitled to a deduction for the contributions in computing its profits for corporation tax purposes.

(3) If, however, the tribunal finds that the relevant sums are taxable under ITEPA (and the related NICs are due), correspondingly MDPL must be entitled to a deduction for the contributions in computing its profits for corporation tax purposes.

7. In HMRC's view (a) the determinations have been validly issued and MDPL should not be permitted to bring one of its arguments on this score; it was raised at too late a stage in the proceedings, and (b) MDPL cannot obtain a tax deduction for the contributions in computing its profits for corporation tax purposes whether or not the relevant sums are subject to income tax under ITEPA (and to related NICs) (particularly by reference to the decision in *Scotts Atlantic Management Ltd and another v HMRC* [2015] STC 1321 ("*Scotts Atlantic*")).

8. In summary:

(1) For all the reasons set out in Part C, we have decided that the relevant sums are not taxable under the general rules in ITEPA or under Part 7A (and NICs are, accordingly, not due).

(2) For all the reasons set out in Part D, I have decided that, if the conclusion in (1) were to be incorrect, for each relevant accounting period, MDPL would be entitled to a deduction for the amount of the contributions in computing its profits for corporation tax purposes. I note that Mr Woodman does not agree with this conclusion but as chairman I exercise my casting vote.

(3) For all the reasons set out in Part E, we decided to permit MDPL to raise its arguments regarding the validity of the determinations but find that none of the determinations are invalid.

Part B - Facts

9. We have found the facts on the basis of the evidence of Dr Thomas, who attended the hearing and was cross examined, and the documents in the bundles. We found Dr Thomas to be a credible witness and we have accepted his evidence except where stated to the contrary. Our opinion as regards Dr Thomas' credibility was formed at the hearing and confirmed in our discussions that took place very shortly after the hearing. We note that Dr Thomas was candid about the purpose and operation of the RT arrangements and that, viewing the documents now, he could see they contained, as HMRC put it, untruths. We have commented further on the evidence he gave at the hearing below.

Background

10. MDPL is an England and Wales registered company incorporated on 31 May 2007, whose principal activity during the period from 31 May 2007 to 5 April 2015 was that of operating a dental surgery. Dr Thomas was the sole shareholder for the whole of this period and the sole director since 27 November 2007.

11. Dr Thomas qualified as a dental surgeon in 1996 and purchased the "Marlborough" dental practice in April 2000. He operated as a sole trader for the first seven years (and employed up to seven persons). He became concerned about trading without limited liability and, having consulted his trusted accountant, Mr Craig Freeman, he decided to form MDPL.

12. Dr Thomas heard about the RT arrangements through a friend, a doctor. He discussed it with Mr Freeman who put him in touch with an independent financial adviser. Dr Thomas also discussed the RT arrangement with his father-in -law, a retired HMRC officer. He first used the arrangements when operating as a sole trader.

13. Dr Thomas had a telephone conference with Mr Paul Baxendale-Walker about a tax planning arrangement involving trusts sometime before 4 September 2007. A financial adviser from Baxendale Walker LLP and Mr Freeman were also present on the call. Mr Baxendale Walker assured Dr Thomas that the scheme is legal and had been operating for eleven years without intervention from HMRC. He explained that MDPL would put monies into a trust and Dr Thomas would then obtain loans which would not be taxable but that MDPL could get a tax deduction for the contributions. He also said that the loans would be "rolled over" until Dr Thomas died and interest would accrue but would be added to the principal. Neither Mr Freeman nor the adviser said they had any concerns with the RT arrangements. Dr Thomas' father-in-law reviewed the introduction pack and did not raise any red flags.

Outline of the arrangements

14. In outline, once MDPL was incorporated, the RT arrangements were put in place as follows:

(1) On 4 September 2007, Dr Thomas was sent various documents from BW regarding "Remuneration Trust Arrangements". He reviewed the paperwork and

queried the references to customers and suppliers as they had not been mentioned on the call and was told that this was something else he could use the monies for. All the paperwork was provided by BW and Dr Thomas considered that he was following their advice and instructions in filling it in.

(2) On 3 October 2007, MTL Management Limited ("**MTL**") was incorporated in Belize with Dr Thomas as the sole director and shareholder.

(3) BW prepared two similar documents entitled "Report to the Board" dated 16 November 2007 and 5 December 2007 setting out how the RT arrangements were intended to work.

(4) On 20 January 2008, Dr Thomas, as director of MDPL, resolved to make contributions to the RT. Dr Thomas could not explain why this took place before the RT was established.

(5) The RT was established by Deed ("**the RT Deed**") executed on 31 January 2008. The deed was made between MDPL (as "the Founder") and Bay Trust International Limited ("**BTIL**") of Belize as the trustee. Dr Thomas signed the RT Deed as the director of MDPL.

(6) On 1 February 2008

(a) BTIL delegated to UPL Holdings Limited, a company established in Belize, "the execution or exercise of all or any of the Trust's powers and discretions conferred upon it as Trustee as regards the management and custody of the Trust Fund".

(b) UPL Holdings Limited, as "the Principal", and MTL, as "the Fiduciary", entered into a "Fiduciary Services Agreement" pursuant to which MTL was stated to have "all the rights to apply and deal with the Property and the income and capital thereof and all accumulations thereto as if it were the beneficial owner thereof…".

(7) On 19 March 2009 and 26 June 2012, Dr Thomas (as "the Protector") and BTIL (as trustee of the RT) executed Deeds of Amendments to the RT Deed which were said to have effect retrospectively to the date the RT was established on 31 January 2008.

(8) Several times each year, in the period from 5 March 2008 to 23 March 2015, MDPL resolved to make contributions to the RT and, usually within a few days, a loan was made by the RT to Dr Thomas of the same or around the same amount.

Remuneration Trust Arrangements

15. BW sent the following documents to MDPL in 2007:

(1) On 4 September 2007:

(a) an engagement letter regarding "Remuneration Trust Arrangements" together with:

(i) a "Professional Liability Statement" in which it was stated that "we advise in circumstances where the client has a prospective "Fiscal Liability". By "Fiscal Liability" we mean any tax or duty payable at any time in any jurisdiction by the client or any connected person or any other person in whom the client has a legal or commercial interest"; and

(ii) a leaflet entitled "Minerva" in which it was stated that "Pricing is simply a percentage of the Tax Value from which our advice, together with the appropriate Plan provides liberation"; and

(b) an engagement letter regarding "Onshore Wealth Administration Arrangements" together with a "Professional Liability Statement" and "Minerva" leaflet which included the same wording as that set out above.

(2) A "Report to the Board" for MDPL dated 16 November 2007 which was stated to be written for the attention of Dr Thomas as the sole director and shareholder of MDPL. The "Professional Liability Statement" and "Minerva" leaflet accompanying the report include the wording quoted in (1) above. The report considered the "application of the MINERVA Remuneration Trust Plan" to the particular circumstances of MDPL and summarises the scheme as follows:

> "[3.3] The Company wishes to pay or provide benefits to its present suppliers and customers and future employees, together with other classes of potential beneficiary.
>
> [3.4] The Company's sole purpose in so doing is the discharge of its commercial liabilities to make payments to or for the benefit of contractors or customers and others with whom the Company has a commercial relationship. The Company has no legal liability to such persons in respect of such contributions, i.e. under a contract or otherwise. The Company does not wish to do anything which might have the effect of evidencing that legal liability to make such payments has arisen. …
>
> [3.6] The Company derives no corporation tax advantage from the Trust or any other means of payment or provision of such benefits, since direct payments would themselves be fully deductible in computing the Company's taxable profits. The taxation liability arising from any particular investment or distribution of Trust funds depends upon all the relevant circumstances, none of which the Company has power to prescribe or procure. …
>
> [5.1] The directors of the Company will need to quantify the commercial liabilities incurred by reason of the Company's trade during the relevant accounting period. The directors of the Company will then need to consider whether a trust of the kind discussed in this Report will provide a satisfactory commercial vehicle for the discharge of those liabilities...
>
> [5.2] The directors of the Company will need to discuss how the Trust will be used to implement the incentive program. The Company must then hold a Board Meeting, evidenced by appropriate Minutes, or pass Written Resolutions."

Paragraph 5.8 of this report set out the benefits that the trustee of the RT could provide to members of the RT, including cash gifts, non-cash benefits and loans (with or without interest).

(3) A second "Report to the Board" for MDPL dated 5 December 2007 in a similar form to the first report.

(4) An "Onshore Wealth Administration Memorandum" which included the following explanations:

(a) The "Onshore Wealth Administration Option" involves the use of a Personal Management Company ("**PMC**").

(b) The only rational reason for having a UK incorporated PMC (rather than one incorporated in "BVI" or Belize) is "psychological comfort".

(c) "The PMC trusteeship is in the nature of a bare trust or nomineeship."

(d) "The cash in the relevant Offtrust is transferred" to the PMC's bank account and the PMC can invest and use that cash "as the Client directs".

(e) How the money held by the PMC is used is "your decision".

(f) In relation to any loans, if "the Client" died: "There is no question of the PMC calling in the loans and throwing the widow/partner out of the matrimonial home, for example, since she controls the PMC".

16. Dr Thomas confirmed that (a) MTL was set up to act as his PMC to perform the role described in the Onshore Wealth Administration Memorandum, and (b) funds which MDPL resolved to transfer to the RT were contributed to it and then paid by MTL to Dr Thomas as loans.

Written resolutions for contributions to be made

17. As noted, on 20 January 2008 Dr Thomas, as director of MDPL, made written resolutions as regards the making of a contribution for the accounting period ending on 31 March 2008:

(1) It was resolved that:

> "the Company make contributions to a scheme established under irrevocable trust ("the Scheme") for the purpose of funding the provision of discretionary benefits to providers of service, services, products and custom to the Company and their respective wives, widows and dependants".

(2) The initial contribution was resolved to be £100 and a further £125,000 was resolved to be contributed in respect of the accounting period ending on 31 March 2008.

(3) There were the following statements:

> "It is further noted that the establishment of the Scheme provides a means for discharging constructive obligations of the Company…
>
> We have reviewed the detailed Responses which the Director had given to a Questionnaire provided by his professional advisors. The Questionnaire and Responses are attached to this Resolution. It is resolved that those Responses continue to accurately reflect the purpose of the Company in establishing the proposed Scheme. …
>
> [Contributions] for the year ended 31 March 2008 and subsequent years.. reflect part of the economic cost to the Company of earning its profits for that period…
>
> It is noted that at the end of each accounting year, the Director would note the total contributions made by way of discharge of its pre-existing constructive obligation for that year…
>
> The Company has approved the list of persons other than employees who have provided service, services, products and custom to the Company in the last accounting period, which is attached to this Resolution ("the Providers List") …
>
> It is resolved that such amount of contribution for the year ended 31 March 2008 and subsequent years will be paid wholly or partly out of revenue income of the Company."

18. Attached to the resolution of 20 January 2008 is a questionnaire which lists a series of questions ("**the questionnaire**") and responses, which Dr Thomas confirmed were prepared by BW. The questionnaire records, so far as is relevant, the following:

> "1. Has the company's trade been conducted in such a way as to place a commercial obligation on the Company to provide benefits for consultants and other suppliers? Yes…but the Company does not want to recognise any liability to pay or provide benefits to any particular person, because that could create an actual legal liability.

> 2. Has the company's trade been conducted in such a way as to place a commercial obligation on the Company to provide benefits for customers? Yes ... but the Company does not want to recognise any liability to pay or provide benefits to any particular person, because that could create an actual legal liability.
>
> 3. Are the directors taking independent professional advice on the creation of the incentive arrangement? Yes ... …
>
> 5. It is intended that the trust be discretionary. That means that no beneficiary can order the trustees to make a payment to him. Why do the directors think this is a good idea? Because the obligation to contribute funds arises from commercial, but not legal liability. If fixed benefits were provided, this could constitute an admission of a specific legal liability upon the Company to pay particular persons. By putting monies into a trust, the Company discharges its commercial liability and does not have to take any further action. It allows time for the trustees to consider the provision of specific benefits to specific persons.
>
> 6. Does the company consider that it is possible to allocate any or all of the contribution to any particular employee or employees or that it is desirable to do so? Why? The Company does not want to spend its expensive management time in determining which specific person should get what. The discretionary trust allows each potential beneficiary to make a case to the trustees for the receipt of a benefit.
>
> 7. The discretionary trust will prohibit the refund of contributions to the company. Why do the directors think this is a good idea? Because otherwise the Company could be said to have not in reality discharged its commercial liabilities. …
>
> 9. How and when will potential beneficiaries be informed? That is the Trustees' responsibility. The Company will provide them with a list of those who have provided service, services and custom to the Company."

19. The list, attached to the resolutions of 20 January 2008, of persons who were said to have provided service, services, products and custom to MDPL did not include Dr Thomas.

20. We note that all written resolutions for the making of contributions by MDPL were in substantially the same form and terms as those set out above.

21. On 8 August 2012 HMRC wrote to five of the parties listed in the "Providers Lists" attached to the written resolutions for contributions to enquire about their knowledge of the RT. The four parties who responded did not suggest that they had had anything other than an arm's length business relationship with MDPL (one of the parties said that they had not traded with MDPL, at the address given by HMRC, at any time) or that they had ever had any correspondence with MDPL or BTIL regarding the RT. Three of the parties specifically said either that they did not know about the RT or that they did not know that they were beneficiaries. When questioned at the hearing, Dr Thomas named a few suppliers who he said knew he had a trust. However, he confirmed that he did not tell any of them they were beneficiaries mainly because he was not told he had to tell them. He said that he was just told that he had to write down a list of people who he paid for their services to MDPL.

RT Deed

22. In the RT Deed executed on 31 January 2008:

(1) "The Beneficiaries" are defined as:

> "...the wives husbands widows widowers children step-children and remoter issue of past and present Providers and the spouses and former spouses (whether or not remarried) of such children and remoter issue

> and also means...future Providers and the wives husbands widows widowers children step-children and remoter issue of future Providers and the spouses and former spouses (whether or not remarried) of such children and remoter issue...PROVIDED THAT no Excluded Person shall be a Beneficiary..."

(2) A "Provider" is defined as "...a person who provides or has provided or may in future provide service or services or custom or products (save for items of a capital nature) to the Founder".

(3) Excluded Persons are defined as the Founder (or any person connected with it), any Participator in the Founder (or any person connected with any such Participator), every person who presently or at any future time falls within the definition of "present or former employee" (as that phrase is defined in s 143 of and schedule 24 to the Finance Act 2003 and s 245 of the Finance Act 2004).

(4) The only potential beneficiaries who might possibly have been aware were parties such as BW and MDPL's accountants/advisors.

(5) Dr Thomas was named as "the Protector".

(6) It was provided that:

(a) "the Trustees shall procure that the Trust Fund from time to time is invested under the supervision and custodianship of such company as may be nominated in writing by the Protector (or such person as the herebefore named may jointly in writing appoint)";

(b) the Protector (or such person as he may in writing appoint) was to have the power to appoint and remove trustees of the RT;

(c) the powers given in the above provisions "shall be absolute and shall not be a fiduciary power"; and

(d) subject to certain other clauses, the Protector (or such person as he may in writing appoint) "...shall with the consent in writing of the Trustees have the power at any time by deed to alter or add to all or any of the provisions of this Deed in any respect and such power shall be absolute and shall not be a fiduciary power."

23. The subsequent amendments do not materially alter the stated purpose of the RT or the powers of those involved.

Contributions to the RT

24. As noted, typically, each time that MDPL resolved to make a contribution, a loan of the same or a very similar amount as the contribution was made by MTL to Dr Thomas very shortly after the resolution was made (within a few days or sometimes within a day or, on one occasion, on the same day). For example, the following took place as regards contributions in the accounting period ending on 31 March 2008:

(1) On 5 March 2008:

(a) MDPL resolved to make a contribution of £75,000 to the RT.

(b) Dr Thomas wrote to BTIL, the trustee of the RT, on MDPL headed paper, asking it to consider advancing a loan to him of £74,000.

(2) On 6 March 2008, Dr Thomas and MTL, who was stated to be the nominee of the trustee of the RT, entered into a finance agreement pursuant to which MTL agreed to lend Dr Thomas £74,000. The agreement provided for the loan, plus "Discount" at a rate of 2% above the London Inter-Bank Offered Rate at the date of the agreement, to be repaid 10 years and 1 day after the date of the agreement.

(3) On 25 March 2008:

(a) MDPL resolved to make a contribution of £30,000 to the RT.

(b) Dr Thomas wrote to BTIL, the trustee of the RT, on MDPL headed paper, asking it to consider advancing a loan to him of £30,000.

(4) On 26 March 2008 Dr Thomas and MTL (as nominee of the trustees of the RT) entered into a finance agreement pursuant to which MTL agreed to lend Dr Thomas £30,000 on the same terms as those set out above.

I note that it appears that MDPL transferred money to MTL on an earlier date than it made a resolution to contribute to the RT as, on each of 18, 19 and 20 March 2008, MDPL transferred £10,000 to MTL.

25. The bundles include various letters from MDPL to BTIL, the trustee of the RT, requesting authority for contributions to be made directly to the bank account of MTL. Where replies from BTIL are provided, they all approve MDPL's requests.

26. Resolutions for contributions were made as follows:

(1) In 2008, on 5 March for £75,000, 25 March for £30,000, 15 April for £10,000, 27 May for £10,000 and on 3 September 2008 for £10,000.

(2) In 2009, on 3 September for £70,000, 26 March for £10,000, 31 July for £10,000, 24 August for £10,000 and on 15 September for £10,000.

(3) In 2010, on 9 February for £10,000, 1 March for £10,000, 10 March for £15,000, 29 March for £10,000, 30 June for £10,000, 22 July for £20,000 and on 4 August for £50,000.

(4) In 2011, on 12 January for £30,000, 15 March for £50,000, 11 August for £50,000 and on 28 November for £40,000.

(5) In 2012, on 26 March 2012 for £60,000, 10 October for £50,000 and on 5 November 2012 for £30,000.

(6) In 2013, on 14 March for £30,000, 21 March for £10,000 and on 23 August for £45,000.

(7) In 2014, on 16 February for £40,000, 26 March 2014 for £45,000 and on 12 September for £50,000.

(8) In 2015, on 9 February for £30,000 and on 23 March for £50,000.

No resolution has been provided for the contribution of £10,000 in late June 2010.

27. There were further occasions when funds were transferred to MTL before the relevant resolutions were made by MDPL for a contribution to be made to the RT:

(1) On 14 April 2008, MDPL transferred £5,000 to MTL and the related resolution for a contribution of £10,000 and request for a loan of £10,500 was made on 15 April 2008. (Evidence of MDPL transferring the other £5,000 has not been provided, although Dr Thomas did receive £10,500 into his bank account from MTL on 18 April 2008.)

(2) On 3 August 2010, MDPL transferred £50,000 to MTL and the related resolution was made on 4 August 2010.

(3) On 11 September 2014, MDPL transferred £50,000 to MTL and the related resolution was made on 12 September 2014. Dr Thomas said the only explanation was a "clerical error" because "the paperwork was produced in accordance with what [BW] had told [him he] should be doing". He could not remember the individual contribution.

28. It appears that (a) there are four loans in respect of which there is no evidence that Dr Thomas ever wrote to BTIL requesting that the loans be made: loans of £10,000, £50,000, £30,000 and £50,000 recorded as made on 5 April 2013, 18 September 2014,

13 February 2015, and 27 March 2015, and (b) on at least one occasion, Dr Thomas asked for, and received a loan from MTM in a single day. When it was put to Dr Thomas that there was no record of a request for one of the loans referred to, he said that he was sure a letter of loan request was done for every loan taken and that he had "definitely" done them.

29. It was put to Dr Thomas that on 17 September 2014, he received £50,000 into his personal bank account and he agreed that it was a fair assumption that this was the same £50,000 in respect of which a resolution was made on 12 September 2014. When it was put to him that the associated loan documentation was dated 18 September 2014, he again asserted that this was a "clerical error".

30. It was put to him that, as the director of MDPL, he was cavalier and did not care about the accuracy of these documents, because the arrangements were that MDPL would pay money to the RT and MTL would lend him the money and the paperwork was neither here nor there. He disagreed: "I quite like to get all my paperwork in order in general, in life….and that's why my explanation for this is a clerical error".

31. We accept Dr Thomas' evidence that the errors identified were clerical errors. It is appears that Dr Thomas did seek to put in place a paper trail using the documents provided by BW on the basis that (as is evident from the evidence below) he thought that this was necessary to achieve the desired tax benefits.

Accounts and salary

32. As shown in its accounts:

(1) For all accounting periods other than that ending on 31 March 2011, MDPL realised a small loss ranging from £1,396 to £12,396.

(2) In each accounting period, MDPL paid Dr Thomas a relatively small salary ranging from £4,390 for the accounting period ending on 31 March 2008 to £10,548 and £9,893 for the accounting periods ending on 31 March 2014 and 31 March 2015 respectively.

Dr Thomas' additional evidence

Advice on the RT arrangements

33. Dr Thomas said that he had incorporated his business as he felt it "safeguarded" him personally in that "that if I fell into arrears with the bank, HMRC, suppliers, then I would be safeguarded under the umbrella of a limited company" and the company would be sued rather than him. He added that he felt this safeguarded him: "If there was any patient that wanted to sue me, if I lost my associate and he wasn't earning money for the company, if there was bad publicity and all the patients stopped coming to see me". He noted that he had a young family and he needed to protect them as well.

34. Thomas said the discussions on the RT arrangements with his father-in-law were not done on a professional basis and he did not pay him. He asked his father-in-law to ask his colleagues if they knew anything about RT arrangements. He thought that as he worked for HMRC "he might know people in a better position than myself and him to comment on the validity of [RTs]". He was sure he spoke to him a few times about it but "it wasn't a formal thing, it was just something I asked him, if he could ask some colleagues in work". He agreed it was not a professional consultation.

35. The only other advice he took was from BW and his accountant, Mr Freeman and his company/team. He said that Mr Freeman is not an expert in RTs, but he is a trusted accountant and Dr Thomas would like to think that he knows about tax. Dr Thomas spoke a lot to Mr Freeman about the RT arrangements, because he would have to account for them: "I would have spoken to him directly. It wouldn't be in emails or writing, I would have had long conversations with him…whether it was meetings or on

the telephone. Because he wanted to know more about it as well, so he was asking…to clarify it from his point of view as well".

36. Dr Thomas agreed that BW was the architect of the scheme and dealt with HMRC as regards the scheme and that it was their advice he relied on as regards its tax effects. It was put to him that in fact, as regards the tax effects of the scheme, he/MDPL acted on BW's advice and nobody else's: He said "Yes" but added that he "would have discussed that advice with other people, though". It was put to him that although he talked to his father-in law and Mr Freeman, he did not *rely* on anyone else and that Mr Freeman did not know much about the RT arrangements and, at the time, was finding out about the scheme in the same way that Dr Thomas was. He said:

> "Yes, but he was talking to more people about it, so I discussed everything with my accountant as well. Even though he wasn't giving me the main advice, I would discuss that advice with him, to say: well, is this right? Is this what I should be doing? So the answer is yes and no".

37. It was put to him that Mr Freeman did not know any more about the scheme than Dr Thomas did. He said:

> "Well, I think he did know a lot more about it than me in the end, because… he's in the trade. He's an accountant. He had to know, because he had to account for it….I would say he knows a lot more about it than I did."

38. Dr Thomas acknowledged that he paid BW a sum whenever MDPL made a contribution calculated as 10% of the contribution. He was asked if it occurred to him that that might compromise their independence. He said "No, because they were providing….ongoing advice."

39. Dr Thomas said in his witness statement that BW answered all his questions about the RT arrangements. When he was asked what his questions were, he said:

> "Was it legal? Was it fraud? Was it, you know, anything I shouldn't be doing? And the answer was: no. And he sort of pointed me towards these publications; the fact there had been no successful challenges by HMRC to anyone with [RT] arrangements for the past 11 years. So, yeah, there was quite a bit of evidence which showed that it was legal and that what I was doing was, I suppose, what you would call a legal loophole…..I wouldn't have done it if it was fraud."

40. He said that otherwise, his questions were:

> "Just the practicalities of what was required for the company, what happened to the money, where it went, what you did with it, how it was accounted for……just asking sort of about the money, the legalities of it all; sort of any support; who I would deal with if I had questions."

Purpose of the scheme

41. Dr Thomas agreed that:

(1) One main feature of the RT arrangements was to reduce MDPL's tax liabilities and that it was also one of the objectives to take the monies contributed to the RT out into his hands tax-free; that was one of the things that appealed to him about the scheme.

(2) In light of that, the only driver for deciding how much was to be paid into the RT arrangements was to reduce MDPL's profits to nil for corporation tax purposes; that was how he quantified how much MDPL was to pay to the RT. He added "but it would have been the same as dividends" if he had gone down that route. It was, in his view, "a very similar arrangement to taking dividend from profits". He plainly meant that if the RT arrangement had not been put in place, the whole of MDPL's profits would have been paid out by way of dividend.

(3) Precisely the same sums would have been contributed to the RT whether he held 100% of the shares or if, for example, he had held 75% and his wife held 25%. MDPL would have paid that exact same amount whatever the level of his shareholding; whether he held 100% of the shares or less than 100%, did not make any difference to that.

42. Dr Thomas was asked why, in the documents in the bundles, in response to a question from HMRC as to how the amount of the contributions to the RT were calculated, BW replied on his behalf and instructions that: "It was calculated using [Dr Thomas'] judgment." He said he did not know what the reply meant.

43. Mr Gosh suggested in his submissions that, on the basis of this evidence, Dr Thomas accepted that he would have received 100% of the contributions as loans even if there had been another shareholder such as his wife. However, we do not accept that conclusion can be drawn from this evidence. In cross examination the relevant questions were focussed on whether, if Dr Thomas had not held all the shares in MDPL, that would have made any difference to the sums contributed to MDPL. Dr Thomas was not asked whether if the shareholdings were different he would still have received all the sums contributed by way of loan.

Dr Thomas' understanding as regards the loans

44. It was put to Dr Thomas in a variety of ways that when he wrote to ask if the trustee would consider advancing a loan to him he knew he was going to get the loan. He was consistent in his answers:

(1) He acknowledged that he was told that MTL would make the loans but he did not consider that he was writing to himself (as the sole shareholder and director of MTL) with loan requests. He emphasised that he physically wrote to the trustee, a party other than himself, who did not have to say "yes" to the loan request and he had to wait for the answer. He hoped he would get the loan and the trustee never refused it.

(2) He later accepted that, when contributions were made, his expectation was that that money would be lent to him and that he was told that the loan was not going to be repaid if he did not want it to be. He agreed that he did not have any expectation of "not getting the loan, ever". He agreed that he knew perfectly well that MTL had full legal power and title over the trust assets but did not accept that is why he had the expectation he would get a loan or that he knew he would get the loans:

> "I hoped I'd get….the loans, because……I was told they did have the power to say no, but they never did…..And I was still trying to understand exactly how it all went on, and I was told that the trustees were there…..as a safeguard, and I had to ask them, and so I was reliant on them saying yes. And that's why I used the term I hoped that they would always say yes."

(3) When it was put to him that he would not have approved the making of the contributions unless he knew he was going to receive a corresponding loan, he said he was told he had to write to the trustees and they would "say yes or no" and he hoped the loan was given, and in fact it was but he was told the trustee could refuse but they never did and he did not think they would refuse. He added:

> "I was not au fait with the whole trust arrangement and how it actually functioned as far as legally, and I relied on the advice from [BW] as to how it is. And I….was under the understanding that….[the trustee] had the final say. I thought that was the point of them….. I hoped I would get the loan, because I had to ask the trustees in the first place, which I

> thought was the whole part of this - the scheme. That's what I was told and that's what I thought. I was never refused a loan, but there was always a possibility that I could be, because I had to ask the trustees."

45. We take from the above evidence that (a) Dr Thomas had been told that it was part of the plan for getting the desired advantages that the trustee had to have the ability to refuse to make loans to him of the requested amount, but (b) he had no reason to think that, in practice, they would refuse the loans and, given that he knew that the funds passed into a vehicle (MTL) which he controlled, he cannot have been in any real doubt that he would receive the loans; any risk in that respect is so highly theoretical as to be meaningless.

46. He agreed that he knew that he would not have to repay the loan if he did not want to and that even on death the loan may not be repaid, because that was up to whoever owned the shares in MTL, as his PMC. It was put to him that in fact, therefore, there is no 10-year term for the loan. He said:

> "Well, there is a ten-year term, because when I was coming towards the end of the ten−year term, I did ask, I said: right, well, what happens now? And…I was told that…. there would be a new loan form……and…because it says ten years in the agreement, I questioned [BW] as to what happens when the agreement runs out, and he said: rolling over, yes, but you would - there would be a new agreement….I never got to the ten years with them being loans, and they've been changed to fiduciary receipts.".

47. Dr Thomas has "no idea" what changing the loans to fiduciary receipts meant or what the purpose of doing so was. He agreed that the change in status from loans to fiduciary receipts did not change what he did with the money.

Nature of the receipts

48. Dr Thomas confirmed that he is aware of the difference between dividend and salary and that there is a procedure to go through for a dividend to be declared. When asked why he currently takes a small salary and a much larger dividend from the company he provides his dental services through he said this was on the advice of his accountant and financial advisers "as to the best way, the most tax-efficient way, to run a small company".

49. It was put to Dr Thomas that the loans he received had nothing to do with him holding shares in MDPL; it was just a good way of extracting that money tax-free. He said: "That's what I was told, yes". We note that Dr Thomas agreed only that this is what he was told; he did not state that he thought that the loans had nothing to do with his shareholding.

50. Dr Thomas agreed that neither he, as a director of MDPL, nor BW, thought that the money contributed to the RT was a dividend. He said that he did not take advice on whether MDPL could get a tax deduction for a distribution.

51. When it was put to Dr Thomas that commercially he needed the loans because that was money that otherwise would have gone to him as earnings, he said that, if the money had not been in the RT, it would not have come as earnings, but as shareholder's dividends. It was put to him that before he incorporated MDPL this was all money that he was earning because of his expertise as a dentist. He said:

> "No, because I would have been earning off my associate and my hygienist, so it was all - it would have all been profits of the company, of the business. So it wouldn't have just been what I was doing."

52. He agreed that before incorporation, he took the profits of the business as an unincorporated professional dentist and, in effect, he took the same by way of loan after incorporation, namely, the profits that he used to live on. It was put to him that the

reason that monies were paid to MDPL was because of the work he did as a director and that there cannot be another reason. He said that was the case as regards some of the monies but noted that "the hygienist made money and so did my associate". Counsel then asked him to "forget the associate dentist for the minute" and he replied: "Well, all the….monies went into the limited company, yes." It was then put to him that before he put MDPL in place he had contracts and people paid him and after he put MDPL in place, people paid MDPL and the only reason was because he was the director. He then said: "Yes".

53. We do not take from this evidence that, as Mr Gosh suggested, Dr Thomas accepted that the monies received by MDPL (and passed on to him under the RT arrangements) were all related to his role as director given that he only agreed with that proposition when asked to put to one side the fact that MDPL employed others, such as the associate dentist and hygienist. Otherwise, he was clear that, in his view, but for the RT arrangements, MDPL's profits would have been extracted as dividends and that those profits are generated by other person's activities for MDPL as well as his own (as accords with the evidence set out at [41(2)]).

Dr Thomas' understanding of the BW report

54. Dr Thomas was asked a number of questions about the statement in the BW report that "the sole purpose" of the RT arrangement "is the discharge of its commercial liabilities to make payments…. for the benefit of contractors and customers ..."

(1) He was asked how his evidence above squares with this statement. He said this is inconsistent and that was one question he asked BW who said "it's just the way the RTs are put….you didn't have to do it". He was asked if there is there anywhere where he corrected this. He said:

> "No. A lot of my conversations, after speaking to [BW], were with one of his advisers from Glasgow, which he just said: look, it's all in the legislation and the documents, but you don't have to do it. Even though it does say "sole purpose", he said: no, you don't have to do it."

(2) He agreed that (a) in making contributions no part of the purpose was to meet a commercial liability "but that's what [BW] said that it could be classed as" and (b) he did not even understand what the commercial liabilities are. He said he thought that Mr Freeman would have known that the contributions were not for the sole purpose, or any purpose, of meeting these commercial liabilities. He also agreed that so far as he was concerned the loans were the primary purpose of the scheme.

55. Dr Thomas was asked a number of questions about why he did not alert HMRC to the fact this statement is not correct:

(1) When asked if he felt the need at any time to let HMRC know that this statement was not correct when he instructed [BW] to deal with HMRC, he said:

> "No, because….[BW] would speak to the Revenue, as they administered the [RT] and they were…my advisers and, so far as I was concerned, the experts…Well, I don't profess to totally understand the whole workings of the RT. And the way I was sold it was in sort of layman's terms of generally how it works from my point of view, which would be contributions…It wasn't its sole purpose, no."

He added that he did not know the onus was on him to tell HMRC and: "It was all in my tax returns to say that I was making contributions….company tax returns, that I was making contributions to the [RT]".

(2) He was asked if it is fair summary that he thought it was all to do with meeting commercial liabilities, but as long as he was guided by expert advice and he had a "reasoned judgment", then it's none of HMRC's business. He said:

> "I never said it was none of the Revenue's business, because we declared it every year in the company's tax returns. So we didn't hide the fact that we were making [RT] contributions. And the reason for that was because I thought it was all legal and above board….Just that I was guided by [BW] as to what he said you can - you know, you can do and how the trust works….Well, with all the evidence that [BW] had provided with me and, yes."

(3) When he was asked how candid he thought he had been with HMRC, he said:

> "We've given you everything you've requested and we never hid it in the first place. Everything you've requested, as far…..the things I've been asked for, I've provided you with…. No, no, for the whole thing. I don't know what else….I would need to provide the Revenue with. We were telling the Revenue in our tax returns that we were making contributions. I didn't know that I would have to supply anything else, and…..that would have been down to my accountant."

56. It was put to Dr Thomas that the statement in the BW report that MDPL "derives no corporation tax advantage from the Trust….since direct payments would themselves be fully deductible in computing the Company's taxable profits", means . that if MDPL had made the contributions "direct to somebody, they would have been deductible, so you're doing nothing wrong". He said "this is one point which, again, I don't fully understand the wording of it, because to me it seems to contradict itself" and that he "asked about all these things, and they [BW] said it's all part of the structure of the RT".

57. Dr Thomas was also asked about the statement in the BW report that the directors of MDPL "will need to quantify the commercial liabilities incurred by reason of the Company's trade during the relevant accounting period":

(1) When asked how he went about this quantification exercise he said:

> "I was told by [BW] that the contributions to the trust were a commercial liability and so exempt from - well, became an expense to the business."

(2) He was asked in what way he relied on this report for the view the contributions were commercial liabilities. He said he did not rely wholly on the report because he was conversing with people directly in Glasgow, who were advising him on how to administer it (such as, Michael Brett who he spoke to quite a lot at the beginning)

(3) It was put to him that the difficulty is that he had said that the contributions were quantified just to reduce the corporation tax profits to nil. He said:

> "Yes, that's how it was……I was making them [the contributions] to the trust, because [BW] were saying they are a tax-deductible entity to the company and I could make them with all the deeds and paperwork in place."

(4) It was put to him that he did not undertake a quantification exercise but just said "how much do I need to pay to reduce my profits to nil and that was the end of it". He said "Yes, it was". He agreed that it was all to do with tax, nothing to do with the trust being a safe haven and nothing to do with paying dividends, because the whole point was that he was looking for a taxfree loan.

Dr Thomas' understanding of written resolutions and basis for a corporation tax deduction

58. Dr Thomas said he thought MDPL would get a deduction for the contributions to the RT as business expenses but he did not know what sort of expense: "That was never explained. [BW] just said….it was an allowable business expense". He said he asked about it but "that's the answer I got". He said he did not think it was odd that, as counsel put it, simply paying the money into a trust was deductible, and this gave rise to "this fiscal paradise where you could just take the money out as a loan" (and see the comments above).

59. It was put to him that there is nothing in the bundles to indicate he used RT monies for spending on going to the rugby or for a meal with business contacts, as he said occurred in his witness statement. He said:

> "..the money I used was, I thought, for the trust….I used money from [MDPL] because….I couldn't access easily the money from the trust….The only - the way I got money from the bank account was I had to email them and then they would phone me. I couldn't go into a restaurant and use money directly from the trust to pay for a meal….It was money from the limited company and I was told it would be accounted for through the trust…..That it would be apportioned to the trust….even though it came from the limited company, was to be…..used as an incentive money from the trust….The accountants said they would account for it, however they do it."

60. He was asked if he thought that these sums would be deductible in the same way that the other contributions were deductible. He said:

> "No, because it would be through the limited - it would be through [MTL]. It would be accounted for through that….That's what I was told by the accountants…..So I…understood it…would just be reflected in the end of year accounts…..As an incentive payment from [MTL]….Well, there were suppliers that I would take out. I wasn't told I had to write down who I incentivised specifically…..I was told by my accountants that they would sort it out through the accounts…. I assume it would be through the end of year reporting….Well, I'm sorry, I can't be any clearer than that, but that is what I felt happened or was happening."

61. He was asked about the meaning of the statement in the written resolutions that the scheme "provides a means for discharging constructive obligations of the Company". He said that to this day he still did not understand 100% what "constructive obligation" means. He added, however, "that that was stating that the contribution would be tax deductible to the company. That's how I understood it…. And I still do". He noted that this is a document that was provided to him by [BW] and he "was told it was necessary for this to be filled in for all the paperwork".

62. When asked about the meaning of "economic cost" in the statement in the resolutions that "contributions…reflect part of the economic cost to the Company of earning its profits", he said that:

> "it's cost in the company…..… but I don't understand….that paragraph. You know, I have said what I understand that paragraph means, but I don't fully understand it…..The contribution was tax deductible to the company. That's what I was told by [BW]; that's what I was under the impression that the contributions were; and that's what I feel that that paragraph means."

63. When it was put to him that he was being evasive, he said:

> "I don't understand what else you want me to say, because that's what I think it means…. That it can only be made if the company makes a profit…Exactly

> the same: I think it's that the contributions can be made if the company has made profit and that they are tax deductible to the company."

64. Dr Thomas was asked what was in his head when he signed the written resolutions. He said:

> "What was in my head was what I had been informed by [BW] about how it all works; and that those resolutions were part of the paperwork; and I administered the trust according to directions from [BW] in Glasgow, his advisers. I asked lots of questions along the way: is this right? Is that right? What do I do with this? What do I do with that? So, yes, it was in my head, but it was in my head from advice I took from advisers within [BW]…Well, again, I was told that the contributions were tax deductible to the company; as in, you know, there was a legal loophole to make them tax exempt."

65. He was questioned further on the wording in the written resolutions and the questionnaire:

(1) It was put to him that the statement in the written resolutions that the director had provided responses to the questionnaire is misleading. He said:

> "I don't have an answer, because these resolutions would have been written by and provided to me by [BW]. Yes, I have signed them, but I don't know, I can't answer your question".

(2) In response to the question of what "due and careful consideration" he gave to the Trust Deed he said:

> "The consideration would have been what I was told by BW I should be doing".

(3) He confirmed that the answers in the questionnaire were prepared by BW and not by him. When asked if he understood that the matters referred to in the questionnaire are questions of fact, he said:

> "Well, yes. The trustees were recommended to me by [BW]. As far as what was contributed, it was only profit. I didn't have a fixed amount that would be contributed at any certain time; it was whenever there was profit in the business."

(4) He agreed that the statements in the questionnaire do not reflect the running of the proposed scheme and that statement in the written resolution that the director made them was untrue when made as he must have known at the time.

(5) He was asked why he signed a resolution that was untrue not just as he had accepted above but also as regards the statements in the other paragraphs given his evidence that the scheme was nothing to do with benefiting suppliers; it was to do with obtaining corporation tax deductions and tax-free loans. He agreed that the other paragraphs were untrue but said that he was told that the contributions were not liable for tax through MDPL. He agreed that, insofar as these paragraphs are replicated in all the other resolutions that he had signed, they were equally not true.

(6) He said he did not know why these statements were in the resolutions when they were not true. They were supplied by BW and BW said they were all part of the paperwork that was necessary. It was put to him that it was blindingly obvious that they are untrue so they were designed to mislead HMRC and he was asked what other reason he could give. He said that he could not give a reason.

66. It was put to him that he thought that the trust purpose was simply not relevant to him. He said:

> "It was part of the overall scheme, that there has to be a trust…..Well, it's not necessarily the specific purpose. I don't really understand, you know, I would

have to sit down and have a really good look at a lot of these paragraphs to actually understand what they mean."

67. We note whilst Dr Thomas accepted that looking at the documents now there are statements in them that are untrue, he was not questioned about (a) whether or, the extent to which, he realised that the relevant statements were untrue at the relevant time when the transactions were entered into (other than as regards the fact that, as he accepted, he must have known that he had not prepared the answers in the questionnaire), or (b) whether he had intended to mislead HMRC in entering into the documents with these statements in them (as opposed to being asked whether the documents were designed to be misleading). We do not, therefore, find it appropriate to express any opinion on whether Dr Thomas knowingly intended to mislead HMRC. We note also that given concessions made by MDPL at the hearing, we do not need to make any findings as to whether Dr Thomas/MDPL acted "deliberately" within the meaning of the relevant legislation.

Part C - Income tax and NICs

Are the relevant sums taxable as earnings?

Overview of the dispute

68. The first issue is whether the relevant sums received by Dr Thomas under the RT arrangements constitute "earnings from employment" under the general rules in ITEPA such that MDPL is liable to account for income tax and NICs in respect of them. The parties' submissions are set out in detail below but, in outline:

(1) MDPL considers that the contributions/loans were not made as a reward for Dr Thomas' services for MDPL as director; there is nothing linking them in the required way with Dr Thomas' role as such. Rather the evidence demonstrates that the sums are distributions paid in respect of Dr Thomas' shareholding in MDPL. It is notable, in particular, that the sums reflect the entirety of MDPL's profits and that the clear evidence is that, had MDPL not used the RT arrangements, they would have been paid to Dr Thomas as its sole shareholder by way of dividend.

(2) In HMRC's view, on the contrary the payments must represent the fruits of Dr Thomas' work for MDPL as director (and be taxable as such) on the basis that (a) MDPL was paid for the work that Dr Thomas did as a dentist solely because he was the director of MDP, and (b) there is no identifiable non-employment source for the payments given they were not declared as a dividend and, on the evidence, were not paid in respect of Dr Thomas' shareholding in MDPL.

69. Whilst to some extent the dispute between the parties is a factual one, they also disagree on the correct approach to determining whether sums constitute earnings as a matter of law and the effect of the relevant caselaw. In particular, they place different emphasis and reliance on the decisions in *RFC 2012 plc (in liquidation) (formerly Rangers Football Club plc) v Advocate General for Scotland* [2017] STC 1556 ("*Rangers")*, *HMRC v PA Holdings Ltd* [2011] EWCA Civ 1414 ("*PA Holdings*") and *Kuehne and Nagel Drinks Logistics Ltd v HMRC* [2012] EWCA Civ 34, [2012] STC 840 ("*Kuenhe*").

Law

70. In summary, sums are taxable as employment income (under s 6 ITEPA) if they are "earnings from an employment in a tax year" (s 10(2) ITEPA) where:

(1) "earnings" are defined as: "(a) any salary, wages or fee", "(b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is

money or money's worth" (meaning something that is (i) of direct monetary value to the employee, or (ii) capable of being converted into money or something of direct monetary value to the employee (under s 62(3) ITEPA), or "(c) anything else that constitutes an emolument of the employment" (under s 62(2) ITEPA);

(2) an "employment" includes any employment under a contract of service (under s 4 ITEPA); and

(3) the provisions in ITEPA that are expressed to apply to "employments" apply equally to "offices" (such as the office of director), unless otherwise indicated and in those provisions, as they apply to an "office", references to being "employed" are to being "the holder of the office", "employee" means the "office holder", and "employer" means "the person under whom the office-holder holds office" (s 5 ITEPA).

I refer to these provisions as the "employment tax provisions" and amounts taxable under them as "earnings".

71. Broadly, the PAYE system applies in respect of "PAYE income" for a tax year which includes "PAYE employment income for the year" (under s 683(1)) as defined to include "any taxable earnings from an employment in the year determined in accordance with [ITEPA] section 10(2)" (under s 683(2)(a)). Under regulation 21 of the Regulations (as made under s 684 ITEPA) an employer is required to deduct income tax from such amounts and account for such tax to HMRC on making a "relevant payment" to an employee.

72. Liability to pay class 1 NICs on earnings in respect of employment is governed by section 6 of the Social Security Contributions and Benefits Act 1992 ("**SSCBA**"). Schedule 1 to that Act requires the employer, who pays earnings to an employed earner, to pay both the employer's and the earner's class 1 contributions to HMRC. It appeared to be common ground that the determination of the appeal in relation to income tax will govern liability to NICs.

73. The intended scope and purpose of these provisions is examined by reference to the case law set out below.

74. Sections 383 and 384 of the Income Tax (Trading and Other Income) Act 2005 ("**ITTOIA**") impose a charge to income tax on "dividends and other distributions of a UK resident company" by reference to amount or value of the dividends paid and other distributions made in the tax year. The term "distribution" has the meaning given by Chapters 2 to 5 of Part 23 of the Corporation Tax Act 2010 ("**CTA 2010**") (excluding s 1027A). The relevant provisions for present purposes are in s 1000 CTA 2010 which provides as follows:

> **"1000 Meaning of "distribution"**
>
> (1) In the Corporation Tax Acts "distribution", in relation to any company, means anything falling within any of the following paragraphs.
>
> Any dividend paid by the company, including a capital dividend.
>
> *Any other distribution out of assets of the company in respect of shares in the company,* except however much (if any) of the distribution—
>
> (a) represents repayment of capital on the shares, or
>
> (b) is (when it is made) equal in amount or value to any new consideration received by the company for the distribution.
>
> For the purposes of this paragraph it does not matter whether the distribution is in cash or not…… (Emphasis added.)

75. In ss 1024 to 1028 CTA 2010 there are extensive provisions which set out what constitutes a repayment of capital for the purposes of the above provisions. Under s

1113 CTA 2010 for the purposes of the above provisions, "a thing is regarded as done in respect of a share" if "it is done to a person - (a) as the holder of the share, or (b) as the person who held the share at a particular time" (sub-s(3)) and/or if "it is done in pursuance of a right granted, or an offer made, in respect of a share" (sub-s(4)).

76. Having regard to the natural meaning of the terms used in s 1000 CTA 2010 (as further explained in s 1113) and viewing those provisions in the overall context of Part 23 CTA 2010, it appears that the purpose of ss 383 to 385 ITTOIA as regards distributions is, in broad terms, to tax a shareholder on any value which a company delivers out of its assets into a shareholder's hands by some non-prescribed means (whether directly or indirectly) as a return on his shareholding except where one of the specified exemptions apply:

(1) On its natural meaning, any "other distribution out of assets" of the company (meaning "other" than a dividend) can be taken to mean the payment, delivery, provision or giving of the assets or value from the assets of the company.

(2) Without attempting to provide an exhaustive definition, it seems that a distribution is "in respect of shares in the company" as that term is explained in s 1113 CTA 2010, where the relevant asset or value is put into the hands of a shareholder *in his capacity as such*, in effect, as a return on or by reference to his shareholding as an investment in the company, and not in some other capacity and for some other reason.

(3) There is nothing in the opening wording of the provision to suggest that the scope of s 1000 CTA 2010 is confined to circumstances where the relevant asset/value is provided by the company directly to the shareholder or in a manner which directly impacts on the capital structure of the company. Indeed, the lack of prescription indicates that any means of delivery, payment or provision of the asset/value to the shareholder, whether direct or indirect, is intended to be captured as long as it is made in respect of the shares he or she holds in the sense explained above. In our view, the subsequent carve-out from the scope of the provision for repayments of capital or cases where new consideration is received does not affect the generality of the opening words.

77. HMRC seemed to say at times that there can be a distribution for these purposes only in circumstances in which formal company law procedures are followed. In our view, it is not evident that the term "distribution" is intended to be interpreted for the purposes of determining a person's tax position under ss 383 to 385 ITTOIA and s 1000 CTA 2010 to correlate wholly to the meaning given to that term for company law purposes given the different underlying purpose behind the company law rules to which the terms is relevant (namely, the protection of a company's creditors). In any event, company law does not indicate that a restricted interpretation is to be given to the term. In particular, there is a substantial body of caselaw that illustrate the breadth of circumstances in which, there may be a "distribution" albeit the courts were considering whether there was an unlawful distribution:

(1) As set out by Lord Walker in the leading authority, *Progress Property Company Ltd v Moorgarth Group Ltd* be [2010] UKSC 55, [2011] 1 WLR 1, the theme running through the cases is that the issue of whether there is an unlawful distribution is "a matter of substance, not form. The label attached to the transaction by the parties is not decisive" (see [16]).

(2) The cases he gave by way of example (at [17] and [18]) include situations where:

(a) Payments of "so called interest" made "under a complicated and artificial tax-avoidance scheme" were held to be "in fact gratuitous (and so

unlawful) dispositions of the company's money" (see *Ridge Securities Ltd v Inland Revenue Commissions* [1964] 1 WLR 479).

(b) Sums paid by a company during a company's decline to a director of the business, were held to be unlawful distributions on the basis that "the label of remuneration does not square with the facts" even through "the directors in question intended no impropriety" *(Re Halt Garage (1964) Ltd* [1982] 3 All ER).

(c) A businessman who indirectly owned and controlled Aveling Barford Ltd, procured the sale by it to Perion Limited (a Jersey company he also controlled) of certain property, which had development potential and had been valued by valuers at £650,000, for a price of only £350,000. Hoffmann J (as he then was) concluded that: "It was the fact that [the transaction] was known and intended to be a sale at an undervalue which made it an unlawful distribution (*Aveling Barford Limited v Perion Limited & Ors* [1989] BCLC 626).

(3) We note that HMRC themselves referred to the case of *Toone & Ors v Ross & Anor, Re Implement Consulting Ltd* [2019] EWHC 2855 (Ch) where it was held that payments made to employees through a form of employee benefit trust were distributions.

Caselaw on meaning of earnings

78. As set out by Lord Hodge in *Rangers* (at [35]), it is established in a vast body of case law, that income tax on emoluments (previously under schedule E as provided for in s 19 ICTA) or earnings (in ITEPA) is, "principally but not exclusively, a tax on the payment of money by an employer to an employee as a reward for his or her work as an employee". He continued to explain that:

(1) under the schedule E rules, emoluments were required to be from employment, so that schedule E imposed tax on "the remuneration which an employer pays to its employee in return for his or her services as an employee",

(2) this concept also underpins the concept of "earnings" in ITEPA, and

(3) that which was an emolument under prior legislation remains an emolument under ITEPA such that:

> "What is taxable is the remuneration or reward for services: *Brumby v Milner* [1976] 1 WLR 29, 35 per Lord Russell of Killowen in the Court of Appeal; [1976] 1 WLR 1096, 1098-1099 per Lord Wilberforce in the House of Lords….."

79. Much of the caselaw relates to assessing whether this test is satisfied in circumstances where the party providing a payment or other benefit is motivated by more than one purpose or reason for doing so. We have set out details of some of the older authorities on this as they were referred to in *Kuehne* on which HMRC place emphasis.

80. The starting point is the often-quoted decision of the House of Lords in *Hochstrasser* v *Mayes* [1960] AC 376; [1960] 38 TC 673 ("*Hochstrasser*"). In that case, ICI operated a scheme under which it made a tax-free loan to an employee to enable him to purchase a house on the basis that, if the employee was later transferred to another place of work and sold his house at a loss, ICI would make good the loss. The majority of the House of Lords held that such a payment made by ICI to an employee was not taxable as an emolument "from" the employee's employment as a "perquisite" or "profit" (under the legislation then in place) on the basis that it was not a reward for past services.

81. Viscount Simmonds said, at page 390 and 391, that the test of taxability is "whether from the standpoint of the person who receives it the profit accrues to him by virtue of his office" and acknowledged that fine distinctions may arise in cases where the question is whether a "payment is made to an employee as a reward for his services or…is made out of affection or pity". In this case he thought there was little doubt on which side of the line this case fell; the payment was not a reward for services.

82. Lord Radcliffe agreed with Viscount Simmonds but added some comments of his own. He also acknowledged, at page 391, in effect that it is not easy to draw the line but noted that (a) the test to be applied "is the same for all, namely that the payment "must arise "from" the office or employment" and (b) in the past several explanations have been offered in the courts as to the significance of the word "from", such as that the payment must have been made to the employee "as such" or "in his capacity of employee" or "by way of remuneration for his services", but:

> "these are all glosses, and they are all of value as illustrating the idea which is expressed by the words of the statute. But it is perhaps worth observing that they do not displace those words. For my part, I think that their meaning is adequately conveyed by saying that, while it is not sufficient to render a payment assessable that an employee would not have received it unless he had been an employee, *it is assessable if it has been paid to him in return for acting as or being an employee*." (Emphasis added.)

83. Lord Radcliffe decided, at 392, that in that case this test was not met because the payment was "in substance a free benefit conceded to his employee". In his view, the employer wanted "to ease the mind and mitigate the possible distress of an employee" as regards his housing situation such that it "was paid to him in respect of his personal situation as a house-owner who had taken advantage of the housing scheme and had obtained a claim to indemnity accordingly".

84. Lord Denning said, at 397, that it was essential to focus on the words of the statute. The question was simply whether the relevant amount was a profit from the employee's employment. He thought that was not the case for the simple reason "that it was not a remuneration or reward or return for his services in any sense of the word".

85. In *Tyrer v Smart (Inspector of Taxes)* [1979] 1 WLR 113, the House of Lords held that an employee received a taxable employment "perquisite or profit" when he was given the right to subscribe for shares in the parent company of his employer when the parent decided to "go public" at what was expected to be (and in fact turned out to be) a preferential rate. At page 114, Lord Diplock described it as well established that the relevant test is "whether the benefit represents a reward or return for the employee's services, whether past, current or future, or whether it was bestowed upon him for some other reason". He said that the "borderline may be a fine one" (as is illustrated by *Hochstrasser* and *Laidler v Perry* [1966] AC 16) and the employer's purpose may be a relevant factor:

> "…the purpose of the employer in granting the benefit to the employee is an important factor in determining whether it is properly to be regarded as a reward or return for the employee's services. The employer's motives in conferring the benefit may be mixed and the determination of what constitutes his dominant purpose is a question of fact for the Commissioners to determine."

86. Lord Diplock said, at page 116, that the crucial finding of fact was that the company's purpose in making the shares available to employees was "to encourage established employees of the company and of companies within the group to become shareholders in the parent company" with its aim being "to achieve a better relationship with the employees so that they would become and continue to be loyal employees,

having an understanding of and a sense of involvement in the affairs and fortunes of [the group]". He considered that this was a clear (and correct) finding and that "the offer was made as a reward for past (since he had to have served five years to qualify for the offer) and more particularly for future services and accordingly was made to him in return for acting as or being an employee".

87. In *Shilton v Wilmhurst (Inspector of Taxes)* [1991] STC 88, the House of Lords held that an amount of £75,000 paid to Mr Shilton by the football club he was then employed with as an inducement to take a contract with a new club was an emolument of employment with the new club. In giving the judgement, with which the other Lords agreed, Lord Templeman in effect endorsed the approach taken by Lord Radcliffe in the earlier *Hochstrasser* case. He said, at page 91d to e, that because the relevant provision embraces all "emoluments from employment" it must therefore comprehend an emolument provided by a third party. He said that the term applies:

> "first to an emolument which is paid as a reward for past services and as an inducement to continue to perform services and, second, to an emolument which is paid as an inducement to enter into a contract of employment and to perform services in the future. *The result is that an emolument "from employment" means an emolument "from being or becoming an employee*." (Emphasis added.)

88. He considered that the authorities are consistent with this analysis and are concerned to distinguish between an emolument which is derived "from being or becoming an employee", and "an emolument which is attributable to something else …..for example, to a desire on the part of the provider of the emolument to relieve distress or to provide assistance to a home buyer". He said that if "an emolument is not paid as a reward for past services or as an inducement to enter into employment and provide future services but is paid for some other reason, then the emolument is not received "from the employment"" although he appreciated applying this distinction is "frequently difficult and gives rise to fine distinctions" (at page 92e to f). He concluded, at page 94, that "an emolument arises from employment if it is provided as a reward or inducement for the employee to remain or become an employee and not for something else" (at page 94h).

89. In *Wilcock v Eve* [1995] STC 18 Carnwath J held that no employment tax was due on a payment to a taxpayer which was made by the group within which he was formerly employed to compensate him for his loss of share option rights when he ceased to be employed (on a management buyout of the employer company).

90. At page 27d to f, Carnwath J said that the question was:

> "whether…. the loss of rights under the share option scheme is "intimately connected with the employment" in the same way as the union rights in *Hamblett v Godfrey*; or alternatively whether it is to be treated as something distinct, such as the loss incurred on the sale of a house in *Hochstrasser v Mayes*".

91. He had earlier set out that in *Hamblett v Godfrey* [1987] STC 60 a payment made by the Crown to an employee for the loss of trade union rights was held to be taxable as employment income, in his view, on the basis that it was "for the loss of rights which were in effect part of the employment" (page 25f to j). He noted that in that case Knox J drew a distinction with the *Hochstrasser* case on the basis that the House of Lords there found "a separate source for the payment in question, namely the housing agreement" which dealt with the taxpayer's position "as householder" whereas in the *Hamblett* case "there is no such independent source other than the Crown's desire to recognise the loss of rights intimately linked with employment".

92. In *Kuenhe* the Court of Appeal referred to the above authorities in upholding the tribunal's decision that (a) sums paid to individuals on their transfer to a new employer company were taxable as earnings on the basis that they were paid and received as an incentive to work willingly and without industrial action for the new employer, and (b) the fact that they were also paid and received as compensation for the loss of the pension scheme previously available to the individuals did not affect the conclusion that they were paid for the services the employees rendered and as a reward or inducement for future willing service.

93. At [32], Mummery LJ said that the use of "from":

> "in a fiscal context indicates, as matter of plain English usage, that *there must, in actual fact, be a relevant connection or a link between the payments to the employees and their employment*." (Emphasis added.)

94. At [50], Patten LJ noted that the court's task it to apply the statutory test to the fact and not to apply some other test based on a gloss (referring to *Hochstrasser*) but he thought some gloss is inevitable because:

> "it is accepted that it is not enough merely to show that the payment was received as an employee and would not have been received if the individual had not been an employee. Something more must be established. This has been expressed in terms of the difference between *causa sine qua non* and *causa causans* but it does, on any view, *require a sufficient causal link to be established between the payment and the employment*." (Emphasis added.)

95. He said, at [51], that he thought that the ways in which that necessary link has been described and analysed in the earlier cases has to be respected even though the ultimate question is whether the "from" question can be answered in the affirmative. He noted that Neill LJ in *Hamblett v Godfrey* describes those explanations as valuable and authoritative (see page 726 G and H). He thought that the cases show:

> "that the question of taxability involves one being able to characterise the payment as one "from employment" if it derives "from being or becoming an employee" and is not attributable to something else such as a mark of esteem or a desire to relieve distress. I take this formulation from Lord Templeman in *Shilton v Wilmshurst*…."

96. He said, at [52,] that it must follow from this that, in order to satisfy the test, one must be able to say that the payment is from employment rather than from a non-employment source. He said that this has certainly been the approach of the courts in most of the decided cases referring to the comments of: (a) Viscount Simmonds in *Hochstrasser*, (b) Lord Wilberforce in *Brumby v Milner* [1976] STC 534 at 536 where he said this is "not an easy question to answer", (c) Lord Diplock in *Tyrer v Smart* at 36: as regards the "determination of what constitutes his dominant purpose"; and (d) Carnwath J in *Wilcock v Eve* at page 25 where he said that where there is more than one operative cause "there is an element of value judgment in deciding on which side of the statutory line the payment falls".

97. At [53], Patten LJ said that this process of evaluation requires the judge to make findings of fact "based on the evidence as to the reasons and background to the payment and then to apply a judgment as to whether the payment was from the employment rather than from something else". He considered, at [56], that the tribunal judge was "obviously" right to say that "a payment can be from employment even though there are other reasons for it". He noted that in all the cases he had referred to there are competing causes. In each case the payments were in part motivated by feeling of generosity towards the recipient. However:

> "Employment does not have to be the sole cause but it does have to be sufficiently substantial as to characterise the payment as one from employment."

98. He added at [59]:

> "If the employment is a substantial and equal cause of the payment, it becomes open to the judge to say that the statutory test is satisfied. The payment is then from the employment even if it also substantially attributable to a non-employment cause."

Rangers

99. HMRC also relied on the decision of the Supreme Court in *Rangers*; in their view, the reasoning in that case applies equally here. However, as explained below, we agree with MDPL that, in the circumstances of this case, the decision in *Rangers* does not provide the answer to whether the relevant sums are earnings.

100. In *Rangers*, as set out at [18] to [22] and [31], the taxpayer companies (RFC) and related companies set up a trust arrangement for the remuneration of footballers and other employees which operated as follows:

(1) When the relevant company wished to benefit an employee, it made a payment to a trust, asked the trustee to resettle the sum on to a sub-trust and requested that the sub-trust income and capital should be applied in accordance with the employee's wishes. The trustee had a discretion whether to comply with those requests but, in practice, the trustee without exception created the requested sub-trust. The employee was appointed as protector of the sub-trust with the power to change the trustee and the beneficiaries.

(2) As regards footballers, generally:

(a) When RFC negotiated the engagement of a footballer, the discussions focused on the figure net of tax which the footballer would receive. A senior RFC executive explained the mechanism of creating a sub-trust in the name of the footballer and the benefits of the trust mechanism, in particular, that he could obtain a loan of the sum paid to the sub-trust from its trustee which would be greater than a payment net of tax deducted under PAYE if he were to be paid through payroll. The loan was to be repayable on an extended term of ten years on a discounted basis. Both RFC and the footballer expected that the loans would not be repaid at term but would be renewed (and paid out of the footballer's estate on death).

(b) On recruitment of a footballer, the terms of his engagement were recorded in (a) contract of employment which set out the terms of employment and the footballer's remuneration which would be paid subject to deduction of PAYE and NICs, and (b) a side-letter in which a senior executive of RFC undertook that it would (a) recommend to the trustee of the main trust (i) to include the footballer as protector of a sub-trust and (ii) to fund the sub-trust with the sum or sums which had been agreed in the recruitment negotiation, and (b) fund the main trust to enable the trustee to carry out those recommendations.

(3) The same or similar arrangements were used for other employees generally as regards bonuses. Whilst the employees had no contractual right to the bonuses before they were awarded, they were paid as a reward for the work which the employees had carried out in their capacity as such.

101. HMRC assessed RFC to tax on the basis that under the PAYE system it should have accounted for income tax and NICs on amounts paid into the main trust because

they comprised payments of emoluments/earnings from an employment. Adopting a purposive approach to the interpretation of the relevant legislation, the Supreme Court unanimously decided in favour of HMRC. Lord Hodge gave the judgment with which the other Lords agreed.

102. As Lord Hodge noted, at [23], it was clear from documents made available as examples of the arrangements that the sums paid to the main trust and the sub-trusts represented remuneration for employment. As regards the arrangements with footballers, he noted that:

(1) In one case RFC undertook in the side letter to the pay the footballer free of taxes the sum it had undertaken to pay into the main trust for funding the sub-trust, if the trustee of the main trust did not make him the protector of the sub-trust or fund the sub-trust.

(2) In another case:

(a) There were documents in which a footballer's agent recorded his client's remuneration in these terms:

> "Annual Salary £8,000 per week. Contribution to Remuneration trust £8,000 per week namely £416,000 per annum which equates to the sum of £250,000 per annum net. The player will accordingly receive £125,000 in October and February during each year of the Contract. Rangers will grant the appropriate indemnity that they will be responsible for payment of any tax should the revenue seek to recover any tax from the player on these amounts."

(b) The contract of employment the parties entered into provided for the payment of an annual salary of £416,000 and in a side letter RFC confirmed that it would recommend to the trustee of the main trust to include the employee as the protector of a sub-trust and to fund the sub-trust with £125,000 on each occasion in October and February during the period which matched the term of the contract of employment.

(3) The tribunal recorded that RFC offered the prospective employees this form of deal, combining a payroll payment and the transfer of funds through the trust mechanism on a "take it or leave it" basis.

103. As Lord Hodge identified, at [36], the central issue was "whether it is necessary that the employee himself or herself should receive, or at least be entitled to receive, the remuneration for his or her work in order for that reward to amount to taxable emoluments". Having examined the legislation at length, he concluded, at [41], that as a general rule the charge to tax on employment income:

> "extends to money that the employee is entitled to have paid as his or her remuneration whether it is paid to the employee or a third party. The legislation does not require that the employee receive the money; a third party, including a trustee, may receive it."

104. He said, at [49], that, none of the exceptions from this general rule are in point. In particular, he did not think that the general rule is affected by the caselaw in which it has been held that sums to be paid by an employer to which the employee does not have a vested right until the occurrence of a contingency, do not constitute emoluments from employment until that contingency is fulfilled (see *Edwards v Roberts* (1935) 19 TC 618 and *Forde and McHugh Ltd v Revenue and Customs Comrs* [2014] 1 WLR 810).

105. However, at [50], he set out that the decision of the Privy Council in *Hadlee v Comr of Inland Revenue* [1993] AC 524 is in point. That case concerned legislation in New Zealand which provided that income tax was payable by every person on income

derived by him during the year for which tax was payable. A partner in an accountancy firm assigned a proportion of his share in the partnership to a trust under which the primary beneficiaries were his wife and child and argued he was not liable to income tax on that proportion of his annual partnership income. The Privy Council held that income tax was a tax on income which was the product of the taxpayer's personal exertion and that the taxpayer could not escape liability to pay that tax by assigning a part of his share in the partnership. Lord Hodge said that:

> "While the relevant provision of the New Zealand statute was worded differently from the United Kingdom legislation, the latter, by its emphasis on emoluments arising from a taxpayer's employment, adopts a similar concept of the tax charge. It supports the view which I have reached that a charge to income tax on employment income can arise when an arrangement gives a third party part or all of the employee's remuneration."

106. Lord Hodge held, at [51] to [54], that under the PAYE provisions there was a "payment" of emoluments/earnings from which deductions were required on the basis that there is no "general rule or "principle" that a payment is made for the purposes of PAYE only if the money is paid to or at least placed unreservedly at the disposal of the employee" (and conclusions in earlier cases to the contrary were based on a misapplication of a gloss on the meaning of the term).

107. He summarised his conclusions, at [58] and [59], as follows:

> "In summary, (i) income tax on emoluments or earnings is due on money paid as a reward or remuneration for the exertions of the employee; (ii) focusing on the statutory wording, [none of the relevant provisions]…. (except section 62(2)(b)), provide that the employee himself or herself must receive the remuneration; (iii) in this context the references to making a relevant payment "to an employee" or "other payee" in the PAYE Regulations fall to be construed as payment either to the employee or to the person to whom the payment is made with the agreement or acquiescence of the employee or as arranged by the employee, for example by assignation or assignment; (iv) the specific statutory rule governing gratuities, profits and incidental benefits in section 62(2)(b) of ITEPA applies only to such benefits; (v) the cases, to which I have referred above, other than *Hadlee*, do not address the question of the taxability of remuneration paid to a third party; (vi) *Hadlee* supports the view which I have reached; and (vii) the special commissioners in *Sempra Metals* (and in *Dextra*) were presented with arguments that misapplied the gloss in *Garforth* and erred in adopting the gloss as a principle so as to exclude the payment of emoluments to a third party.
>
> Parliament in enacting legislation for the taxation of emoluments or earnings from employment has sought to tax remuneration paid in money or money's worth. No persuasive rationale has been advanced for excluding from the scope of this tax charge remuneration in the form of money which the employee agrees should be paid to a third party, or where he arranges or acquiesces in a transaction to that effect….."

108. Applying the legislation to the facts Lord Hodge held:

(1) At [64], that the relevant provisions were and are "drafted in deliberately wide terms to bring within the tax charge money paid as a reward for an employee's work". The scheme was designed to give each employee access without delay to the money paid into the trust, if he so wished, and to provide that the money, if then extant, would ultimately pass to the member or members of his family whom he nominated. He concluded that "having regard to the purpose of the relevant provisions…the sums paid to the trustee of the main trust for a footballer constituted the footballer's emoluments or earnings".

(2) At [65], the fact that there was a chance that the trustee might not agree to set up a sub-trust and might not give a loan of the funds of the sub-trust to the footballer, does not alter the nature of the payments to the trustee. In applying a purposive interpretation of a taxing provision in the context of a tax avoidance scheme it is legitimate to look to the composite effect of the scheme as it was intended to operate (referring to *Inland Revenue Comrs v Scottish Provident Institution* [2004] 1 WLR 3172 at [23])

(3) At [66] the fact that in other cases, the employees had no contractual entitlement to the bonuses before their employers decided to give them does not alter the analysis of the effect of the scheme. The fact that bonuses were voluntary on the part of the employer is irrelevant so long as the sum of money is given in respect of the employee's work as an employee (*Blakiston v Cooper* [1909] AC 104, 107 per Lord Loreburn LC, *Hartland v Diggines* [1926] AC 289, 291 per Viscount Cave LC).

(4) Accordingly, at [67], payment to the trust should have been subject to deduction of income tax under the PAYE Regulations.

109. It is plain, therefore, that there was no doubt in this case that the relevant sums constituted a reward for the relevant employees' services (as set out at [100] to [102] and [108] above). The issue was whether the sums were prevented from being earnings because they were routed through the trust arrangements; the answer was that they were not. As regards the different circumstances of this case, the decisions tells us only that *if* the relevant sums constitute a reward for Dr Thomas's services as director, it would be no bar to them being taxed as such that they are paid through the RT arrangements. The decision does not mean, as HMRC seemed to suggest, that sums are taxable as earnings simply because they are routed through such arrangements.

PA Holdings

110. Both parties relied on the decision of the Court of Appeal in *PA Holdings* that dividends paid to employees on shares awarded to them in effect as a discretionary bonus were taxable as earnings and not as dividends. Moses LJ gave the leading judgment with which the other panel members agreed.

111. Moses LJ set out the relevant facts, at [6] to [20]. In outline, prior to the transactions in question, PA had a well-publicised policy to pay its staff generous annual bonuses each year by paying profits into employee benefit trusts from which awards were made under discretionary bonus schemes. PA's accounts for 1999 included provisions for bonuses so that that the employees had a valid expectation that PA would pay bonuses for that year. The bonuses were designed to reflect an employee's efforts, the achievements of the section of PA in which the employee worked and profitability as a whole. In 1999 Ernst & Young proposed an arrangement to re-route bonuses so that they were paid as dividends from a UK resident company pursuant to share award made to the employees, with the intention they would be taxed as distributions. The overall effect of the scheme was that any employee who chose to do so received 99p in dividends and 1p in share redemption proceeds, rather than receiving a bonus of £1.

112. At [23] Moses LJ recorded that, on the basis of the facts he had set out, the tribunal made the following main conclusions:

(1) The cash dividend received by the employees was a profit arising from the employment because it was made in reference to the services the employee rendered by virtue of his office and was in the nature of a reward for past, present or future services (the test applied by Upjohn J in *Hochstrasser v Mayes* [1959]

Ch 22). On a purposive approach to the construction of the relevant provisions, it reached the same result.

(2) Under the schedular system for taxing income in place at the time (as provided for under ss 15 to 20 of the Income and Corporation Taxes Act 1988 ("**ICTA**")), the payments received by the employees were, therefore, emoluments within the meaning of schedule E. However, they were also dividends or distributions within the scope of schedule F (as provided for under s 20(1) ICTA).

(3) On that basis, s 20(2) ICTA required the payments to be taxed under Schedule F as dividends only as it provided that: "No distribution which is chargeable under Schedule F shall be chargeable under any other provision of the Income Tax Acts". However, absent any equivalent provision to s 20(2) for NICs, since the payments were emoluments, they were earnings for those purposes.

The UT followed the same approach.

113. Moses LJ said, at [26] and [27], that it was essential to identify "the source" of the income noting that different schedules, with their own rules, applied "according to the source of the income" and "generally, classify the property, profits or gains to be brought into charge for income tax purposes by reference to the source or character of the income in the hands of the recipient". He set out, at [28,] that guidance as to the purpose of the schedular system was definitively expressed in *Fry v Salisbury House Estate Ltd* [1930] AC 432 from which he derived the following fundamental propositions (which he said remain good at [31]):

> "i. income tax is only one tax, and the different Schedules do no more than to provide the method of computation charge and assessment peculiar to the Schedule to which the income is allocated;
>
> ii. the Schedules are mutually exclusive, each Schedule is dominant over its own subject matter and provides a complete code for the class of income which falls within that Schedule;
>
> iii. the same source of income cannot be taxed twice."

114. In passages on which both parties place reliance, at [32] to [40], Moses LJ said that the tribunal was correct that the relevant income was derived from the employees' employment:

(1) He accepted, at [33], that there are circumstances in which employees may be awarded shares as an incentive or reward where the source of dividends or distributions they later receive in respect of their shareholding "may properly be identified as the shares and not their employment" so that the employees "receive those payments in their capacity as shareholder or investor and not as employee" (citing *Abbot v Philbin* [1961] AC 352 as an example of such a case).

(2) He continued, at [34], that the answer to the character of the receipts in "lies not in the administration of some post-*Ramsay* prophylactic against tax avoidance but in the methods which the courts have long been accustomed to deploy whenever it is necessary to decide whether income is from employment.." which he described, at [35] to [38], noting that:

(a) the conventional approach of the courts is to look at all the circumstances of the case in order to determine whether a payment is an emolument (citing *Brumby v Milner* 1976 51 TC 583 at 607G);

(b) whilst over the years judges have indulged in judicial glosses on the statutory words there was no need for any such gloss, rather the "correct approach is to consider all the facts relevant to the receipt of the income";

(c) this requires "the court not to be restricted to the legal form of the source of the payment but to focus on the character of the receipt in the hands of the recipient" (citing *Dale v IRC* [1954] AC 11); and

(d) in other words: "The question is one of substance and not form" (referring to Viscount Simonds in *Hochstrasser v Mayes* at 706).

(3) He said, at [39] that on that approach:

> "The court should not be seduced by the form in which the payments (that is as dividends declared in respect of the shares in [the company]) reached the employees. It should focus on the character of the receipt in the hands of the recipients."

(4) He noted, at [40], that the tribunal had followed that approach in holding that the payments were emoluments and they relied in particular on the facts that (a) the purchase of the shares in the relevant company, which were then awarded to employees, was funded in full by PA, (b) the dividends and full value of the shares were transferred at no cost to the employees, (c) the intention was to motivate and encourage the employees, (d) payment was represented to them as payment of the bonus for that year, (d) those who left, even after PA had provided funds for the scheme were not eligible, and (e) that the employees had no right to the payments was irrelevant. He considered that was the correct approach which:

> "owes nothing and need owe nothing to the law's development, during the past thirty years, in its attitude to artificial tax avoidance…..For at least sixty years courts have identified the character of a receipt in the hands of the recipient by looking at its substance and not its form".

(5) He concluded, at [43], that unlike in *Abbott v Philbin:*

> "The payments received by the employees owed nothing to fluctuations or increases in the value of shares in [the company] and everything to the amount which PA had decided to award as bonuses to its employees…….the quantum of that which the employees received was entirely dictated by the amount PA decided to award as bonuses. The receipts were triggered by PA's decision to continue its policy of making bonus payments and to fund the 1999 Trust and arrived in the hands of employees, as they were intended to do, as bonuses."

115. Moses LJ then turned to the question of whether the tribunal and UT had interpreted s 20 correctly and held that they had not. He held, at [63], that the error of the tribunal and UT was in thinking that both schedules E and F could be relevant whereas "income falls either under the one or the other" and the factual finding that the income fell within schedule E precluded any finding that it also fell within schedule F:

(1) At [54], he said that:

(a) The UT were correct to base their conclusions on issues of statutory construction, in obedience to the principle that "the paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case"" (referring to *MacNiven v Westmoreland Investments Ltd* [2001] UKHL 6 [8], [2003] 1 AC 311) and *Barclays Mercantile Business Finance Limited v Mawson* [2004] UKHL 51 [2005] 1 AC 684 at [38]).

(b) The issue was "to determine whether the statutory provision in question is concerned with the character of a particular act rather than the character of the entirety of transactions which have a commercial unity" (citing Lord Hoffmann's reference to *MacNiven*, in *Carreras* [8]).

(2) He explained, at [57] that, following those principles, the UT concluded that, as a charging provision, any transaction which came within the wide definition of a dividend or distribution within s 20(1), whether part of a series of transactions, of a composite transaction or of pre-ordained transactions, fell to be charged under schedule F and not under schedule E. However, this is where the UT erred in that, as he said at [58], s 20(1) "must be construed within the context of the statutory scheme of which it forms part" (being s 1 and ss 15 to 20 ICTA) which "classify the nature of the income in the hands of the recipient by reference to mutually exclusive Schedules…" (referring again to *Carreras at* [8] set out at (2)(b) above).

(3) At [59] he said that whilst the tribunal and the UT "hit the nail on the head….they failed to drive it in":

> "They concluded that the payments were emoluments by having regard to all the circumstances of the case and by looking to the substance and purpose of the payments and not to the mere form in which they were received. In reaching their conclusion, they followed a long-accepted, traditional approach to the facts. That approach enabled them, within accepted limits, to look beyond the form of distributions, mere machinery, by which the intention to pay bonuses was fulfilled."

(4) He concluded, at [60], that once that conclusion had been reached, there was "no room whatever for any further consideration of a different Schedule". If the payments were emoluments in the hands of the taxpayer's employees, they could not be dividends or distributions in their hands. Any other conclusion "offends the basic principle expressed in *Fry* that if income falls within one Schedule it cannot be taxed under another" and, at [61]:

> "The principles of *Fry*, and for that matter all the jurisprudence relating to the issue whether payments are from employment, to which I have already referred, establish that, once they had concluded that the payments were emoluments, the [tribunal] and [UT] had exhausted the enquiry as to the character of the income which the statute obliged them to undertake. There was no room for any further enquiry, no room for asking whether the form of the payments came within the wide embrace of the definitions of dividends or distributions for the purposes of Schedule F."

(5) In his view, at [64], it is the structure of Part 1 ICTA and the application of the fundamental principles of income tax law and not s 20(2) which dictates that conclusion; that section does not apply unless a distribution chargeable under schedule F can be identified and, as its wording makes clear, it does not apply to a payment chargeable under Schedule E. He emphasised, at [65], that s 20(2) is not devoid of effect. It resolves the conflict where income from one and the same source, shares or certain securities could be charged under two different schedules but:

> "It is not concerned to charge income under Schedule F when the source of the income is charged under the different and mutually exclusive Schedule E. Schedule F does not take priority over Schedule E. It does not charge emoluments at all. No question as to the application of section 20(2) arises. The income never came within section 20 at all."

116. At [66] to [70], he said that his conclusion owed little to HMRC's deployment of familiar anti-avoidance jurisprudence but he thought that he should not overlook the application of those principles (as summarised by Arden LJ in *Astall and Another v Revenue and Customs Commissioners* [2009] EWCA Civ 1010, [2010] STC 137). On

that approach, he reached the same conclusion that, viewed realistically, the payments were emoluments ([67]). He said, at [70], that:

> "PA decided that its employees should receive a bonus, Mourant identified which of the employees, from the list provided by PA, should receive a bonus and those employees received a bonus. That, to adopt the dismissive terms of Special Commissioner de Voil in *DTE*, was the beginning and end of the matter. It is, in my view, the beginning and end of these appeals."

Submissions

117. HMRC submitted that their analysis that the payments constitute earnings is supported by and is entirely in line with:

(1) the findings in *Kuehne* that the question of whether sums are "from" employment is not a "but for" test and that it is relevant to ask what the non-employment source is;

(2) the decision in *PA Holdings* that in determining the source of a payment, the focus is on the substantive nature of the payment and not the form; and

(3) the decision in *Rangers.* The contributions were diverted earnings in the manner found in *Rangers* given that they were paid to the RT as the first step in extracting monies generated by Dr Thomas as director from his employer, MDPL, into his hands through loans that were expected to be tax free.

118. HMRC said that what Dr Thomas/MDPL would have done as regards the extraction of funds into Dr Thomas' hands, if the scheme had not been put in place, does not affect the analysis. If MDPL had declared and paid a dividend, the payment would not have been earnings and, if MDPL had paid the money directly to Dr Thomas expressly as salary, it would have been. However, those are not the facts of this case.

119. HMRC focussed on the evidence which, in their view, supports their stance that the payments do not constitute dividends or distributions out of the assets of MDPL in respect of shares in it. HMRC seemed to suggest that it lends support to their analysis that, on the evidence as they interpret it, (a) Dr Thomas accepted that the scheme had nothing to do with commercial liabilities or being a safe haven or paying dividends: it was all to do with avoiding tax by moving the fruits of Dr Thomas' labour into his hands under documents which he did not understand and which contain factual "untruths" and multiple errors, and (b) no dividends or distributions were formally declared or made and the parties did not consider that they were using such mechanisms under the scheme. They made the following further specific points:

(1) The contributions were paid to MTL, as Dr Thomas' PMC which he controlled, as the first step in extracting the monies as "loans" on what was thought to be a tax-free basis. Dr Thomas knew that MTL had full legal title and power over the funds.

(2) The contributions were not made for the purpose of MDPL earning its profits or for the purposes of MDPL's trade. They were quantified solely by reference to what it took to reduce MDPL's corporation tax profits to nil and were of amounts that lead to MDPL reporting a loss for all but one of the relevant accounting periods and a negative profit and loss account in the capital and reserves section of the balance sheet for every relevant accounting period.

(3) Dr Thomas knew the difference between money received as a dividend and money received as salary and neither he (as MDPL's director) nor BW thought that the payments were dividends or distributions. There was no consideration of whether declaring a dividend or making a distribution was lawful. If MDPL had thought that it was paying a dividend, it would not have claimed a corporation tax

deduction. Dr Thomas said the contributions would be for the same amount even if the shareholdings in MDPL had been different (and so Mr Gosh, seemed to suggest, accepted that the loans to him would have been for the same amount but see the comments above).

(4) Dr Thomas plainly knew that the monies would be lent to him when each contribution was made. He could not square the stated purpose of the RT with his hope and expectation of receiving loans. He did not ask BW about the purpose of the RT but did ask about who could benefit from loans.

(5) Dr Thomas knew that he would not have to repay the loans. He explained that the loans were "changed to fiduciary receipts" before the end of the 10-year term but said he has "no idea" what that means or what the purpose of doing so was. This did not change what Dr Thomas did with the money.

(6) The loans did not replace dividends: 31 loans were made over a seven year-period.

120. Mr Firth said that HMRC are not correctly applying the tests set out in caselaw for determining whether sums constitute earnings:

(1) Under the guidance set out in the caselaw, whether the relevant sums constitute a reward for Dr Thomas' services as a director of MDPL is to be assessed simply by looking at why the payments were made by MDPL and not by reference to where MDPL itself got the monies from or why its customers paid monies to it.

(2) This case is not all fours with the circumstances in *Rangers*; the different circumstances of that case do not provide an answer as to whether the payments constitute earnings.

(3) HMRC seem to suggest that the sums must be earnings simply by default given they were not declared as a dividend and, so they say, are not paid in respect of Dr Thomas' shares in MDPL. However, that argument is entirely out of kilter with the decisions in *PA Holdings* and *Keuhne*:

(a) It is clear from *PA Holdings* that if a payment is in substance earnings, it does not change its character due to the mechanism which is used to deliver it. Therefore, if as in this case, sums represent the profits of a business which do not have the requisite link with employment, the mechanism by which they are paid, whether as a dividend or through the RT trust, which itself has nothing to do with Dr Thomas' employment, cannot affect their character as non-earnings.

(b) The confusion underpinning HMRC's case is laid bare by their assertion that the analysis is binary. *Keuhne* illustrates that, on the contrary, if there is more than one reason for a payment, if the employment related reason is a substantial cause of the payment, the payment may constitute earnings (see [46]). Whilst identifying an alternative explanation for a payment may be helpful in assessing whether it constitutes earnings, it is not necessary to be able to do so to conclude it does not constitute earnings. In any event, the source of the relevant sums is Dr Thomas' shareholding in MDPL as set out below.

121. Mr Firth continued that, on the correct test, the evidence does not support that the relevant sums are earnings:

(1) None of the documents support the view that the sums were paid to reward Dr Thomas for his services as an employee. Unlike in *Rangers*, they were not part of any contractual negotiations with an employee and were not paid in respect

of any work done. Unlike Dr Thomas' salary, which was paid monthly, they were paid out sporadically, as and when there were profits to distribute.

(2) If Dr Thomas had not operated a business through MDPL, these profits would have arisen to him as owner of the business. The effect of incorporating was that those same profits arose to him as owner of the company that carried on the business. Moreover, the relevant sums represent the profit of MDPL's business *as a whole* including sums generated from the activities of the hygienist and associate dentist. If MDPL has not made a profit, there would not have been any contributions/loans, hence their sporadic nature.

(3) The clear evidence is that if MDPL had not contributed the profits to the RT, it would have paid them to Dr Thomas as dividends and not as salary. Moreover, the contrary view that the sums would have been paid as salary is contrary to what happened and to the advice that tax advisers commonly give in respect of companies owned by a single owner/director, namely, that a small salary should be paid and the remainder of the profits extracted by way of dividend.

(4) HMRC's own case excludes the possibility that the payments were provided as a reward for Dr Thomas's service as a dentist given that they assert the payments had no business purpose at all.

(5) For the reasons set out below, it is irrelevant that formal company law procedures for declaring a dividend were not gone through or that the documents drafted by BW do not refer to the payments as distributions.

122. Mr Firth added that it is clear that the source of the sums received by Dr Thomas is the shares for the following reasons:

(1) It is highly relevant that, as noted, the relevant sums represent the *overall undifferentiated* profits from MDPL's business and that, but for the use of the RT arrangements, the sums would have been paid as dividends.

(2) The fact that no dividend or distribution was declared or formally paid does not affect the analysis. In addition to the points recorded above:

(a) The fact that no dividend was declared because the company was advised it could achieve a better tax outcome by using a different mechanism, the RT, can have no bearing on the character of the payment made through that mechanism.

(b) The case law establishes that where a payment is made for the benefit of shareholders which is not a reward for service and is not lawfully declared as a dividend it may nevertheless constitute a distribution (such as *Toone & Ors v Ross & Anor, Re Implement Consulting Ltd* [2019] EWHC 2855 to which HMRC referred).

(c) It is also established in caselaw that "if a payment is made in substitution for a payment which might, subject to a contingency, have been payable….the nature of the payment which is made in lieu will be affected by the nature of the payment which might otherwise have been made" and that there will "usually be no legitimate reason for treating the two payments in a different way" (see *Mairs v Haughey* [1994] 1 AC 303 at 319, Lord Woolf). Hence, if it is established (as it is) that, but-for the payment to the RT, the sums would have been paid as a dividend and would not have been employment income, the fact that the same amount was delivered by a different mechanism (the RT) does not affect the character of the payment.

(3) HMRC's case is based on a misreading of the oral evidence. We have commented on this in our conclusions below.

123. Finally, Mr Firth emphasised that if HMRC's analysis is found to correct it would give radical results which would be wholly out of kilter with how sole shareholders/directors are taxed. A dividend paid by a company to its sole shareholder/director who alone performs services for the company always represent the "fruits of his labour" in the sense HMRC use that term and the logical outcome of their analysis, therefore, is that such sums will always be taxable as earnings.

124. Mr Gosh said that:

(1) HMRC's stance does not involve "gluing" the taxable receipts attributable to the dentist and hygienist on to Dr Thomas. In determining the source of the contributions, the revenue generated for MDPL by those persons can be ignored given that their salaries are deducted in computing MDPL's profits. If a barrister's fee is increased because another person types his opinions, the barrister obtains the whole fee in his capacity as such and may or may not get a tax deduction for a payment he makes to that person. All HMRC are interested in is the pointed question of whether the work that Dr Thomas did, in his capacity as a director of MDPL (as the only reason that money went into MDPL and not to him) was the fruits of his labour.

(2) The idea that it would be a revolutionary decision for the tribunal to adopt HMRC's arguments is wrong given that in *PA Holdings* payments made in the form of dividends were found to be taxable as earnings. All depends on the particular facts of the case. The mere mechanics of payment are not conclusive but are part of the overall evidence which the tribunal must consider and weigh. The pertinent facts of this case are that, on the basis of untruthful documents, through making contributions to a RT that Dr Thomas neither understood nor was interested in, Dr Thomas extracted money that he earned in his capacity as a director which, on his own evidence, he did not take out as a dividend. In his own words, the shares were not the source of either the contributions or the loans and, for the reasons already given, those sums were the fruits of what Dr Thomas did in his capacity as a dentist and a director of MDPL. That is the only reason the money was paid to MDPL. The aim of the scheme was to get that money to him tax-free. Moreover, the tribunal reached the conclusion HMRC argue for here in respect of payments made under an RT arrangement to a sole owner of a company and sole director in *La Vita Pizzeria Limited v HMRC* [2017] UKFTT 692 (TC).

125. Mr Firth replied that:

(1) HMRC's submissions do not provide any answer to the difficulty that the overall profits cannot be conflated with the profit arising from Dr Thomas' own personal work. The work of each person employed by MDPL will generate a profit which forms part of the overall undifferentiated profit unless, as is unlikely, the salary paid to that person exactly matches the revenue he generates. This situation is not at all like the example Mr Gosh gave. The hygienist and associate dentist provide free-standing services to customers which are charged for separately to Dr Thomas' work as a dentist. In contrast, the barrister's assistant does not provide any free-standing service to the customer/client for which a separate charge is made.

(2) The decision in *La Vita Pizzeria Limited v HMRC* does not assist HMRC's case given that, in that case, both HMRC and the taxpayer proceeded on the basis that the relevant payments were "from employment" for the purposes of ITEPA.

In fact, it is clear that the tribunal regarded this as unrealistic. The most that the tribunal was prepared to accept was that the relevant payment had the "effect of being a reward", not that it was intended as such. This is clear from [118] (and see also [150]:

> "There was no evidence that the EBT structure was ever considered as a potential means of rewarding staff other than Mr Arcari and (at least before his death) his brother. In our view it is also somewhat unrealistic to regard it as a scheme to motivate Mr Arcari as an employee. He owned the business and his focus was on saving tax. However, both the appellants and HMRC proceeded on the basis that, for La Vita as well as the other appellants, the payments into the sub-funds were intended to motivate or reward the relevant employee, and we do accept that the £400,000 had the effect of being a reward to Mr Arcari for his contribution to the business."

Decision

126. For all the reasons set out below, we have concluded that the relevant sums do not constitute earnings.

127. To recap, it is plain from the caselaw that sums constitute earnings if they are paid as remuneration or a reward in return for a person's services as an employee. The courts have consistently recognised that, given the test is centred on why or in return for what a payment is made, establishing the purpose of an employer in making a payment is key to assessing, as it was put in *PA Holdings*, its character in the hands of the recipient "looking at its substance and not its form". As summarised in *Kuehne* the courts have also recognised that this may be a difficult finely balanced exercise where there is more than one reason for a payment. As it was put at [52] of that case, a tribunal or court needs to be satisfied that the payment is from employment rather than from a non-employment source. That involves evaluating the reasons and background to the payment and applying a judgment as to whether the payment was from the employment rather than from something else. Whilst employment "does not have to be the sole cause" of the payment "it does have to be sufficiently substantial as to characterise the payment as one from employment" (see [56] of *Kuehne*).

128. In this case, the question is, essentially:

(1) whether contributions made by MDPL (which enabled those funds to pass into Dr Thomas' hands as loans) are to be regarded as remuneration or a reward for the provision of Dr Thomas' services as director of MDPL on the basis that that role is the reason why MDPL made the contributions or is a sufficiently substantial case of the contributions for this test to be met; or

(2) whether MDPL made the contributions for a different reason such that they have a non-employment source, the only identifiable other reason being that they were made in respect of Dr Thomas' shareholding in MDPL.

129. The difficulty is that, in the circumstances of this case, there is little to tell us what underlying purpose MDPL had in enabling the relevant sums to flow into Dr Thomas' hands. In our view, however, such relevant evidence as there is, points to the conclusion that the relevant sums were not paid to Dr Thomas under the RT arrangements as a reward for his services as director but rather constitute distributions made as a return on his shareholding in MDPL. On a purposive approach to their construction, the distribution provisions are plainly broad enough to capture the relevant sums notwithstanding that they were paid in the form of contributions to an RT and subsequent loans. We note the following:

(1) There was no contractual obligation on MDPL to pay the sums as a reward for Dr Thomas' services as director/dentist and there is nothing in any of the documents or evidence to suggest that that was the reason for the extraction of MDPL's funds into Dr Thomas' hands.

(2) The sums paid to Dr Thomas comprised the totality of the overall profits of MDPL's business, as computed after the deduction of expenses, such as salaries paid to those employed by MDPL including the relatively small salary paid to Dr Thomas and, accordingly they were paid out sporadically.

(3) Dr Thomas' evidence was that, had those profits not been routed through the RT arrangements, they would have been paid to him by way of dividend and not as salary. It lends support to the credibility of Dr Thomas's evidence in this respect that:

(a) As Mr Firth noted, it is a well-known common practice for a sole owner and director of a company to organise matters such that the relevant company pays him or her a low salary and much more substantial dividend payments (and see the comment in [130] below).

(b) That is how Dr Thomas extracts profits from the company he now operates through now he no longer uses the RT arrangements and, as noted, MDPL paid him a small salary during the periods in question.

(4) For the reasons set out in full below, we do not accept HMRC's view that Dr Thomas' evidence is not relevant. In short, (a) his evidence, as the controlling mind of MDPL, indicates that its purpose, in putting in place steps to extract the funds into the hands of Dr Thomas, was to provide him with a return on his investment in it as shareholder in the same way as if it had formally declared and paid a dividend, and (b) it does not detract from this that Dr Thomas and MDPL did not consider that MDPL was making a dividend or check that in making the relevant contributions MDPL was not making an unlawful distribution for company law purposes.

130. We note that there is nothing to prevent the sole owner and director of a company from arranging for the profits of the company's business to be extracted in the form of salary and as dividends/distributions in such proportions as he or she may wish. We are not aware of any principle that would render any such split ineffective for tax purposes even if it results in salary payments that may not fully reflect the value of services provided by such an individual as director/employee viewed on an arm's length basis. As Mr Firth noted, the guidance on the General Anti-Avoidance Rule includes commentary that arrangements of this type are not caught by that rule (see B4.2 of the guidance) In other words, it appears that, as the law currently stands a sole owner and director of a company (as the person through whom the company acts) can simply choose, in effect, to what extent he is to be rewarded by the company for his role as director/manager of the company's business and/or as shareholder/owner of the company. Certainly, there is no presumption that, if the profits of such a company are extracted from it into the hands of the shareholder/director otherwise than by way of the making of a dividend which conforms with company law procedures, the profit must be assumed to be received as a reward for the shareholder/director's services as director/employee.

131. In support of their views to the contrary, HMRC rely on the fact that, so they argue, (a) MDPL received the income generated by its dental business because of Dr Thomas' role as director, (b) the resulting profits represent the "fruits of his labour", and (c) the payments of them as contributions to the RT were not declared as dividends and were not related to his shares in MDPL. However, we see a number of difficulties with

HMRC's analysis as a matter of legal principle and with the conclusions they seek to draw from the evidence:

(1) HMRC's analysis of the facts does not chime with the distinction for corporate law (and tax) purposes between MDPL, as a legal person in its own right, and the individuals involved in its management and operation. It is MDPL who, as a legal person separate from those individuals, carries on a business/trade of operating a dental practice; it engages with the customers for the provision of dental services in return for fees from the customers. As a corporate entity, its management is necessarily conducted on its behalf by its director and its operation is carried out by the individuals engaged to provide the range of dental services it provides. In that context, therefore (a) MDPL simply necessarily acts through Dr Thomas' agency as its sole director in conducting its dental business, and (b) the overall profit from MDPL's business arises from the work done on its behalf by all of its employees and not just that of Dr Thomas (whether as dentist or director).

(2) In our view, the fact the relevant sums were paid through, as HMRC put it, untruthful RT arrangements, which were implemented only for tax avoidance purposes, does not of itself, as HMRC seemed to suggest, provide evidence that the relevant sums are a reward for Dr Thomas' services as director/dentist (or, for that matter, that they are distributions):

(a) Dr Thomas now acknowledges that (a) the RT arrangements were put in place solely with the aim of getting the profits of the MDPL's business into his hands without any tax charge whilst enabling MDPL to obtain a tax deduction for the relevant sums, and (b) the RT arrangements do not succeed in giving these intended tax effects given that they are based on factually incorrect propositions as regards the basis on, and purposes for which, the contributions were paid.

(b) However, we cannot see that the use of an ineffective structure solely for the purpose of generating a tax advantage, as based on spurious grounds, itself sheds any light on the underlying reason for the extraction of funds from MDPL into Dr Thomas' hands. Once the RT arrangements are stripped bare of the admitted untruths on which they are based, as accords with the approach taken in *PA Holdings*, we are simply left with the conundrum of determining, as a matter of substance, MDPL's purpose in putting the monies into Dr Thomas' hands.

(c) In other words, in the circumstances of this case, the manner in which the relevant sums were extracted from MDPL tells us only that Dr Thomas/MDPL wanted to avoid a tax charge for Dr Thomas on those sums whilst ensuring MDPL could obtain a tax deduction for them. Given the stated reasons for the arrangements are spurious and unfounded, they do not of themselves shed light on the further specific question of whether the parties' underlying purpose was (i) to avoid a tax charge for Dr Thomas on sums intended as a reward for his services as director whilst preserving for MDPL the tax deduction which the employer would usually obtain in respect of such sums, or (ii) to avoid a tax charge for Dr Thomas on sums intended as a return on his shares in MDPL whilst generating a tax deduction for MDPL which is not usually available.

(3) It follows from our comments at (2) that we regard the reliance which HMRC puts on the evidence which they see as demonstrating that the contributions/loans do not constitute dividends/distributions as misplaced.

Moreover, in light of Dr Thomas' acceptance that the RT arrangements were structured to obtain the desired tax advantage on the basis of untruths and his other evidence, it seems unsurprising that Dr Thomas said that he and BW did not consider MDPL to be paying dividends under the RT arrangements and did not consider the company law or tax consequences of the relevant sums being dividends or distributions:

(a) Dr Thomas was plainly aware that the aim of using the RT arrangements was to route MDPL's profits into his hands under a legal form, as contributions to the RT and loans from the RT, which on the face of it do not attract tax as opposed to in the form of dividends or salary which would attract tax. Moreover, he appears to have accepted, in reliance on BW, that the RT structure is a viable structure from a legal and tax perspective albeit that he did not understand why it would work to give the desired tax results. He plainly thought that, acting as director on behalf of MDPL, he was following a plan set by BW, which did not involve any dividend, distribution or salary mechanism, but rather involved a RT structure which would, through some "loophole" or reasoning which he did not understand at the time (or, it seems, fully question), result in getting MDPL's profits into his hands with the desired tax results.

(b) Whilst such an acceptance may fall short of the actions and attitude which may be expected of a reasonable taxpayer, it does explain why Dr Thomas/MDPL (a) did not appreciate that MDPL could be considered as making a distribution of the profits extracted from it through the RT arrangements as a legal and tax matter, and (b) accordingly did not consider the tax or company law considerations of it doing so.

(c) It does not necessarily follow from this that Dr Thomas' and MDPL's purpose was not to provide Dr Thomas with a return on his investment in MDPL as its sole shareholder and was, so HMRC assert, to provide Dr Thomas with a reward for his services as director. Rather it simply (A) demonstrates that Dr Thomas, as director of MDPL, thought that, through using a particular legal form for the profit extraction, he could achieve a particular desirable tax result, and (B) leaves open the question of whether Dr Thomas/MDPL's underlying purpose in paying the relevant sums through this ineffective structure was to reward Dr Thomas for his services as director or to provide him with a return on his investment as a shareholder.

(4) For the reasons already set out in Part B, Dr Thomas did not accept, as Mr Gosh at times seemed to suggest, that (a) he would have received the same amounts through the RT structure even if he had not been the sole shareholder of MDPL, and (b) the relevant sums were not paid in respect of his shares in MDPL.

(5) As a matter of legal analysis, we do not consider that HMRC's approach is correct, even if all of MDPL's profits can be regarded as the fruits of Dr Thomas' work as director (because he manages the overall dental business on its behalf):

(a) HMRC assert that the result which their analysis would produce is not radical (as Mr Firth suggests) because it is based on the particular facts of this case. However, they have not pointed to any material factor indicating that the relevant sums are sufficiently linked with Dr Thomas' role as director to constitute earnings or that the sums are not paid in respect of Dr Thomas' shares other than those on which we have already

commented. In the absence of the identification of any other reason, HMRC's stance comes down to a proposition along the lines that:

(i) income/profits arising to a corporate owner of a business, which are in part generated by the activities of its sole shareholder and director, are necessarily linked in their entirety to that individual's role as director and/or employee, and

(ii) unless paid by way of formal declaration of a dividend, the extraction of those sums from the company into the individual's hands constitute earnings as the fruits of the individual's work as director/employee. In other words, HMRC's stance amounts in effect, to a proposition that, in those circumstances, there is a presumption or a default position that the company's purpose in paying profits to that individual is to reward him for his role in generating those profits as employee/director.

(b) However,

(i) HMRC's approach is unsupported by and is out of kilter with the case law on this topic. As set out in full above, in assessing whether sums constitute earnings the courts look at the reasons why the employer makes a payment to an employee/director and not the reasons why it receives the funds in the first place.

(ii) For the reasons already set out, the decision in *Rangers* takes the question of the correct categorisation of the relevant sums no further forward. In that case, it was plain that, on the different facts of that case, the sums in dispute constituted a reward for the footballers' and other employees' services as employees (see, in particular, [100] to [102] and [108] above). Whilst the fact that the sums were paid through a trust structure with some similarity to the RT arrangements was held not to be a bar to those sums being taxed as earnings, it was not of itself the reason why they were viewed as earnings.

(iii) The proposition that the formal declaration of a dividend breaks the link or connection with employment which, in HMRC's view, otherwise exists, is implicit in their submissions on this issue (and they stated this explicitly in relation to the connection test under Part 7A). However, such a proposition is unsustainable for the reasons already set out and is out of kilter with the body of caselaw which establishes that sums may constitute distributions whether or not formal company law procedures are followed.

(6) We do not consider that there is anything in *La Vita Pizzeria Limited v HMRC* which detracts from our conclusions.

Are the relevant sums taxable under Part 7A?

132. The next question is whether the relevant sums are taxable as income under Part 7A and, in particular, whether the requirements of sub-s (1)(c) of s 554A ITEPA 2003 are met. Section 554A provides as follows:

"(1) Chapter 2 applies if—

(a) a person ("A") is an employee, or a former or prospective employee, of another person ("B"),

(b) there is an arrangement ("the relevant arrangement") to which A is a party or which otherwise (wholly or partly) covers or relates to A,

(c) *it is reasonable to suppose that, in essence -*

(i) the relevant arrangement, or

(ii) the relevant arrangement so far as it covers or relates to A, is (wholly or partly) a means of providing, or is otherwise concerned (wholly or partly) with the provision of, rewards or recognition or loans in connection with A's employment, or former or prospective employment, with B,

(d) a relevant step is taken by a relevant third person, and

(e) it is reasonable to suppose that, in essence—

(i) the relevant step is taken (wholly or partly) in pursuance of the relevant arrangement, or

(ii) there is some other connection (direct or indirect) between the relevant step and the relevant arrangement.

(2) In this Part "relevant step" means a step within section 554B, 554C or 554D. (3) Subsection (1) is subject to subsection (4) and sections 554E to 554Y. …

(5) In subsection (1)(b) and (c)(ii) references to A include references to any person linked with A.

(6) For the purposes of subsection (1)(c) it does not matter if the relevant arrangement does not include details of the steps which will or may be taken in connection with providing, in essence, rewards or recognition or loans as mentioned (for example, details of any sums of money or assets which will or may be involved or details of how or when or by whom or in whose favour any step will or may be taken).

(7) In subsection (1)(d) "relevant third person" means—

(a) A acting as a trustee,

(b) B acting as a trustee, or

(c) any person other than A and B. …

(11) For the purposes of subsection (1)(e)—

(a) the relevant step is connected with the relevant arrangement if (for example) the relevant step is taken (wholly or partly) in pursuance of an arrangement at one end of a series of arrangements with the relevant arrangement being at the other end, and

(b) it does not matter if the person taking the relevant step is unaware of the relevant arrangement.

(12) *For the purposes of subsection (1)(c) and (e) in particular, all relevant circumstances are to be taken into account in order to get to the essence of the matter*." (Emphasis added.)

133. It appeared to be common ground that a relevant step was taken within the meaning of s 554C(1)(a) ITEPA which provides that a person ("P") takes a step within this section if P pays a sum of money to a relevant person. Therefore, we have not set out further details of ss 554B, 554C and 554D ITEPA.

134. Where the relevant conditions are satisfied, chapter 2 of Part 7A provides, broadly, that the value of the relevant step counts as employment income of A in respect of A's employment with B generally for the tax year in which the relevant step is taken (see s 554ZA ITEPA). The precise relevant steps which are caught and hence, the sums which are potentially caught by Part 7A, are in dispute as set out below. It did not appear to be disputed, however, that to the extent Part 7A is applicable NICs would also be due in respect of the sums taxable under that part. That is because regulation 22B of the Social Security (Contributions) Regulations 2001 provides that amounts treated as

employment income by Part 7A are also treated as remuneration derived from an employed earner's employment for the purposes of s 3 SSCBA 1992.

135. HMRC said that it is clear that, for the purposes of s 554A(1)(c) ITEPA, the scheme was a means of providing Dr Thomas with loans and that the loans were provided in connection with Dr Thomas' employment with MDPL:

(1) HMRC emphasised that the decision of the Court of Appeal in *Barclays and others v HMRC* [2008] STC 476 establishes that the phrase "in connection with" needs to be construed by reference to other parts of the provision in which it appears and the surrounding provisions of the legislative scheme (see [18] to [26]). Accordingly, when used in s 554A, the phrase must be construed by reference to s 554A as a whole as viewed in the overall context of Part 7A. Given that Part 7A is anti-avoidance legislation, it is intended to be construed broadly and s 554A is drafted deliberately broadly to cast a wide net. Moreover, the use of the phrases "it is reasonable to suppose" and "in essence" instruct the tribunal to take a realistic view of the structure of the arrangement and what it is intended to achieve.

(2) HMRC essentially gave the same reasons for viewing the loans as made in connection with Dr Thomas' employment with MDPL as those they gave in support their view that the relevant sums constitute earnings. Again, they emphasised that the monies were received by MDPL due to Dr Thomas' work for it as dentist and director and the fruits of those labours were channelled to him under the scheme. They said that, whilst declaring and paying a dividend would have severed this connection, contributing this money to the RT as part of a tax avoidance scheme did not do so.

136. Mr Firth submitted that the conditions in s 554A(1)(c) are not satisfied for the following reasons:

(1) The connection test is not met:

(a) It is accepted that the connection test is cast deliberately broadly. However, there is a limit to the test and the tribunal must examine the surrounding words and context of the legislative scheme to determine the required degree of connection (in terms of remoteness, proximity and type of connection) intended by the phrase where used in the particular context (see *London Luton Hotel BPRA Property Fund LLP v Revenue & Customs* ([2019] UKFTT 212 (TC)).

(b) On that approach, it is plain that the intended type of connection in sub-s(1)(c) is that A's employment is part of the reason for the reward, recognition or loan. That is the only sensible interpretation as regards a reward or recognition and the reference to loans must be read on an equivalent basis. It would be anomalous if an arrangement is not caught on the basis that it is not concerned with providing reward or recognition in connection with A's employment but would be caught due to the provision of a lesser benefit of a loan.

(c) For the reasons already given in relation to whether the relevant sums constitute earnings, Dr Thomas' employment with MDPL is not part of the reason for the contributions/loans.

(2) In any event, even if there is the requisite "connection", the arrangement is not a "means of providing" and is not "concerned with providing reward, recognition or loans with that connection:

(a) Read in context, this test is satisfied only if the purpose of the arrangement is to achieve the relevant connection.

(b) To take an example, the payment of a dividend by a company to its sole shareholder/director necessarily involves the provision of a benefit to a person who is an employee of the company. However, the dividend is not a "means of providing" benefits in connection with that employment, within the meaning of sub-s(1)(c), as the connection is not part of what the arrangement is seeking to achieve.

(3) The above analysis is confirmed and taken further by the fact that the legislation twice refers to the need to have regard to "the essence of the matter" (as stated in (1)(c) itself and in s 554A(12)):

(a) On its ordinary meaning that term is intended to identify those features of the matter that are essential, key, fundamental or indispensable. For example, the Oxford English dictionary defines the term as "intrinsic nature or indispensable quality of something, especially something abstract, which determines its character" or "a property or group of properties or something without which it would not exist or be what it is".

(b) If there is a connection with Dr Thomas' employment, it is not fundamental or part of the essence of the arrangement such that it is not intended to be caught by sub-s(1)(c) .

(4) Attributing the income generated by other staff of MDPL to its director, as is the effect of HMRC's argument, dilutes the application of sub-s(1)(c) to such an extent that it is meaningless. On that logic the work of and income thereby generated by any employee can be attributed to the employee's manager, and to the manager's manager and so on. On the present facts, that rationale would mean that the loans are also connected with the employment of every other employee of MDP. This cannot be the type of connection that Parliament intended.

(5) If the source of the funds used to provide a benefit means it is connected with employment, it would follow that many distributions on a winding up of a close company are connected with the termination of the directors' employments (as directors). Even if there could be such a connection it is not part of the essence of the arrangement or what it is a means of doing. There is nothing essential or fundamental about the alleged connection between who generated the funds and the making of loans under the arrangements.

137. We agree with MDPL's view that, reading s 554A(1)(c) in context, for there to be a "connection" of the required kind with Dr Thomas' employment, the employment must be part of the reason for the reward, recognition or loan. On that basis, an assessment of whether is reasonable to suppose that, in essence the RT arrangement so far as it relates to Dr Thomas is (wholly or partly) a means of providing or, is otherwise concerned (wholly or partly) with, the provision of, rewards or recognition or loans *in connection* with Dr Thomas' employment requires essentially the same analysis as that set out in relation to whether the relevant sums constitute earnings. Accordingly, we have concluded that this test is not met as regards the connection test for all the same reasons as are set out above.

138. Finally, we note that there was a dispute as to precisely which sums are caught by Part 7A if, contrary to our view, it is applicable. Part 7A was introduced by the Finance Act 2011 ("**FA 2011**") with effect in relation to relevant steps taken on or after 6 April 2011 (under para 52(1) of schedule 2 FA 2011). However, that provision is subject to what HMRC described as an "anti-forestalling" provision in para 53 of schedule 2 FA 2011. Para 53 provides that:

(1) Chapter 2 of Part 7A applies to a step (a) if on or after 9 December 2010 but before 6 April 2011 a relevant step ("the early step") within section 554C(1)(a) ITEPA is taken, (b) chapter 2 of Part 7A of would have applied by reason of the early step had the reference in para 52(1) of schedule 2 to 6 April 2011 been a reference to 9 December 2010, and (c) the early step is not chargeable to income tax by virtue of schedule 34 to the Finance Act 2004 in whole or in part.

(2) In determining the tax year for which the employment income of "A" counts for the purposes of s 554Z2(1) ITEPA, the early step is treated as having been taken on 6 April 2012; but, otherwise, chapter 2 of Part 7A applies by reference to when the early step was actually taken.

139. HMRC's view is that Part 7A applies to contributions and loans made on or after 9 December 2010 but before 6 April 2011 under these "anti-forestalling rules" which results in additional income tax and NICs liability in the 2012/13 tax year. This was disputed by MDPL and the issue was dealt with in written submissions received after the hearing.

140. MDPL submitted that, having regard to the caselaw on the correct approach to determining the scope of a decision by HMRC and of the appeal made in respect of it, these sums are not within the scope of the determinations and the current appeal. Mr Firth referred to the recent decision on this topic in *Clark v HMRC* [2020] EWCA Civ 204, in particular, at [106] to [108]. At [106], the court endorsed the approach taken to this issue by Kitchin LJ (as he then was) in *Fidex Ltd v HM Revenue & Customs* [2016] EWCA Civ 385, [2016] STC 1920 where he said, at [45]:

> "In my judgment the principles to be applied are those set out by Henderson J [in *Tower MCashback LLP v Revenue and Customs Commissioner* [2008] STC 3366] as approved by and elaborated upon by the Supreme Court. So far as material to this appeal, they may be summarised in the following propositions:
>
> (i) The scope and subject matter of an appeal are defined by the conclusions stated in the closure notice and by the amendments required to give effect to those conclusions.
>
> (ii) What matters are the conclusions set out in the closure notice, not the process of reasoning by which HMRC reached those conclusions.
>
> (iii) The closure notice must be read in context in order properly to understand its meaning.
>
> (iv) Subject always to the requirements of fairness and proper case management, HMRC can advance new arguments before the FTT to support the conclusions set out in the closure notice."

141. MDPL submitted that, having regard to the caselaw, the loans/payments made in the 2010/11 tax year were not any part of what the officer had in mind when raising a determination for the 2012/13 tax year:

(1) These are different amounts that were paid in a different year.

(2) As far as HMRC were concerned, they had already taxed those amounts when raising determinations for the 2010/11 tax year.

(3) Those amounts were not assessable under the ordinary Part 7A machinery but solely by virtue of deeming machinery tucked away in FA 2011.

(4) That deeming machinery had its own mechanism for arriving at the chargeable amount and when it is to be assessed – none of which was in the contemplation of the decision-making officer.

142. Mr Firth concluded that there is no reading of the PAYE determination in this case that leads to the conclusion that any amounts other than those paid in the 2012/13 tax year were in the contemplation of the decision-making officer. He added that it appears that HMRC are trying to collect tax on these amounts twice because they are standing by the whole of the amount they state is due for the 2010/11 tax year (on the basis that HMRC say it is general earnings in any event) but that includes the amounts HMRC later decided should have been included in 2012/13 (along with amounts that, on no view, fall within Part 7A).

143. HMRC appeared to accept that the principles set out in the case law Mr Firth referred to are relevant to determining the scope of the relevant determination and the appeal in respect of it. They said, however, that the relevant determination on its terms plainly covers the relevant loans; it concerns the PAYE liabilities arising in that year "in connection with…[MDPL's] Remuneration Trust arrangements" and the loans made between 9 December 2010 and 5 April 2011 are part of those arrangements. In any event, MDPL are wrong to submit that HMRC seek to collect tax twice in respect of the same loans. If HMRC succeed in their arguments that the amounts are both general earnings and fall to be charged pursuant to Part 7A, s 554Z11C ITEPA would effectively remove any double taxation.

144. Given our conclusions above, we do not need to decide this issue. However, in brief, our view is that:

(1) It is reasonable to suppose, on the basis of the broad and general wording in the relevant determination and given the background to its issue (as to which see Part E), that HMRC's conclusion was that all relevant sums arising in connection with the RT arrangements which are properly attributable to the tax year 2012/13 are subject to income tax in that year. On that basis, we cannot see that HMRC are precluded from arguing that income tax is chargeable under Part 7A in respect of the 2012/13 tax year by reference to the value of all relevant sums properly attributable to that year whether they arise in that tax year or in an earlier period under the anti-forestalling rules.

(2) Given that the appellant did not object to HMRC raising the argument on fairness grounds (and whether Part 7A applies was addressed in full at the hearing), there is no basis for the tribunal to preclude HMRC from raising this point.

(3) There is no concern that the relevant sums may be taxed twice for the reason given by HMRC.

Part D –Deduction for corporation tax purposes

145. MDPL accepts that if, as we have decided, the relevant sums are not taxable under ITEPA, it is not entitled to a deduction for the contribution in computing its profits for the relevant accounting periods for corporation tax purposes. However, we have considered whether, as HMRC argue, MDPL is not entitled to such a deduction even if the relevant sums are taxable under ITEPA in case we are wrong in our conclusions that they are not so taxable and as we heard full argument on this point.

Dispute

146. HMRC submitted that MDPL is not entitled to a deduction for the contributions on the basis that they were not laid out or expended or incurred wholly and exclusively for the purposes of its trade (a) for accounting periods ending on or before 31 March 2009, under s 74(1) ICTA, or (b) for accounting periods ending on or after 1 April 2009, under s 54(1) CTA 2009.

147. It appeared to be common ground that contributions to the RT which were used to fund entertainment or gifts are not deductible (but HMRC noted that, in any event, they do not accept that this was a purpose of any contribution) (under s 577 ICTA or s 1298 CTA 2009 which both limit deductions for expenses incurred on business entertainment).

148. HMRC referred to:

(1) *Strong & Co Ltd v Woodifield* [1906] AC 448 where, at 453, Lord Davey said that the phrase for "for the purpose of the trade" means "for the purpose of enabling a person to carry on and earn profits in the trade".

(2) The well-known formulation of the "wholly and exclusively" test set out by Millett LJ in in *Vodafone Cellular Ltd and ors v Shaw* [1997] STC 734 at 742:

> "The leading modern cases on the application of the exclusively test are *Mallalieu v Drummond (Inspector of Taxes)* [1983] STC 665, [1983] 2 AC 861 and *MacKinlay (Inspector of Taxes) v Arthur Young McClelland Moores & Co* [1989] STC 898, [1990] 2 AC 239. From these cases the following propositions may be derived. (1) The words for the purposes of the trade mean to serve the purposes of the trade. They do not mean for the purposes of the taxpayer but for the purposes of the trade, which is a different concept. A fortiori they do not mean for the benefit of the taxpayer. (2) To ascertain whether the payment was made for the purposes of the taxpayer's trade it is necessary to discover his object in making the payment. Save in obvious cases which speak for themselves, this involves an inquiry into the taxpayer's subjective intentions at the time of the payment. (3) The object of the taxpayer in making the payment must be distinguished from the effect of the payment. A payment may be made exclusively for the purposes of the trade even though it also secures a private benefit. This will be the case if the securing of the private benefit was not the object of the payment but merely a consequential and incidental effect of the payment. (4) Although the taxpayer's subjective intentions are determinative, these are not limited to the conscious motives which were in his mind at the time of the payment. Some consequences are so inevitably and inextricably involved in the payment that unless merely incidental they must be taken to be a purpose for which the payment was made. To these propositions I would add one more. The question does not involve an inquiry of the taxpayer whether he consciously intended to obtain a trade or personal advantage by the payment. The primary inquiry is to ascertain what was the particular object of the taxpayer in making the payment. Once that is ascertained, its characterisation as a trade or private purpose is in my opinion a matter for the commissioners, not for the taxpayer."

(3) The decision in *Scotts Atlantic* which concerned a scheme designed to enable the taxpayers to provide their directors and employees with benefits through a form of employee trust arrangement, on the basis that (a) the employees would not be taxable on the benefits at that time, but (b) the taxpayers would obtain a tax deduction for the cost of the scheme in computing their profits for corporation tax purposes under s 74 ICTA. The scheme was specifically designed to circumvent the provisions of schedule 24 of the Finance Act 2003 which are aimed at preventing exactly that tax result, in effect, by disapplying the entitlement to a tax deduction for contributions which the employer would otherwise have under s 74 ICTA. The UT held (amongst other findings) that the taxpayers were not entitled to a deduction for the contributions under s 74 in the first place because "one purpose was to implement a pre-arranged scheme in order

to obtain a tax deduction; the purpose was not simply to benefit employees and directors through the medium of an employment benefit scheme" (at [81]).

149. In *Scotts Atlantic*, the taxpayer argued that the only purpose of the contributions was to provide benefits for employees through the employee benefit trust arrangements. HMRC argued that there was another purpose, namely, to secure a tax deduction. In their view, not only was securing this tax deduction a purpose of the scheme (which was accepted) but it was also a purpose of the expenditure so that the contributions were not wholly and exclusively expended for the purposes of the employer's trade.

150. The UT set out the principles of the "wholly and exclusively" test adopting the principles set out in *Vodafone* including the need to distinguish between object and effect. They noted, at [55], that a trader "may have a choice of the way in which it achieves an end which is exclusively for the benefit of the trade. The choice may be influenced, or indeed wholly determined, by the tax consequences of each choice". In their view:

> "A taxpayer is perfectly entitled to order its affairs in a way which incurs the least tax liability. The mere fact that a choice is influenced or dictated by the tax consequences does not necessarily mean that the choice involves a duality of purpose as regards the expense. The words of Millett LJ are just as relevant and applicable where there is a choice as where there is not: in each case, the question is whether the payment is made exclusively for the purposes of the trade, and that is a question of fact for the FTT."

151. At [56], the UT explained that the taxpayers argued that the tribunal erred on the basis that its conclusion that a main purpose of the relevant expense was to reduce tax liabilities is inconsistent with the principle stated by Romer LJ in *Bentleys, Stokes & Lowless v Beeson* [1952] 2 All ER 82 at 85, 33 TC 491 at 504 (as approved by the Court of Appeal in *Interfish Ltd v Revenue and Customs Comrs* [2014] EWCA Civ 876, [2015] STC 55) that:

> "if, in truth, the sole object is business promotion, the expenditure is not disqualified because the nature of the activity necessarily involves some other result, or the attainment or furtherance of some other objective, since the latter result or objective is necessarily inherent in the act."

152. The UT continued to explain that (a) the taxpayers noted that the tribunal had accepted that the purpose of the expense was to benefit employees and that this should be a business purpose, and (b) the arrangements adopted to reward the taxpayers' employees had the incidental effect of reducing their tax liabilities: but that did not mean that the costs had not been incurred exclusively for trading purposes. In the taxpayers' view, the tribunal had wrongly treated an incidental effect as a purpose.

153. The UT considered precisely what the relevant finding of fact was that the tribunal had made. They noted, at [65], that, on one interpretation of its decision, the tribunal appeared to have found that the taxpayers had incurred expenditure for the purposes of their trade, but that because those companies then decided to incur that expenditure in a particular way, their objects in incurring it came to include in addition the object of avoiding corporation tax. They said, at [66], that it that was the tribunal's reasoning, it was incorrect:

> "That reasoning would be to confuse the object of the expenditure with the reasons for incurring it in the way in which it was in fact incurred. As we have already noted at paragraph 55 above, a taxpayer is entitled to order its affairs in a way which incurs the least tax liability and the mere fact that a choice is influenced or dictated by the tax consequences does not necessarily mean that the choice involves a duality of purpose. It does not, therefore, necessarily follow that the adoption of the scheme by [the taxpayers] results in a duality of

> purpose (although it may do so as a matter of fact) unless this is one of those cases referred to by Lord Oliver *MacKinlay v Arthur Young*…. where the results (in the present case, the securing of deductions) are so inevitably and inextricably involved in particular activities (in the present case, the making of the contribution and the effecting of the scheme) that they cannot but be said to be a purpose of those activities."

154. However, at, [67], the UT held that this is not the correct interpretation of the tribunal's decision. The tribunal provided "a separate finding that the all pervading object (ie to achieve a corporation tax deduction) made it impossible to treat the corporation tax result sought for the contributions as the "ordinary, intended or realistically expected outcome" of making salary, bonus or equivalent payments". Hence "the words "ordinary, intended or realistically expected outcome" are thus being adopted as the yardstick by reference to which a result can be ignored as a separate object" and, at [68]:

> "….this gloss on the "wholly and exclusively" test is either (i) putting into other words Millett LJ's description of a "consequential and incidental benefit of the payment", and saying that this was not a situation in which the tax benefit was merely consequential or incidental, or (ii) is stating, in different language, the proposition to be derived from what Lord Oliver said in *MacKinlay v Arthur Young*, so that the securing of the deductions cannot but be said to be a purpose of the contributions."

155. They were satisfied, at [70] to [73], that the tribunal had based its decision on a finding that they were entitled to make, that one of the purposes of the contributions (in contrast with the purpose of the method of expenditure) was to obtain a tax deduction which would not have been available if the contribution had been made by more conventional means, and that, in these particular circumstances, such purpose was not an incidental consequence of the expense. Whatever else, the tribunal "did not conclude that because the tax benefit was a consequence of the contribution, it was a purpose of the expense".

156. They concluded by emphasising, at [73], that the important words in Romer LJ's comments in *Bentleys* are "if, in truth, the sole object is business promotion". In their view the principle is that "if such is the case, then an incidental effect does not as a matter of law disturb that conclusion". In this case, the tribunal did not find that there was a sole object but only that the companies had another object. In doing so, it recognised that an incidental consequence of a tax deduction did not mean that such a deduction was necessarily an object. They continued, at [74], that the point made in *Bentleys* was that expenditure is not disqualified:

> "*because* the nature of the activity necessarily involved some other result, in other words that the mere existence or knowledge of that result is not enough to give a dual purpose.
>
> But if the fact-finding tribunal concludes that its inquiry into the mind of the taxpayer revealed that the taxpayer actually had that other purpose as an object of the expenditure, then the fact that that result is a natural consequence of the expenditure will not cause that finding to be perverse."

Decision

157. Mr Gosh said that *Scotts Atlantic* establishes that, if *in truth*, the *sole* object of expenditure is business promotion, the expenditure is not disqualified from being tax deductible just because some other result happens. However, in his view, in this case there is no business promotion object at all:

(1) As Dr Thomas accepted the contributions were made purely for tax purposes; it was no part of the purpose to meet commercial liabilities of MDPL.

(2) Dr Thomas told untruths in all relevant resolutions which he made as the sole director of MDPL for the making of every contribution by MDPL to the RT. There is no explanation for the untruths other than misleading HMRC; Dr Thomas could not give a reason.

(3) The documentation and its implementation exhibit a complete disregard for tax compliance obligations. HMRC do not accept that these were clerical errors. Rather, these exhibit a careless (at best) attitude to tax compliance obligations, where a corporation tax deduction and tax-free extraction of monies from a company was critically dependent on this documentation.

158. In HMRC's view, accordingly, the payments were not either (a) paid subjectively (in the mind of Dr Thomas, as the sole director) for the purposes of MDPL's trade or (b) incurred as expenses enabling MDPL to carry on and earn profits in any trade. Therefore, regardless of what other purposes MDPL may have had and, regardless of whether the contributions were used to make loans (the only other apparent purpose was providing entertainment to clients), the contributions are not deductible.

159. Essentially, I agree with MDPL's contrary view that MDPL would be entitled to deduct the contributions in computing its profits for corporation tax:

(1) At this stage of the analysis, we are acting on the assumption that the relevant sums constitute earnings. On that basis, it follows that:

(a) MDPL's purpose in laying out, expending and incurring the contributions (and thereby funding the loans) must be taken to be to provide Dr Thomas with earnings; and

(b) in choosing to deliver the relevant funds to Dr Thomas as contributions and loans through the RT arrangements, MDPL's purpose must be taken to be to avoid the sums being taxed as earnings on a basis that preserved the usual consequential tax effect of an employer paying such sums, namely, that MDPL would obtain a tax deduction for them in computing its profits for corporation tax purposes.

(2) On that basis, having regard to the decision in *Scotts Atlantic* and, in particular, the comments of the UT at [65] to [74] of that decision, I cannot see that MDPL can be taken to have had a separate object of obtaining a tax deduction in laying out, expending or incurring the relevant expenses. The obtaining of a tax deduction for the relevant sums is, as it was put in *Scotts Atlantic,* the "ordinary, intended or realistically expected outcome" or, as it was put in *Vodafone*, a consequential or incidental benefit of, expending sums, which, according to MDPL's "true" intent, were incurred to reward Dr Thomas for his services as director. Moreover, I do not consider that (on the assumptions on which we must act at this stage of the analysis) the assessment of MDPL's underlying true purpose in making the contributions is affected by the fact that:

(a) The particular method for extraction of the relevant sums into Dr Thomas' hands was dictated by the desire to ensure that, contrary to Dr Thomas'/MDPL's "true" purpose, the relevant sums are not viewed as earnings.

(b) In order to give effect to and further this objective, MDPL acted ostensibly on the basis of a justification for obtaining a tax deduction for them (as stated, in particular, in the relevant resolutions) which, as Dr Thomas now accepts, was untrue rather than on the basis of the "true" reason, namely, that the contributions were made to reward Dr Thomas for his services as director.

(3) As Mr Firth submitted, HMRC's argument is, in effect, that the existence of inaccurate or untrue statements in the relevant documents as regards the reasons for the routing of the relevant sums through the RT arrangements is a free-standing reason for a corporation tax deduction to be denied. However, the tribunal must simply establish, in all the circumstances, what MDPL's purpose was in making the contributions. Statements in documents (such as those in resolutions for the making of the contributions) which are admittedly untrue do not cast light on the "true" purpose for which the sums were expended.

160. Mr Woodman does not share the views expressed above. In his view, MDPL pursued a scheme to such an extent that the planned tax efficiency was an object in itself in addition to that of rewarding Dr Thomas. Accordingly, he does not consider that the relevant expenditure was incurred wholly and exclusively for the purposes of its trade.

161. HMRC made an alternative argument that MDPL is prevented from obtaining a deduction for the contributions in computing its profits for corporation tax purposes (if it would otherwise obtain one under the general rules) under the provisions which apply to employee benefit schemes in schedule 24 of the Finance Act 2002 and s 1290 to 1296 CTA 2009). However, those rules do not apply where, as is the case on the assumptions on which are acting at this stage of the analysis, the relevant contributions are paid out of the RT in a form which is taxable under ITEPA.

Part E - Procedural and validity issues

Validity of the corporation tax amendments and discovery assessments

162. As regards corporation tax, there was no dispute that:

(1) (a) HMRC opened enquiries into each of MDPL's corporation tax returns for the periods ending on 31 March in each of the years 2009 and 2012 to 2015 under para 24 of schedule 18 FA 1998 within the applicable time limit, and (b) on 2 November 2017 HMRC issued valid closure notices in which they amended MDPL's corporation tax returns, in respect of unpaid corporation tax regarding the RT arrangements for these accounting periods.

(2) As explained below, the discovery assessments issued on 28 March 2014 under para 41 of schedule 18 ("**para 41**") for the accounting periods ending on 31 March in each of the years 2008, 2010 and 2011 were validly made.

163. Para 41 provides a mechanism for HMRC to make an assessment where the usual time limit of 12 months for them to enquire into a self-assessment corporation tax return has expired and certain conditions are satisfied:

(1) Para 41(1) provides that:

> "(1) If an officer of Revenue and Customs discovers as regards an accounting period of a company that
>
> "(a) an amount which ought to have been assessed to tax has not been assessed, or
>
> (b) an assessment to tax is or has become insufficient, or
>
> (c) relief has been given which is or has become excessive,
>
> he may make an assessment (a "discovery assessment") in the amount or further amount which ought in his opinion to be charged in order to make good to the Crown the loss of tax. …"

(2) Under paras 42 to 44 of schedule 18 HMRC may only issue a discovery assessment for an accounting period for which the company has delivered a company tax return if certain conditions are met, namely:

(a) if the situation mentioned in paragraph 41(1) was brought about carelessly or deliberately by the company, or a person acting on behalf of the company (under para 43); or

(b) if, when an officer ceased to be entitled to give notice of his intention to enquire into the company's return or, broadly, had issued a closure notice in relation to any such enquiry, he "could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of [the insufficiency]" (under para 44).

164. It is common ground that the burden of proof is on HMRC to demonstrate that they have made a discovery within the meaning of para 41 and that the requirements of para 43 or 44 of schedule 18 are met and that HMRC have satisfied this burden:

(1) Mr Lines and Mr Cree of HMRC gave undisputed evidence that (a) on or around 26 March 2014, they discovered that MDPL's corporation tax returns for its accounting periods ending on 31 March in each of the years 2008, 2010 and 2011 contained an insufficiency due to the incorrect claiming of a deduction for sums paid into the RT, and (b) around that time, they formed the view that the loss of tax resulting from the discovery was brought about at least carelessly.

(2) MDPL has expressly accepted that the requirements of para 41 and para 43 of schedule 18 are met on that basis.

165. It is also common ground that the discovery assessments were made within the applicable time limits provided for within para 46 of schedule 18.

Validity of the determinations

166. MDPL argues that the determinations which HMRC issued under regulation 80 for the tax years 2010/11 to 2014/15 are invalid.

167. Regulation 80 provides as follows:

"(1) This regulation applies *if it appears to the Inland Revenue that there may be tax payable for a tax year under* regulation 68 by an employer which has neither been -

(a) paid to the Inland Revenue, nor

(b) certified by the Inland Revenue under [various regulations]. …

(2) The Inland Revenue may determine the amount of that tax to the best of their judgment, and serve notice of their determination on the employer. …

(4) A determination under this regulation may -

(a) cover the tax payable by the employer under regulation 68 for any one or more tax periods in a tax year, and

(b) *extend to the whole of that tax, or to such part of it as is payable in respect of*

(i) a class or classes of employees specified in the notice of determination (without naming the individual employees), or

(ii) one or more named employees specified in the notice.

(5) A determination under this regulation is subject to Parts 4, 5, 5A and 6 of TMA (assessment, appeals, collection and recovery) as if–

(a) the determination were an assessment, and

(b) the amount of tax determined were income tax charged on the employer, and those Parts of that Act apply accordingly with any necessary modifications." (Emphasis added.)

Validity of determinations – requirement in regulation 80(4)

168. MDPL argued that all of the determinations are invalid because they do not identify correctly the employee or class or classes of employees to which they relate for

the purposes of regulation 80(4)(b). For example, the determination for 2011/12 includes in the column for name and national insurance number of the employee, the following statement:

> "All employees and officers of the company who are liable for tax on "employment income" (as defined by Section 7 [ITEPA]) arising in connection with the company's Remuneration Trust arrangements."

169. Mr Firth said that:

(1) It makes a nonsense of the requirement in regulation 80(4)(b), for a determination to purport to identify any class of employees by reference to whether or not the employee is liable to tax on employment income (especially where HMRC have not even specified the year for which the person must be so liable). HMRC were well aware that MDPL did not believe that any employee was liable to tax on employment income by reference to the RT arrangements and that it would conclude, therefore, that nobody was specified in the determination.

(2) Moreover, on the approach taken by HMRC:

(a) The recipient of the determination cannot identify all the members of the stated class until the outcome of any litigation in respect of the determination. However, that would defeat the purpose of the legislation and create uncertainty that Parliament cannot have intended.

(b) It would be open to HMRC to alter who they say is and is not in the class, and thus within the scope of any appeal, by reference to changing views of taxation.

(c) The tribunal would not know which employees it is considering until it has decided who is taxable.

(3) On this approach, there is nothing to stop HMRC issuing every determination in respect of a class of all employees of the recipient who are liable to tax on employment income. If that is sufficient, Parliament has wasted its time in requiring the determination to specify the class.

170. HMRC made the following main points in support of their contrary view that the determinations conform with the requirements in regulation 80(4):

(1) A determination does not need to identify a class of employees to which it applies. It can instead cover the whole of the tax that HMRC are seeking to apply.

(2) The determination for 2010/11 refers to Dr Thomas by name and for the other years it is entirely clear that the determinations refer both to the whole of the tax that HMRC judged to be payable and to those employees and officers involved with the RT arrangements.

(3) In any event, it suffices for regulation 80(4) to be satisfied that, as is plainly the case, the determination identifies a category of persons with a common attribute (namely those subject to the RT arrangements). On that basis, there can be no suggestion that Dr Thomas or anyone else was in the remotest doubt as to whose income was covered by the notices. In *Westek v HMRC* [2008] STC (SCD) 169 the Special Commissioner said the following as regards what is required for a determination to correctly refer to a 'class of employees, at [24]:

> "It seems to me to be self-evident that by describing the employees as those who were in receipt of management charges that the PAYE determination correctly referred to a 'class of employees', which was one of the two options under the PAYE Regulations. It is also clear that no-one was in doubt for an instant as to which employees were included in the class. Whether it eventually emerges that a more accurate description

> of the facts would have suggested that some slight re-phrasing of the description of the class of employees might have been appropriate, I still consider that the notice was clear enough, no-one was in the remotest doubt as to whose income was covered by it, and which of their two categories of challenged payments was in dispute, and I therefore decide that the notice was valid."

171. Essentially, we agree with the points that HMRC made on this issue. We add that it seems to us that whether the requirement of regulation 80(4) is met must be assessed taking into account the context surrounding the issue of the relevant determination such as the related correspondence. Whilst the difficulties raised by Mr Firth could perhaps cause genuine uncertainty as to what employees a determination relates to, it is plain that, in these particular circumstances, any such issue is entirely theoretical and not actual. MDPL cannot have been in any doubt whatsoever that the determination was intended to apply as regards relevant sums received by Dr Thomas.

Validity of the determinations – "staleness" issue

172. MDPL also argued that it is for HMRC to prove that the determinations are valid by demonstrating that (a) "it appears to" HMRC that tax may be payable by MDPL in respect of the relevant sums under the PAYE system, and (b) this realisation had not lost its essential newness or become "stale" by the time the determinations were actually issued. Mr Firth said that, on the wording of regulation 80, the concept of "staleness" must apply in the same way as it has been held to apply in relation to discovery assessments issued under para 41 (or the equivalent provisions in s 29 of the Taxes Management Act 1970). This was the view taken by the UT in *Charlton v Revenue and Customers Commissioners* [2012] UKUT 770 (TCC) ("*Charlton*") and *HMRC v Tooth* [2018] UKUT 38 (TCC) and subsequently by the Court of Appeal in *HMRC v Tooth* [2019] EWCA Civ 826. In *Charlton*, for example, at [37], the UT said this:

> "In our judgment, no new information, of fact or law, is required for there to be a discovery. All that is required is that it has newly appeared to an officer, acting honestly and reasonably, that there is an insufficiency in an assessment. That can be for any reason, including a change of view, change of opinion, or correction of an oversight. The requirement for newness does not relate to the reason for the conclusion reached by the officer, but to the conclusion itself. *If an officer has concluded that a discovery assessment should be issued, but for some reason the assessment is not made within a reasonable period after that conclusion is reached, it might, depending on the circumstances, be the case that the conclusion would lose its essential newness by the time of the actual assessment.* But that would not, in our view, include a case, such as this, where the delay was merely to accommodate the final determination of another appeal which was material to the liability question. Such a delay did not deprive Mr Cree's conclusions of their essential newness for section 29(1) purposes." (Emphasis added.)

173. Mr Firth's main point was that the determinations for the tax years 2011/12 to 2013/14 and that for the tax year 2014/15, which were not issued until 19 February 2016 and 26 April 2016 respectively, may be invalid on this basis.

174. HMRC objected to MDPL raising these arguments, noting that they were not included in the appellant's grounds of appeal, they were raised only in its skeleton argument and MDPL has not made an application for permission to be able to raise it. In their view, for the tribunal to admit this argument at this stage would be unfair and prejudicial to HMRC and amounted to an ambush. Mr Gosh said that (as Mr Firth did not appear to dispute) the tribunal should have regard to the principles set out in *Quah Su-Ling v Goldman Sachs International* [2015] EWHC 759 at [38] and in *Bourke &*

Anor v Favre & Anor [2015] EWHC 277 in deciding how to exercise its discretionary powers in this respect.

175. Mr Firth argued that MDPL had adequately raised this issue given that, in its grounds of appeal, it stated that: "It is for HMRC to demonstrate that they have properly opened enquiries and raised discovery assessments/issued PAYE determinations within the relevant time limits." In his view, MDPL could not be more explicit on the point until HMRC provided the required evidence to demonstrate that the determinations were validly made. He said that HMRC were clearly alive to the need to prove such points as they decided to submit witness evidence as regards the making of a discovery in relation to the discovery assessments. He added that, in any event, on the authority of the UT's decision in *Burgess & Another v Revenue and Customs* [2016] STC 579, ("*Burgess*"), it is not for MDPL to raise issues as to the validity of the determinations. In *Burgess* the UT held, in effect, that it was for HMRC themselves to raise the question of whether the statutory conditions were satisfied for the discovery assessments in question to be validly issued and to discharge the burden of proof on them in that respect. Their failure to do so meant that the tribunal had erred in upholding the assessments and not finding that they were not validly issued; that was the case, even though the taxpayers had not expressly challenged the validity of the discovery assessments in their grounds of appeal.

176. Mr Gosh said that (a) the paragraph Mr Firth referred to does not constitute a particularised ground of appeal, and (b) the reasoning in *Burgess* does not apply to the question of the valid issue of determinations, and, accordingly, the onus is not on HMRC to prove the validity of a determination in the absence of any pleading by the taxpayer on the point. He made a number of points on why the reasoning in *Burgess* does not apply based on what he saw as the essential difference between the regime for issuing determinations and that for issuing discovery assessments.

177. In short, we decided that, having regard to the correct approach to be taken as set out in the caselaw, it was in the interests of justice and fairness for MDPL to be able to raise the issue of whether the requirements of regulation 80(1) for the valid issue of the determinations are met (on the law as it then stood). That was on the basis, in particular, that MDPL had flagged up the question of the validity of the determinations in its grounds of appeal and it appeared that HMRC would be able to provide additional evidence on the discrete "staleness" issue within the time scheduled for the hearing. We do not consider it necessary to make any finding on whether the reasoning in *Burgess* applies in this context.

178. In any event, following the hearing, the issue which MDPL wished to raise has largely become irrelevant. We did not understand MDPL to question that it had appeared to HMRC that tax may be payable by MDPL under the PAYE system and that HMRC had determined that tax to the best of their judgement. MDPL's concern was to challenge HMRC's assumption that the realisation that tax may be payable by MDPL in respect of the relevant payments did not occur until the relevant determinations were actually issued. MDPL submitted that, on the evidence Mr Cree gave, (a) it appeared to him/HMRC that tax may be payable by MDPL in respect of the RT arrangements under the PAYE system in early 2015, around the time that they issued the determination for 2010/11, as regards all of the relevant tax years, and (b) the determinations for the relevant tax years, other than 2010/11, had lost their essential newness or become "stale" by the time they were issued. MDPL based its argument that the concept of "staleness" is to be applied in construing regulation 80(1) on the similarity in the wording of regulation 80(1) and of the provisions relating to discovery assessments (particularly, the use of the word "if") and that the same policy reasons for

the application of this concept must apply in both cases, namely, as MDPL view it, the need to ensure prompt administration.

179. However, the Supreme Court have now decided in *HMRC v Tooth* [2021] UKSC 17 (as released on 14 May 2021) that the UT and the Court of Appeal were wrong to apply the concept of "staleness" in considering the validity of discovery assessments. In summary:

(1) Having referred to *Cenlon Finance Co Ltd v Ellwood (Inspector of Taxes)* [1962] AC 782 and *Inland Revenue Comrs v Mackinlay's Trustees* 1938 SC 765; 22 TC 305 75 on the meaning of "discovery", Lord Briggs and Lord Sales (with whom the rest of the panel agreed) noted, at [75], that there was no suggestion in those cases that:

> "any notion of staleness applied or that a discovery might lose its quality as such simply by the effluxion of time. That would be contrary to the ordinary use of language. Viscount Simonds' reference in the latter case [*Cenlon Finance*] to discovery covering "any case in which … it newly appears that the taxpayer has been undercharged" was a reference to the state of mind of the person said to have made the discovery, to whom it "newly appears" that an assessment to tax is insufficient. A discovery is a particular event in time, and does not cease to be such with the passage of time. As is made clear in both cases [*Cenlon Finance* and *MacKinlay's Trustees*], a discovery within the meaning of what is now section 29(1) of the TMA may consist simply in a new appreciation of the legal significance of a set of circumstances."

(2) They continued, at [76] and [77], that, therefore:

> "….there is no place for the idea that a discovery which qualifies as such should cease to do so by the passage of time. That is unsustainable as a matter of ordinary language and, further, to import such a notion of staleness would conflict with the statutory scheme. That sets out a series of limitation periods for the making of assessments to tax, each of them expressed in positive terms that an assessment "may be made at any time" up to the stated time limit.
>
> There is no basis for implication of an additional and stricter time restriction as suggested by the UT in *Charlton*…."

(3) At [78], they rejected the taxpayer's submission that once a discovery is made by one person it cannot be made again by another:

> "It is perfectly possible, as a matter of ordinary language, to speak of someone making a discovery for himself or herself even if it is something already known to others. The approach in the authorities supports this view. As we have explained above, since section 29(1) is concerned, so far as is relevant, with a discovery made by an officer of the Board, the question is whether the officer of the Board who is deciding whether to make a discovery assessment under that provision has subjectively made a discovery that there has been an under-assessment of tax."

(4) They concluded, at [80], that this interpretation of section 29(1) and the way in which it operates alongside the relevant limitation periods is clear:

> "The subjective nature of the test in section 29(1) by reference to the state of mind of a particular officer means that there is the possibility that a series of officers might each make the relevant discovery if a taxpayer's file is passed from one to another. However, this is not a reason for seeking to introduce further restrictions as a matter of statutory interpretation. The statutory regime makes clear the time limits

> within which the taxpayer may be exposed to a discovery assessment, and they do not run from the date of the relevant discovery."

(5) At [83], they noted that there are a number of protections for the taxpayer in relation to exposure to a discovery assessment in the form of the conditions in 29 and the statutory time limits (and they noted that it is typically only in relation to what amounts to fraud or is akin to fraud that the time limit becomes as long as 20 years) and that those are matters which fall within the scope of an appeal to the tribunal against an assessment. At [84], they also noted that:

> "where the statutory discovery condition in section 29(1) is satisfied, an officer or the Board has a discretion whether to issue an assessment ("may … make an assessment") and they must act in accordance with ordinary principles of public law in deciding whether to do so. So, for example, they must act rationally, must not abuse their powers and may be required to respect any legitimate expectation which they have created. If they fail to do so, the taxpayer may seek relief in judicial review proceedings…In our view, the interpretation of the statutory regime should not be distorted to try to deal with issues which ought properly to be addressed by principles of public law enforceable in judicial review proceedings in the usual way. On the other hand, the fact that the application of these principles would proceed by reference to the state of mind of the officer or the Board in line with the approach in the *National Association of Health Stores* and *Bancoult* cases lends further support to the view that section 29(1) is intended to operate generally with that focus."

180. In light of the Supreme Court's findings MDPL's argument that the concept of "staleness" applies in interpreting regulation 80(1) is unsustainable.

181. Following the decision of the Supreme Court in *Tooth*, the invalidity issue remains relevant only to the extent that HMRC have to demonstrate that it "appeared" to HMRC that, for the relevant tax years, tax may be payable by MDPL under the PAYE system in respect of the RT arrangements. The witness evidence of Mr Cree demonstrates that this requirement was satisfied and (although this was not in any event disputed by MDPL) that the determinations were made to the best of their judgement. Mr Cree said that:

(1) Before the end of 2014, based on the experience he then had of the scheme, in conjunction with his specialist colleagues, he had concluded that employment related income tax and NICs were chargeable "across scheme users" on the basis that the requirements of Part 7A ITEPA and its NICs equivalent applied on the facts of the scheme. It was clear to him that "the scheme always intended that the money contributed to the trust ended up in the control of the director of the contributing company who thereafter treated that money as their own".

(a) This view was communicated to "scheme users" and caseworkers invited them to explain why they had not "operated PAYE tax" (as shown by HMRC's letters to MDPL dated 1 August and 20 October 2014).

(b) Initially an individual caseworker was responsible for reviewing their enquiry case and issuing determinations and NICs decisions to the scheme user. However, around the summer of 2015, as the numbers of scheme users increased rapidly, Mr Cree worked with his now retired colleagues, Mrs Claire Armstrong (who took the lead) and Mrs Cynthia Lewis, to create a process for officers in HMRC who specialise in handling bulk work to deal with this (a Flexible Resource Team). By October 2015 they completed

the instructions and appointed a team to do the work for the 2011/12 to 2013/14 tax years.

(c) Mrs Armstrong and her team prepared a database of "scheme users" identifying the following details intended to provide the team with sufficient information: "Case owner name", "Company Registration Number", "Unique Taxpayer Reference", "Company Name", "PAYE Ref", "Tax Year for Reg 80 etc" and "Award (Total contribution)".

(d) Mrs Armstrong and her team did not identify any scheme user who had accounted for income tax and NICs in respect of monies moving through the scheme. Mr Cree had seen many individual cases by this time and saw that scheme transactions often took place towards the end of the relevant company's accounting period. Hence, the instruction to the team was to use the figure for contributions for the accounting period ending in the financial year for which the determination/decision was to be issued as an estimate of the sum on which tax was due.

(2) In MDPL's case, in line with this approach, the sums in respect of which income tax and NICs are shown as due in each of the determinations and decisions issued to it correspond to the figure shown in the relevant accounts for contributions to the RT.

(3) By August 2014 Ms Sophie Hoy, was responsible for HMRC's enquiries into MDPL. In an exchange of emails on 2 February 2015 Mr Cree informed Ms Hoy that, in his view, Part 7A ITEPA applied to the scheme used by MDPL. Ms Hoy provided specific details evidencing that Dr Thomas had accessed all of the sums contributed by MDPL to the RT by drawing loans on uncommercial terms and, therefore, he instructed Ms Hoy that she should arrange the issue of a determination for 2010/11.

(4) At this time, Ms Hoy sent Mr Cree a spreadsheet showing a number of contributions to the RT and loans made to Dr Thomas (including for tax years following 2010/11). Mr Cree then sent an email to Ms Hoy in which he said the following:

> "First; there are loans made 2010/11 and HMRC might decide that this is remuneration subject to PAYE. Note I say "might", this is our current stance but not one that is seeing support before the FTT. To protect HMRC's interests you'll need to arrange for the issue of a 2010/11 Reg 80 determination. Use the sums loaned to Mr Thomas as the gross remuneration…Finally, if your letter hasn't gone yet please add a paragraph headed Part 7A ITEPA 2003. Simply list the loan advances on or after 9 December 2010. Ask if Marlborough DP Ltd operated PAYE on these loans given the aforementioned legislation. Add that if it did not, by reference to the facts of the case and content of Part 7A then why not?"

(5) On 19 March 2015, Ms Hoy issued the determination for the 2010/11 tax year based on a contribution of £160,000 to the RT, all of which had been paid to Dr Thomas, as disclosed in MDPL's accounts for the period ending 31 March 2011.

(6) As regards the tax years 2011/12, 2012/13 and 2013/14, determinations (in Mrs Armstrong's name) and decisions (in Mr Cree's name) were issued to MDPL, under the process described above, on 19 February 2016. The calculations of the sums due were done on 29 January 2016. The same process was also used when Mrs Armstrong, Mrs Lewis and Mr Cree decided to issue

determinations and decisions to scheme users for 2014/15 on 26 April with a covering letter signed by Mrs Armstrong. The required calculations were made on 19 April 2016.

182. At the hearing, Mr Cree was cross-examined primarily on why it was that HMRC did not issue determinations and decisions for the later tax years at or around the same time as they issued those for the earlier 2010/11 tax year. Mr Cree accepted that there was no reason why determinations could not have been issued in early 2015 for the later years as well. However, this evidence is of no relevance given that the precise timing of when it appeared to Mr Cree that tax charges were due under the PAYE system is no longer in point.

Conclusion

183. For all the reasons set out above, the appeal is allowed.

184. We note that the parties were agreed that the amount of tax in issue is as set out in HMRC's written submissions provided to the tribunal on 20 November 2021, as adjusted in their later written submissions of 25 November 2021, and subject to the fact that MDPL disputes the conclusion set out at [138] to [144] above as regards what sums are taxable in the 2012/13 tax year under Part 7A

185. 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.

HARRIET MORGAN

TRIBUNAL JUDGE
RELEASE DATE: 1 SEPTEMBER 2021