HIGH COURT OF JUSTICE (CHANCERY DIVISION)—12, AND 13 DECEMBER 1985 AND 20 JANUARY 1986

COURT OF APPEAL—6, 8, AND 30 OCTOBER 1987.

HOUSE OF LORDS—28, 29, AND 30 NOVEMBER 1988 AND 23 FEBRUARY 1989

Bray (H.M. Inspector of Taxes) *v.* Best[1]

Income tax—Schedule E—Trusts for the benefit of employees—Employing company taken over—Trust funds distributed among former employees after employment ceased—Whether emoluments of former employment—If so, in which year or years of assessment, if any, they fell to be assessed—Income and Corporation Taxes Act 1970, *s* 181.

In 1957 A. Gallenkamp and Co. Ltd. (the company) established a trust to enable the trustees thereof to purchase shares in the company with a view to their being held by or for the benefit of employees, and for that purpose the company envisaged that it would from time to time advance money to the trustees. Another similar trust was established in 1963.

The company was taken over by Fisons plc in 1977 and on 1 April 1979 the employees of the company transferred into the employment of Fisons. Shortly before the change of employer, and in anticipation of it, the trustees of the two trusts exercised their powers to bring into effect provisions leading to the winding-up of the trusts and the distribution of their net assets among the "eligible employees". All employees who had been employees of the company for a defined period of time were eligible. The trustees' sole concern was to distribute the trust funds upon a fair and equitable basis. They agreed a formula based on length of service with the company and salary level with adjustments to reduce differentials. The trustees did not consider the personal merits of individual employees.

In the course of the fiscal year 1979–80, the year following the year in which the employment ceased, the taxpayer, who had been employed by the company since 1958, became entitled pursuant to the exercise of the trustees' discretion to sums totalling in £18,111. The taxpayer was assessed to income tax under s 181 of the Income and Corporation Taxes Act 1970 in respect of these sums apportioned amongst the years of assessment 1958–59 to 1978–79. On appeal by the taxpayer a Special Commissioner held that the sums payable to the taxpayer were chargeable to tax as emoluments but that they could not be attributed to the year of assessment 1978–79 or be apportioned amongst all the years back to 1958–59 and that accordingly none of the assessments was well founded. The Inspector of Taxes appealed.

(1) Reported (ChD) [1986] STC 96; (CA) [1988] 1 WLR 784; [1988] 2 All ER 105; [1988] STC 103; (HL) [1989] 1 WLR 167; [1989] 1 All ER 969; [1989] STC 159.

The Chancery Division, allowing the Inspector's appeal, held that: A

(1) the Special Commissioner's findings that the payments were emoluments could not be upset;

(2) given that the payments were emoluments they must have been paid in respect of some period of service, whether that be a definable special period or the whole of the period of the employment;

(3) the Case be remitted to the Special Commissioner to decide over B what period the additional emoluments must be deemed to have been earned and how they are to be apportioned over the various financial years in that period.

The taxpayer appealed.

The Court of Appeal allowing the taxpayer's appeal, held that the year or years to which an emolument fell to be attributed was a question of fact C and *prima facie* the year of its receipt was appropriate in the absence of evidence to the contrary. Accordingly, in the absence of any error of law the Commissioners' finding was one of fact which could not be disturbed.

The Inspector appealed.

Held, in the House of Lords, dismissing the Inspector's appeal, that:

(1) for an emolument to be chargeable to income tax under Schedule E D not only must it be an emolument *from* an employment but it must be an emolument *for* the year of assessment in respect of which the charge is sought to be raised;

(2) the fact that the payment was referred to by the Special Commissioner as a "reward for services" did not lead to the conclusion that the payment was additional remuneration for services rendered to the company E in respect of the previous years in which the taxpayer was employed; the phrase "reward for services" meant no more than that the payment arose from the existence of the employer-employee relationship and not from something else;

(3) the fact that the payment was an emolument from the employment did not lead either in logic or on authority to the conclusion that it must F therefore be "for" a chargeable period within the aggregate period during which the employment subsisted. That was a question of fact to be determined in the light of all the circumstances including the source of the payment and the intention of the payer so far as it could be gathered either from direct evidence or from the surrounding circumstances;

(4) on the facts there was nothing to indicate that the payment was G attributable to all or any of the years during which the taxpayer was employed by the company.

Per Lord Mackay of Clashfern L.C.: Counsel may, if it is more convenient, use reports of cases in Tax Cases provided references to the case in the Official Reports are also given.

A *Hamblett* v. *Godfrey* 59 TC 694; [1987] 1 WLR 357 approved.

CASE

Stated under the Taxes Management Act 1970, s 56 by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

B 1. On 30 and 31 January and 1 February 1984 I, one of the Special Commissioners, heard the appeals of Peter Morris Best against the following assessments to income tax under Schedule E (those marked * being further assessments), all of which were made on 4 March 1983 under the provisions of s 35, Taxes Management Act 1970:

	£
C 1958–59	1,096
1959–60	495*
1960–61	1,357
1961–62	520*
1962–63	1,571
1963–64	1,708
D 1964–65	570*
1965–66	2,275
1966–67	2,342
1967–68	2,483
1968–69	2,570
1969–70	3,102
E 1970–71	685*
1971–72	5,172
1972–73	720*
1973–74	740*
1974–75	2,211*
1975–76	795*
F 1976–77	293*
1977–78	845*
1978–79	13,728*

The Respondent consented to his appeals being heard by a single Special Commissioner and I was satisfied that undue delay would thereby be avoided (Taxes Management Act 1970, s 45(2)).

G 2. (a) The background to the case was, shortly, as follows. The Respondent was employed from a date in the fiscal year 1958–59 to 1 April 1979 (in the fiscal year 1978–79) by A. Gallenkamp & Co Ltd. ("the Company"). The Company had been taken over by, and had become a wholly-owned subsidiary of, Fisons Plc in August 1977. On 1 April 1979 all the employees of the Company (including the Respondent) were transferred H to the employ of Fisons Plc. At that time it was envisaged that the Company's trade would be merged with that of Fisons Plc, and the change of employer was effected as a first step towards that merger. In the event, however, the transfer of the Company's trade to Fisons Plc did not take place until January 1983, and in the meantime the Company continued to trade using the services

of its former work-force. Shortly before the change of employer on 1 April 1979, and in anticipation of it, the trustees of two trusts for the benefit of the Company's employees exercised their powers to bring into effect provisions leading to the winding-up of the trusts and the distribution of their net assets. In the course of the next fiscal year, 1979–80, the Respondent became entitled, pursuant to the exercise of discretions vested in the trustees of each of the said trusts, to two sums totalling £18,111, part of the trust funds. The greater part of these two sums represented payments out of the capital of the two funds (the income elements amounting in aggregate to only £1,198.62 out of the total sum of £18,111). Between 1965 and 1976 the Respondent and a number of other senior employees of the Company had received payments out of the income of one of the two funds, and these sums had been accepted by them as taxable under Schedule E and (following the decision in *White* v. *Franklin*(1) 42 TC 283) by the Revenue as qualifying for earned income relief.

(b) On those facts the Respondent accepted liability to income tax for the year of assessment 1978–79 in respect of the said two sums under s 187 Income and Corporation Taxes Act 1970, that is to say to tax only on the excess over £10,000 (s 188(3)). H.M. Inspector of Taxes, however, took the view that the sums were emoluments of or from the Respondent's employment with the Company within the charge to tax under s 181 (to which the benefit of no special relief is attached).

(c) The questions for my decision were therefore:

(i) Whether, in relation to the Respondent's employment with the Company, the payments were "emoluments therefrom" within s 181(1), Sch E, para 1; and, if so,

(ii) Whether, in relation to the words "for the chargeable period" in Case I of Sch E,

(a) the payments should be treated as income of different chargeable periods and spread accordingly over the whole of the period of the Respondent's said employment—the course actually adopted by H.M. Inspector of Taxes; or

(b) the year of assessment 1978–79 (the last year of such employment) was the sole chargeable period and the whole of the payments constituted income of that year; or

(c) the payments could not be attributed to any one or more of the years of assessment during which the Respondent was employed by the Company and there was accordingly no chargeable period within the meaning of the statute.

3. Frank Robert Dixon FCA, a member of the firm which had acted as the Company's accountants for many years, and at the relevant times one of the trustees of each of the two trusts referred to in para 2(a) above, gave evidence before me. Mr. Dixon's account of the manner in which the trustees of both funds allocated shares in the capital and income to former employees of the Company is summarised at pages 9–10 of my decision(2). In his evidence (which I accepted) Mr. Dixon made it clear that in distributing the net assets of the funds the trustees never considered any former employee on

(1) [1965] 1 WLR 492. (2) Page 716A–D.

his merits as an individual and that the personal qualities of individual former employees did not in any way affect the amount of their allocated share of capital and income.

4. I had before me the following agreed documentary evidence:

(a) An agreed statement of facts.

(b) A folder containing copies of Schedule E assessments made on the Respondent; copy correspondence with the Inland Revenue in 1964 and 1965, and between June 1978 and December 1982; a schedule of distributions made to employees by the trustees of the two trusts before 1 April 1979; and a copy of a notice dated 12 December 1979 addressed to former employees of the Company.

(c) A folder relating to the earlier of the two trusts (the General Fund) containing copy deeds, trustees' resolutions and specimen letters informing each of the former employees of the Company of the sum allocated to him or her on the distribution of the fund, and how it would be applied.

(d) A folder relating to the second trust (the Harry Jarrom Fund) containing documents corresponding to those in the folder relating to the General Fund.

None of the documentary evidence listed above is annexed hereto, but copies are available for inspection by the Court if required.

5. I was referred in argument to the following authorities in addition to those mentioned in my Decision:

Herbert v. *McQuade*[1]	4 TC 489;
Cooper v. *Blakiston*[2]	5 TC 347;
Mudd v. *Collins*	9 TC 297;
Beynon v. *Thorpe*	14 TC 1;
Stedeford v. *Beloe*[3]	16 TC 505;
Wright v. *Boyce*[4]	38 TC 160.

6. The facts which I found upon the evidence, and the contentions of the parties, are set out in my reserved Decision which I gave in writing on 16 February 1984. A copy of my Decision is annexed hereto and forms part of this Case[5].

7. The quantum of the accepted liability to tax for the year 1978–79 under s 187 Income and Corporation Taxes Act 1970 was not agreed between the parties until July 1984. On 2 August 1984 I formally determined all the appeals before me by discharging the assessments for the years 1958–59 to 1977–78 inclusive, and by reducing the assessment for the year 1978–79 to the agreed figure of £8,111. (Insofar as the assessments under appeal were not

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[1] [1902] 2 KB 631. [2] [1909] AC 104. [3] [1932] AC 388. [4] [1958] 1 WLR 832.
[5] Pages 710/720 *post*

further assessments, and accordingly included amounts not in issue in the appeals, the tax liability had long since been satisfied.)

8. The Appellant Inspector of Taxes immediately after the determination of the appeals declared to us his dissatisfaction therewith as being erroneous in point of law and on 6 August 1984 required us to state a Case for the opinion of the High Court pursuant to the Taxes Management Act 1970, s 56, which Case we have stated and I, the Commissioner who heard the appeals, do sign accordingly.

9. The question of law for the opinion of the Court is whether I erred in holding that on the facts of this case the sums to which the Respondent became entitled were emoluments of his employment with the Company, but could not be attributed to any one or more years of assessment, and so were not emoluments for any chargeable period or periods.

B. O'Brien } Commissioner for the Special Purposes of the Income Tax Acts

Turnstile House
98 High Holborn
London WC1V 6LQ

6 November 1984.

DECISION

Mr. P.M. Best appeals against assessments to Income Tax made on him under para 1 of Sch E (Case I) for the years of assessment 1958–59 to 1978–79, both inclusive. By agreement of the parties the appeals have been heard by me sitting as a single Commissioner, and I have been asked to give a decision in principle only at this stage. The assessments relate to cash allocations made to Mr. Best following the termination of two trusts associated with the company by whom Mr. Best was employed during the years of assessment; and the appeals are, in substance, those of the persons who were the trustees of those trusts and who are therefore accountable to the Inland Revenue for any sum properly deductible for Income Tax. This is a test case, the trustees having at the same time made indistinguishable allocations to more than 750 other persons in exactly the same position as Mr. Best.

As will appear, the facts of the case bear a resemblance to those in *Brumby* v. *Milner*[1] 51 TC 583 (and *Day* v. *Quick*, heard with it). But there is one major difference between the cases. Mr. Milner and Mr. Quick remained in the same employment after the termination of the trust, and were in that employment when they received their awards on the distribution of the trust funds. In those cases accordingly there was no question of the taxpayer's having received their awards in a fiscal year during no part of which they were in the relevant employment. In the present case, by contrast, Mr. Best (and every one of his fellow employees) left the relevant employment almost immediately after the commencement of the winding up of the trusts. Those events occurred within a few days of the end of the fiscal year 1978–79. The

[1] [1976] 1 WLR 1096.

A provisions of the trusts taking effect on termination were however such that Mr. Best and those of his fellow employees who were eligible to share in the distribution of the trust funds were unlikely to obtain clear rights to cash payments (let alone actual payments) for a considerable period. Those rights thus arose during the fiscal year 1979–80, a year during which none of the beneficiaries was at any time in the relevant employment.

B That is the special feature of this case which has given rise to the debate. Mr. David Braham Q.C. who appeared for Mr. Best, contended that it had a distinct bearing (in his favour) on the question whether the payment eventually received could properly be regarded as having arisen "from" the employment, as required by the charging words of Schedule E. Furthermore, even if the payment were a taxable emolument, a question arises as to the C year or years of assessment to which the payment should be attributed because, as the Inland Revenue has recognised throughout, an assessment for the year 1979–80 (the year of receipt) cannot in this case be made: the relevant employment source did not exist during that year. The Inspector has in fact raised assessments on the basis that apportioned parts of the termination receipts should be attributed to each of the years of assessment D during which the trusts were in existence. Mr. Baron, of the Office of the Solicitor of Inland Revenue, supports that approach as the preferred solution, but suggests in the alternative an attribution of the whole receipt to the final year 1978–79. That particular question, it seems to me, might have come before the Court for decision at the time of *Brumby* v. *Milner* because I note that the class of persons entitled to participate in the winding up of the trust in E that case included former employees. It is a matter of regret to me that neither Mr. Milner nor Mr. Quick fell within that sub-class.

With that introduction I turn to the facts. These were not in dispute, and the agreed Statement of Facts placed before (which was more detailed in certain respects than the recital which follows) was supplemented by the oral evidence of Mr. F.R. Dixon FCA, who was one of the trustees of both trusts.

F Throughout the period with which this case is concerned A. Gallenkemp & Co. Ltd. ("the Company") traded as a manufacturer and distributor of laboratory furniture and apparatus and scientific equipment. It was one of three leading companies in its field. The business had been established towards the end of the last century and the Company was incorporated a few years later. Mr. Best entered the Company's employment in 1958–59, or G earlier, and remained so until the end of March 1979.

In 1957 the issued ordinary share capital of the Company was concentrated in relatively few hands, and control lay effectively with the Board (the members of which held, between them, some 23 per cent. of the shares) and two elderly ladies, the widows of two former chairman, who held between them some 40 per cent. One of those ladies, Mrs. Jarrom, was a H daughter of the founder of the business and she has a special place in the history of this matter. Very few ordinary shares had changed hands for a number of years with the result that even recently appointed directors had had little opportunity to acquire a financial stake in the Company. The Board felt that that was an unsatisfactory situation and decided that a trust should be established (as permitted by s 54 of the Companies Act 1948) to facilitate the I acquisition of shares by employees and full-time directors. The Board saw a further advantage in achieving a wider spread of shareholdings: it would tend to reduce the risk of a takeover. The existing shareholding pattern made the Company particularly vulnerable to approaches of that sort.

Accordingly, on 3 December 1957 a trust deed was entered into between the Company of the one part and three trustees (the chairman of the Company, its solicitor and its accountant). The deed recited the Company's intention to advance sums of money from time to time to the trustees. Clause 1 contained definitions, including a provision defining the Trust Period, ensuring that the trust did not offend the rule against perpetuities. Clause 2 required the trustees to purchase or subscribe for such shares in the Company as the Company should direct. Clause 3 required the trustees to sell shares in the Company to employees on receipt of notice from the Company nominating the purchasers and fixing the price. If the Company so requested, the proceeds of such sales were to be applied in repayment of advances made by the Company (Clause 4). Under Clause 5, trust income (primarily, dividends on shares in the Company not sold by the trustees to employees) could be applied in repayment of advances, but it could also be applied in making payments to such one or more of the employees as the Company should appoint or it could be accumulated as an accretion to the capital of the trust fund. Clause 6 provided:

> "Provided always and notwithstanding anything herein before contained the Trustees may at their absolute discretion without being liable to answer for the exercise of such discretion at any time or times during the Trust Period by writing under their hands direct that the Trust Period shall thereupon forthwith cease and determine either as regards the whole or as regards any part or parts of the Trust Property ...."

I do not need to read the remainder of Clause 6 as it originally stood because Clause 19 provided:

> "The Company may in its absolute discretion at any time or times during the Trust Period by any Deed or Deeds revocable or irrevocable executed with the consent of the Trustees add to alter or modify the trusts powers and provisions herein expressed ...,"

and the provisions taking effect on the termination of the Trust Period were later altered. I will come to them in due course.

No shares became available for acquisition by the trustees for nearly two years. The situation was, however, greatly eased in 1959. On 22 September 1959 a sum of profits was capitalised resulting in the allotment of a four for one bonus issue. The capital of the Company was further increased by £25,000, and the Board offered 20,000 £1 shares to the existing shareholders as a rights issue. That left 5,000 £1 shares available for subscription by the trustees of the 1957 trust. The trustees took up those shares. They also subscribed for 10,428 shares not taken up by the other shareholders under the rights issue. The necessary funds were advanced to the trustees by the Company.

Early in 1960 the trustees acquired a further parcel of shares (750) from one of the shareholders, bringing their total holding to 16,178. At about the same time they sold 10,910 shares to 28 nominated employees and directors at a price acceptable to the Revenue as representing their market value. In April 1960 the trustees paid the whole of the cash balance in their hands (proceeds of sales and interim dividends received on their holding) to the Company in part repayment of the advances made to date.

Early in 1961 there was a further bonus issue (one for one) and rights issue (one for two old shares). The trustees were allotted 5,268 shares by way

A of bonus and took up their full entitlement of 2,634 shares by subscription. They also purchased from Mrs. Jarrom the 13,750 bonus shares to which she was entitled, and subscribed for 6,875 further shares, part of the rights issue not taken up by other shareholders. A little later, the trustees sold 481 shares to an employee.

In August 1961 the trustees purchased a further 13,750 shares from Mrs.
B Jarrom. On that occasion she expressed the wish that those shares should be held as a separate fund in memory of her late husband, and that it should be applied for the benefit of long-service members of the staff. For a period of two years those shares were held by the trustees of the 1957 deed as a distinct sub-fund, known as the "Harry Jarrom Fund". The main body of the assets was thereafter known as the "General Fund".

C During the course of 1962, 7,759 shares comprised in the general fund were sold to 18 nominated employees, again at a price acceptable to the Revenue as representing their market value. The trustees made repayments of advances in that year out of proceeds of sale and dividends in their hands. They made similar repayments in the early part of 1963.

In the summer of 1963 there were signs indicating to the Board that a
D take-over bid might be imminent. On 3 September the power to vary contained in Clause 19 of the 1957 deed was exercised, thereby authorising the trustees (a) to sell shares to persons other than beneficiaries of the trust (that was in anticipation of an offer to shares to the public) and (b) to divide the trust fund (in anticipation of the establishment of the Harry Jarrom Fund as a formally separate trust). By a deed executed later on the same day the
E Harry Jarrom Fund was hived off and became subject to the trusts set out in that deed. The terms of that deed closely followed those of the 1957 deed (as varied), save (i) that the employees and directors eligible to benefit thereunder were limited to those with 10 or more years service with the Company and (ii) that the discretion to distribute income to employees was vested in the trustees rather than in the Company.

F The trustees of the General Fund purchased a small parcel of shares from a shareholder during the autumn of 1963, but no shares were sold to employees or directors in that year.

On 27 November 1963 the Company's capital was re-organised and further increased. The £1 ordinary shares were divided into ordinary shares of 5 shillings each; and a two for one bonus issue was made on capitalisation of
G reserves. Simultaneously, arrangements were made for the sale of 750,000 of the new shares to Messrs. Vickers da Costa & Co. with a view to a public offer for sale by them. Among the shares so sold were 25 per cent. of the shares then held by the General Fund trustees and the Harry Jarrom Fund trustees respectively. Those sales enabled both sets of trustees to repay the whole of the outstanding balances of the sums advanced by the Company.

H The advances having been repaid, the income of both funds was regularly distributed from 1964 until June 1978, in the following ways:

General Fund

Up to the end of 1976, most of the income was distributed each year to the 80 or so senior employees (out of a total workforce of some 950) who were

entitled to receive payments from the Company under a bonus scheme then in force, and who received those payments in lieu of, or in satisfaction of, their entitlement to bonuses. Mr. Best was one of the recipients of such payments in lieu of bonuses every year from 1966 onwards. The liability of such receipts to income tax under Sch E has never been disputed. In addition, larger distributions in the region to £2,000–£3,000 were made over the 14 year period to 20 senior employees who were approaching retirement.

In 1977 payments were made to 4 retiring employees and in 1978 the whole of the available income of the General Fund was appointed to 3 retiring employees and a number of others with more than 26 years service. Mr. Best was not among the latter.

Harry Jarrom Fund

The income was distributed each year to a small number of long service members of the staff, most of whom were on the point of retiring. Mr. Best was not among the recipients.

The change, after 1976, in the way in which the General Fund trustees dealt with their income reflects the fact that on 25 August 1977 the Company became a wholly owned subsidiary of Fisons Plc. The trustees of both funds anticipated that sooner or later the Company's employees and its trade would be absorbed by Fisons and they feared that in that event they might have no eligible beneficiaries, or alternatively might not be able effectively to restrict the beneficiaries to those employees of Fisons who had given service to the Company. Accordingly, the trustees put their minds to winding up the trusts.

During 1978 there was considerable (but inconclusive) correspondence between the trustees and offices of the Inland Revenue, much of it in connection with the possibility of the trust funds being applied in purchasing annuities for Company employees. Towards the end of that year it became known that Fisons planned to transfer the staff to its own employ on 1 April 1979. To prepare the way for the premature termination of the Trust Periods, each of the trusts was varied by deed executed on 15 March 1979. Certain administrative provisions were strengthened to enable the trustees to obtain from the Company information about the employees; and Schedules were added to the 1957 and 1963 trust deeds substituting new trusts of the trust assets (by then cash and accumulating deposit income) to take effect after the Trust Periods were terminated.

The Schedules were (*mutatis mutandis*) in identical terms, save for the definition of "Eligible Employee". To participate in the final distribution of the General Fund, a person would have to be an employee of the Company at the termination date and must have been so employed on 31 December 1977; to qualify for benefit from the Harry Jarrom Fund, a person would have to be an employee of the Company on the termination date and must have been so employed on 31 December 1975. The difference reflected the special purpose underlying the creation of the second trust. The substantive provisions of the Schedules were as follows:—

> "2. The Trustees shall within the nine months immediately following the Termination Date pay or provide for all liabilities mentioned in the definition of the Terminal Fund and apply the Terminal Fund by allocating thereout in respect of each Eligible Employee such a sum as the Trustees shall in their absolute and unfettered discretion think fit but so that

A. No Eligible Employee shall be entitled to receive as of right any sum allocated to him

B. The Trustees shall apply all sums allocated to Eligible Employees in one or more of the following ways and such application shall be made within three months of the allocation in question (the choice of application to be in the absolute and unfettered discretion of the Trustees) namely:—

(i) by paying the same to the Eligible Employee or where the Eligible Employee is dead, to his personal representatives as an accretion to his Estate;

(ii) by purchasing from an insurance company which is an authorised insurer under the Insurance Companies Act 1974 in respect of "long term business" and carries on such business in Great Britain a non-commutable non-assignable annuity policy in his name the annuity whereunder is payable as from his attainment of age 65 (or in the case of a woman, age 60) or, if such age has already been attained at the date of purchase, is payable as an immediate annuity.

3. Every allocation and application shall be made in writing and pursuant to a unanimous resolution of the Trustees.

4. The Trustees before making any payment shall be entitled to deduct or make provision for all taxation payable by the Trustees in respect thereof.

5. Subject to the trusts aforesaid the Trustees shall hold the Terminal Fund upon trust to divide and pay the same to and amongst all the Eligible Employees in shares proportional to their salaries for the year ended 31 December 1978 and so that for the purposes of this paragraph 5 the expression "Eligible Employee" shall not include any person who was at the Termination Date a director of the Company and any payment so falling to be made to an Eligible Employee who has died before it has been made shall be paid to his legal personal representatives."

On 29 March 1979 the trustees of each of the Funds by deed terminated the Trust Period and the provisions contained in the Schedules recently attached to the trust deeds came into effect.

On the following day the trustees caused notices to be put up on the notice boards in the Company's various places of employment informing the general body of employees of the existence of the trusts; announcing their impending winding-up; and outlining the procedure which would be followed. Neither the Company nor the trustees had previously made any official announcement of the existence of the trusts (by way of the issue to employees of a brochure or otherwise) and the notice of 31 March 1979 may, for many of the employees, have been the first intimation of them. A number of the employees, however, would have been aware of the trusts' existence either because they had received distributions from the trustees or because (as shareholders) they would have seen references to the trusts in notices of general meetings of the Company and in its annual reports and accounts.

On 1 April 1979 all the employees of the Company transferred into the service of Fisons.

Between April and December 1979 the trustees of each Fund arrived at the allocations to be made to their respective Eligible Employees in accordance with para 2 of the Schedule. In so doing, they were at pains to arrive at a division which was as fair as possible, and which would be seen in that light by the beneficiaries. To this end, several computer printouts were obtained showing the effect of applying various formulae which attached different respective weights to length of service with the Company and salary levels, and the effect of limiting or scaling down the maximum benefits in various ways. Both sets of trustees concluded that none of the printouts produced a wholly acceptable pattern, but that one of them provided a useful basis for further discussions. In the event both sets of trustees agreed on substantial departures from the figures yielded by applying the formula underlying the computer printout which appeared to be the most appropriate, and in particular they agreed on a cut-off point, thus releasing funds for distribution pro rata to points lower down the scale, thereby reducing differentials. In the result, the total of the allocations made to Mr. Best (£18,111) was some £3,300 greater than it would have been if both sets of trustees had simply adopted the figures produced by the best of the computer printouts.

Formal allocation resolutions were passed by each of the bodies of trustees on 21 December 1979. The General Fund allocations amounted in total to £1,342,376 and the Harry Jarrom Fund allocations amounted in total to £683,352. Each of the 770 individual General Fund allocations and 633 Harry Jarrom Fund allocations comprised both a capital and an income element, and the ratio of capital to income was the same in each case. A letter was sent to each of the allocattees on 22 February 1980 stating the amount or amounts allocated to him or her; and some of the were also asked whether it was their wish that the trustees should apply part of the allocation to the purchase of an annuity.

On 18 March 1980 the trustees of each Fund passed application resolutions in accordance with para 2B of the Schedule. In the event, it was decided that all but 31 of the beneficiaries should receive the whole of their allocations in cash; and of the 31 for whom annuities were purchased, 27 also received some cash. Mr. Best was among those who was to receive the whole of his allocations in cash: part has been paid to him, and part has been retained by the trustees under the authority of the Court pending the final outcome of the present proceedings.

The statutory provisions relevant to the only question which falls to me to decide are contained in ss 181(1) and 183(1) Income and Corporation Taxes Act 1970. The material words in s 181(1) are as follows:

"The Schedule referred to as Schedule E is as follows:—

SCHEDULE E

1. Tax under this Schedule shall be charged in respect of any office or employment on emoluments therefrom which fall under one, or more than one, of the following Cases—

Case I: where the person holding the office or employment is resident and ordinarily resident in the United Kingdom, any emoluments for the chargeable period . . ."

A Section 183(1) defines the expression "emoluments" as including "all salaries, fees, wages, perquisites and profits whatsoever."

The parties agree that the corresponding provisions in the Income Tax Act 1952 (as amended) did not differ in any material sense.

For Mr. Best, Mr. Braham contended that if a receipt were to be chargeable to income tax under s 181 it had to be shown that it was B received as a reward or return for services. A receipt could, in appropriate circumstances, be related back to a previous year of assessment (as in *Heasman* v. *Jordan*[1] 35 TC 518), but a payment made after the services had ceased should be regarded as a testimonial in recognition of past services, rather than as payment for work done as in *Commissioners of Inland Revenue* v. *Morris* 44 TC 685. But the taxpayer does not have to show positively that C the payment to him was made for a particular reason other than as a reward or return for services. Megarry J. made that point in this way in *Pritchard* v. *Arundale*[2] 47 TC 680 at page 686 D, E:

> "After a little discussion, I think that Mr. Heyworth Talbot accepted that the true issue was not the twofold question whether the benefit fell within the taxable category of remuneration for services (as it may briefly D be described) or within the non-taxable category of personal gift, but a single question, namely, whether or not it fell within the taxable category of remuneration for services. "Personal gift" is thus not a category which has to be defined or explained, but merely an example of a transaction which will not fall within the taxable category of remuneration for services. In other words, the question is not one of which of two E strait-jackets the transaction best fits, but whether it comes within the statutory language, or else, failing to do so, falls into the undefined residuary class of cases not caught by the Statute."

That approach was expressly approved by the Court of Appeal in *Brumby* v. *Milner* 51 TC at page 608 E.

Recognising that the Revenue would rely heavily on the decision in F *Brumby* v. *Milner*, Mr. Braham drew attention to a number of distinctions between that case and this, on the facts. In particular, the possibility of benefiting under the trusts could not, in this case, be regarded as an element in the bargain struck between the Company and each employee or as a term of the contract of service: the existence of the trusts was not advertised. The payments were windfalls, and were not in any way analagous to wages.

G Mr. Baron contended that although the "reward for services" criterion was often helpful, s 181 was satisfied if the profit came from the taxpayer's employment. The whole of Mr. Best's allocation was clearly a "profit", notwithstanding that it was partly capital and partly income in the trustees' hands. That profit came "from" Mr. Best's employment with the Company if it arose by virtue of that employment. It did so arise: just as, in *Brumby* v. H *Milner's*. Mr. Milner's profit so arose. A profit arises by virtue of an employment if the employee (or past employee) receives it because he is (or was) an employee without any other qualification than that he was an employee at a particular date or dates. That essentially was the basis upon which the Revenue fought and won *Brumby* v. *Milner* (see in particular the

(1) [1954] Ch 744. (2) [1972] Ch 229 at page 237.

foot of page 602, adjusting Mr. Davenport's words to fit the facts of the present case). A

Such factual differences as exist between *Brumby* v. *Milner* and the present case are, Mr. Baron contended, without significance. The first two sentences in the last substantive paragraph in Lord Kilbrandon's speech in *Brumby* v. *Milner* were directly applicable(1):

> "It is conceded that the income payments made from the trust fund to employees arose from their several employments and were properly taxable in their hands. It was therefore necessary for the Appellant to show that, by contrast, the payment out of capital, to use Lord Reid's words [in *Laidler* v. *Perry* 42 TC at page 363] 'arose from something else'." B

Just as in *Brumby* v. *Milner*, there was nothing else. Distributions of money to large groups of people do not naturally lend themselves to the argument that they fall within the "testimonial" line of cases: especially where the amount to be paid to each individual has been arrived at by applying objective criteria. C

Mr. Baron accepted that the present case differed from *Brumby* v. *Milner* in one respect, namely that in the present case the profit arose during a year of assessment when the relevant employment was not held. Nevertheless, Mr. Baron argued that the year or years of assessment to which the profit should be attributed was a minor and subsidiary question and that once a payment was found to be an emolunent from an employment, some year or years of assessment during the period of employment must be found for it. Since length of service was one of the major factors determining the amounts allocated to each of the ex-employees, it was appropriate to attribute a proportionate part of the allocation to each of the years in which the trusts existed and the employee was in service. The assessments in the present case had been made on that basis. Alternatively, Mr. Baron contended that the whole of the cash allocation must be attributed to the final year, and assessed for 1978–89. D E F

Conclusions

The first question for decision is whether the sums allocated to Mr. Best under the trustees' resolutions of 21 December 1979 constituted emoluments "from" his former employment with the Company. The word "therefrom" in para 1 of Sch E reflects the historic principle that income is taxable according to its source, and the question is therefore whether Mr. Best's former employment was the source of his right to receive cash following the allocation. G

In ny view, to describe the allocation as a "windfall" is merely to say that it was unexpected. It says nothing about its source, one way or the other.

Where a sum is paid to a current employee by his employer (or, I would say, by trustees of a fund associated with the employment) the natural inference is that the employment is the source of the payment. That is not to say that the inference cannot be displaced, as a number of cases (of which *Bridges* v. *Bearsley*(2) 37 TC 289 is one) clearly show; but it is unlikely to be displaced in practice unless a different reason for the payment is established. H

(1) 51 TC 583, at p 614. (2) [1957] 1 WLR 674.

A The inference does not disappear altogether merely because the recipient of the payment happens to be an ex-employee; but in such a case the inference is somewhat weaker, and it is rather more likely that the payment can be attributed to some other reason. In some cases the payment nay have been made as actual consideration for the recipient's resignation from the office or employment (as in *Duncan's Executors* v. *Farmer* 5 TC 417) and in others it B maybe shown that the payment was made as a personal testimonial to its recipient (as in *Cowan* v. *Seymour* [1] 7 TC 372 and *Commissioners of Inland Revenue* v. *Morris*). Indeed, in all but one of the cases cited to me involving a payment to an ex-employee, the payment was held to be non-taxable on some such ground: and in the exception (*Edwards* v. *Roberts* 19 TC 618) the point was not in issue, the taxability of the receipt to some extent being C conceded—somewhat to the surprise, I think, of Lord Hanworth M.R. But none of those cases related to payments to a substantial group of people, and while they are illustrative of the principles to be applied, the results arrived at are not helpful pointers to the proper outcome in a case with very different facts.

By contrast, *Brumby* v. *Milner* was such a case. That case was, however, D in judgment, a rather stronger case for the Revenue on its facts than the present, in that the existence of the trust was known at all material times to all the employees and it plainly constituted an incentive scheme, giving it an identifiable "remuneration" flavour. Moreover, the two features mentioned at the end of the judgment of the Court of Appeal are absent from the present case: pensioners were not Eligible Employees, and an Eligible Employee did E not run any risk of disqualification.

The Court of Appeal summarised their decision in *Brumby* v. *Milner* in this way[2]:

> "We do not consider that the provision for terminal payments can be considered as, so to speak, a throwaway provision bearing no colour of reward for services. The very existence of the discretion to allocate is F against this inference. It appears to us that the scheme is one scheme based fundamentally on reward for services by employees and the fact that after the final payment there is no more by way of bonus to look for does not relevantly distinguish that final payment."

After careful consideration I find that those words summarise also my view of the facts of the present case, so far as the source of the payment is G concerned. In saying that, I am greatly influenced by the words of Lord Kilbrandon already cited, and the absence in the present case of any realistic alternative source for the terminal payments. I do not forget that in the present case the trusts did not exist solely for the purpose of paying cash bonuses. In part at least, they were originally designed as means for getting shares in the Company into the hands of salaried directors and other H employees, and one of the motives behind that had nothing to do with remuneration. But the shares which came into the trustees' hands were not to any substantial extent disposed of in that way (indeed, the Harry Jarrom Fund trustees never made any such dispositions); and the force of any argument based on this difference between this case and *Brumby* v. *Milner* is greatly diminished by the fact that the purchasers had to be nominated by the I Company. The Company was obviously very prosperous and its support for any application for shares amounted in my view to a reward for services.

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(1) [1920] 1 KB 500. (2) 51 TC 583 at p 609.

That is, however, not the end of the matter. If the need to identify the source represents one historic principle of income tax law, the need to be able to attribute income to a particular year of assessment represents another, because of the annual nature of the tax. In my judgment, Mr. Baron's argument underestimates this factor and I do not accept the view that once a payment has been found to be derived from an 'office or employment' source it must be a taxable emolument, attributable to some year or another: thus allotting an altogether insignificant role to the words "for the chargeable period" in the charging provisions of Case I of Schedule E.

It is clear that a payment in one year can fall into assessment for a previous year if it is specifically related to such previous year. This can and often does happen where a back-dated pay award has been made. The same principle has somewhat infrequently been applied in cases where, on the true view of the facts as a whole, the payments do relate to particular previous years. *Smyth* v. *Stretton* 5 TC 36 was such a case; and *Heasman* v. *Jordan*[1] must be regarded as another. I can however see no justification on the facts of the present case for attributing all or any part of the allocated cash to the year of assessment 1978–79; nor for apportioning those sums between all the years back to 1958–59. In the latter connection I attach no weight to the fact that length of service was one of the ingredients of the formula on which the allocations were based—and I note that that factor did not apparently affect the Revenue's thinking when assessing the terminal payments in *Brumby* v. *Milner*. On that short ground I hold that none of the assessments are well founded; and indeed that a single assessment for the year 1978–79 would be equally unfounded. I accept that had the timing been somewhat different an assessment for 1978–79 would have been competent, as in *Brumby* v. *Milner*; but the timing is crucial and the non-existence of an appropriate year of assessment because of the disappearance of the source is one of those accidents which can sometimes happen.

Mr. Braham, in his argument, used the fact that the right to payment arose in a year of assessment after the employment ceased in a different way. As he saw it, that fact was a conclusive, or near conclusive, pointer against the allocations being emoluments from the employment. The inability to connect the payments with any year or years showed that they were not "rewards for services past . . .", to use the approved words of Upjohn J. in *Hochstrasser* v. *Mayes*[2] 38 TC 673, 685. Despite the attractiveness of that approach, I have come to the conclusion that the nature of the payments are not affected by the timing and I accordingly prefer to rest my decision on the ground already expressed. So far as the charge to tax under s 181 is concerned the result is, of course, the same. Mr. Best's appeals succeed in principle.

For the record, I will add that Mr. Braham conceded on behalf of Mr. Best that he would have no defence to an assessment for the year 1978–79 made under s 187 Income and Corporation Taxes Act 1970. On his view of the case (namely, that the employment with the Company was not the source of the allocations for mainstream Sch E purposes) Mr. Braham considered that the income element contained in Mr. Best's allocation should be taxed as trust income under Sch D, the trusts being the relevant sources; and that the capital element was vulnerable (subject to the s 188(3) allowance) to s 187. I am inclined to think, however, that it follows from my view on the source question that Sch D is not appropriate at all and that s 187 would accordingly be applicable in relation to the whole of the terminal receipts.

(1) 35 TC 518. (2) [1959] Ch 22 at page 33.

A B. O'Brien } Commissioner for the Special Purposes of the Income Tax Acts

Turnstile House
98 High Holborn
London WC1V 6LQ

16 February 1984.

B

The case was heard in the Chancery Division before Walton J. on 12 and 13 December 1985 when judgment was reserved. On 20 January 1986 judgment was given in favour of the Crown, with costs.

D.C. Potter Q.C. and *Michael Hart* for the Crown.

David Braham Q.C. and *Richard Bramwell* for the taxpayer.

C The following cases were cited in argument in addition to the cases referred to in the judgment:—*Bridges* v. *Bearsley* 37 TC 289; (1957] 1 WLR 674; *McKeown* v. *Roe* [1928] IR 195.

Walton J:—By a trust deed dated 3 December 1957, A. Gallenkamp & Company Ltd. ("the Company") established a scheme the basic purpose D whereof was to enable the trustees thereof to purchase or subscribe for fully paid shares in the company with a view to their being held by or for the benefit of employees, and for that purpose the company envisaged that it would from time to time advance monies to the trustees thereof. I must read a considerable proportion of the trust deed.

Clause 1:

E "In this Deed except where the context precludes such a construction (a) the expression 'the Trust Period' means the period beginning on the date hereof and continuing until the expiration of twenty years from the death of the last survivor of all the descendants now in existence of His late Majesty King George the Fifth ... (d) the expression 'employees' except where used in Clause 19 hereof means all F persons for the time being employed by the Company including Directors holding salaried employment or office in the Company but so nevertheless that a person who shall at any time have sold or transferred any share in the Company to the Trustees shall not be deemed to be an employee or to be entitled to any benefit hereunder and so also that neither" two named persons "shall be deemed to be an employee or to G be entitled to any benefit hereunder unless and until the Company shall otherwise in writing direct ... (g) the expression 'the Trust Property' means all sums advanced by the Company to the Trustees during the Trust Period for the purposes hereof and includes the investments and property for the time being representing the same."

Clause 2:

H "The Trustees shall so often during the Trust Period as the Company shall in writing direct raise out of the Trust Property and apply in the purchase of or subscription for such number of fully paid

shares in the Company as the Company shall direct (in the case of every such purchase at such price and from such person or persons as the Company shall direct) such sum or sums of money as may be necessary for such subscription or purchase and the shares so subscribed for or purchased shall be held by the Trustees upon the trusts hereof." A

Clause 3:

"(a) The Company may at any time or times during the Trust Period give notice in writing to the Trustees requiring the Trustees to sell and transfer any fully paid share or shares in the Company for the time being subject to the trusts hereof to any employee who may be nominated by such notice as transferee thereof at such price as may be fixed by such notice. (b) Upon the receipt of any such notice the Trustees shall be bound on payment of the purchase price to transfer the share or shares specified in the notice to the employee thereby nominated." B C

Clause 4:

"The Trustees shall hold the net proceeds of sale of any shares sold by them pursuant to Clause 3 hereof upon trust at the request in writing of the Company to apply the same in or towards the repayment to the Company of all moneys advanced by the Company to the Trustees for the purposes of this Deed and for the time being not repaid and subject to any such request and repayment such proceeds of sale shall be held by the Trustees as part of the capital of the Trust Property." D

Clause 5:

"Subject to any direction of the Company in pursuance of any of the preceding Clauses hereof the Trustees shall hold the Trust Property upon trust so soon as conveniently may be after the expiration of each year during the Trust Period to pay and divide the income of the Trust Property to and among such one or more exclusively of the others or other of the persons who were employees of the Company immediately prior to the expiration of such year in such shares and proportions as the Company shall during such year or within eleven calendar months after the expiration thereof appoint and in default of such appointment and so far as any such appointment shall not extend the Trustees shall invest such income in manner authorised by Clause 10 hereof and hold the investments so made as an accretion to the capital of the Trust Property for all purposes Provided that not-withstanding anything hereinbefore contained the Trustees may (but not without the consent of the Company first had and obtained) apply such income or any part or parts thereof in or towards repayment to the Company of any moneys advanced to the Trustees for the purposes hereof and for the time being outstanding and not repaid and Provided further that the Company may at any time during the Trust Period appoint as respects any investments made pursuant to this clause or the investments or property for the time being representing them that the same shall be treated for the purposes of this clause as if they were income of the Trust Property for the then current year or for the year then last expired." E F G H

Clause 6:

"Provided always and notwithstanding anything hereinbefore contained the Trustees may at their absolute discretion without being I

liable to answer for the exercise of such discretion at any time or times during the Trust Period by writing under their hands direct that the Trust Period shall thereupon forthwith cease and determine either as regards the whole or as regards any part or parts of the Trust Property and upon any such direction the trusts and power hereinbefore declared concerning the Trust Property or the part or parts thereof to which such direction relates shall forthwith cease and determine and the Trust Property or the part or parts thereof to which such direction relates shall be held upon the trusts declared in the next succeeding clause hereof."

Clause 7:

"Upon the expiration or earlier determination of the Trust Period the Trustees shall sell call in and convert into money the Trust Property (or if the Trust Period shall have been determined as regards only some part or parts of the Trust Property then such part or parts thereof) and shall hold the net proceeds of such sale calling in and conversion upon trust to apply the same in or towards the repayment to the Company of all moneys advanced by the Company to the Trustees for the purpose of this Deed and for the time being not repaid and subject to such repayment upon trust to divide such net proceeds to and among the employees whose salaries for the year then last expired were in excess of One thousand five hundred pounds if more than one in shares proportionate to their salaries for such year."

Clause 19:

"The Company may in its absolute discretion at any time or times during the Trust Period by any Deed or Deeds revocable or irrevocable executed with the consent of the Trustees add to alter or modify the trusts powers and provisions herein expressed but so nevertheless that no such addition alteration or modification: (a) shall enable any person who shall at any time have sold or transferred any share in the Company to the Trustees to take any benefit hereunder); (b) shall enable the Company to receive any benefit hereunder other than the repayment of sums advanced by the Company to the Trustees for the purposes hereof together with interest (if such addition alteration or modification shall provide for the payment of interest) on any sum so advanced at a rate not exceeding one per centum over the current Bank Rate from the date of such advance or from the date of such addition alteration or modification (whichever shall be the later date); (c) shall be such that the scheme hereby established shall cease to be such a scheme for the purchase of and subscription for fully paid shares in the Company to be held by or for the benefit of employees of the Company as is referred to in Proviso (b) to sub-section (i) of Section 54 of the Companies Act 1948."

There were, I gather, many deeds of variation executed. For present purposes they are mostly immaterial, but two must be mentioned. The first is a deed of variation of 8 March 1979. By clause 1(b) thereof it was provided as follows:

"There shall be substituted for Clauses 5 and 5A as previously altered renumbered and adopted the following clause, namely: '5. Subject to the provisions of the preceding Clauses hereof the Trustees shall hold the Trust Property upon trust during the Trust Period to pay or apply the annual income of the Trust Property in each year to or for

the benefit of all or such one or more exclusively of the others or other of the employees for the time being if more than one in such shares and proportions and generally in such manner in all respects as the Trustees shall in their absolute and unfettered discretion think fit. Subject to and in default of such payment or application the Trustees shall within one month after the end of each year pay and divide such income to and between the employees at the end of the year if more than one in shares proportionate to their salaries for such year Provided that if and so long as there is during the Trust Period no employee of the Company the Trustees shall apply all income of the Trust Property not paid or applied under the foregoing provisions of this Clause to such charities or for such charitable purposes as the Trustees shall determine'."

The second deed of variation was made on 15 March 1979, at a time when the company had become a wholly-owned subsidiary of Fisons plc, which happened in August 1977, and the employees of the company, who had down to this date continued to be employed by the company, were about to become employees of Fisons plc instead. This duly happened on 1 April 1979. In anticipation thereof the second deed of variation made considerable changes in the ultimate beneficial interests in the trust fund. By clause 1(a) thereof it was provided as follows:

"There shall be substituted for Clause 7 thereof the following Clause, namely: '7. Upon the date (hereinafter called "the Termination Date") of expiration or earlier determination of the Trust Period the Trustees shall sell call in and convert into money the whole of the Trust Property and shall hold the net proceeds of such sale calling in or conversion and any other moneys subject to the trusts hereof (including all income in the hands of the Trustees on the Termination Date) and any income that may be received by the Trustees after the Termination Date on trust to pay or apply the same in accordance with the provisions of the Schedule hereto'."

By clause 1(b) thereof it was provided:

"There shall be substituted for Clause 9.(1) thereof the following Clause, namely: '9.(1) A Statement in writing signed by the Secretary of the Company purporting to contain the names of the persons who were on any particular date or dates employees of the Company within the meaning of this Deed and in relation to such persons all or any of the following information: (a) the length of their employment and/or service with the Company (b) the amount of salary and/or other remuneration paid or payable to them for any particular period or at any particular date (c) such other data and/or information as the Trustees shall require, shall so far as regards the protection of the Trustees be sufficient evidence of the matters stated therein and the Trustees shall be entitled to assume that no person not named in such statement was in fact an employee on the particular date or dates in question'"; and by clause 1(c): "The Schedule hereto shall be added at the end of the Principal Deed".

The Schedule reads as follows:

"1. In this Schedule: (1) 'the Company' means A. Gallenkamp & Company Limited (2) 'the Termination Date' means the date of expiration or earlier determination of the Trust Period (3) 'Eligible Employee' means a person who was at the 31st December 1977 and is at

A the Termination Date an employee of the Company (including a director holding salaried employment or office with the Company) but who has not at any time before the Termination Date sold or transferred any share in the Company to the Trustees for the time being of the Principal Deed (4) 'the Trustees' means the trustees or trustee for the time being of the Principal Deed (5) 'the Terminal Fund' means the net B monies remaining held by the Trustees pursuant to Clause 7 of the above written Deed (together with any after accrued interest on such monies) after payment of or provision for the undermentioned liabilities. The liabilities to be paid or provided for shall be"—and then those are set out. "(6) the masculine includes the feminine save where the context precludes such a construction.

C 2. The Trustees shall within the nine months immediately following the Termination Date pay or provide for all liabilities mentioned in the definition of the Terminal Fund and apply the Terminal Fund by allocating thereout in respect of each Eligible Employee such a sum as the Trustees shall in their absolute and unfettered discretion think fit but so that A. No Eligible Employee shall be entitled to receive as of D right any sum allocated to him B. The Trustees shall apply all sums allocated to Eligible Employees in one or more of the following ways and such application shall be made within three months of the allocation in question (the choice of application to be in the absolute and unfettered discretion of the Trustees) namely: (i) by paying the same to the Eligible Employee or where the Eligible Employee is dead, to his E personal representatives as an accretion to his Estate; (ii) by purchasing from an insurance company which is an authorised insurer under the Insurance Companies Act 1974 in respect of 'long term business' and carries on such business in Great Britain a non-commutable non-assignable annuity policy in his name the annuity whereunder is payable as from his attainment of age 65 (or in the case of a woman, age 60) or, if F such age has already been attained at the date of purchase, is payable as an immediate annuity.

3. Every allocation and application shall be made in writing and pursuant to a unanimous resolution of the Trustees.

4. The Trustees before making any payment shall be entitled to deduct or make provision for all taxation payable by the Trustees in G respect thereof.

5. Subject to the trusts aforesaid, the Trustees shall hold the Terminal Fund upon trust to divide and pay the same to and amongst all the Eligible Employees in shares proportional to their salaries for the year ended 31st December 1978 and any payment so falling to be made to an Eligible Employee who has died before it has been made shall be H paid to his legal personal representatives."

I must now mention that the trustees acquired a particular parcel of shares from one Mrs. Bertha Ellon Jarrom in August 1961. She was the widow of, I think, a former managing director of the company, and she expressed a wish that those shares should be held as a separate fund in memory of her late husband and applied for the benefit of long-serving members of the staff. On I 3 September 1963, the Harry Jarrom Fund was accordingly hived off from the main fund and became subject to the trusts of a deed of that date. The terms of that deed closely followed the trusts of the original trust deed of 3

December 1957 save that (i) the employees and directors eligible to benefit thereunder were limited to those with ten or more years' service and (ii) the discretion to distribute income was vested in the trustees rather than the company.

The trusts of this fund were also varied by a deed of variation of 15 March 1979, along precisely similar lines to the deed of variation of the same date affecting the main trust fund, the only material distinction being that to be eligible for a distribution therefrom an employee had to have been in the service of the company as at 31 December 1975.

I am really not I think concerned in any manner with the actual history of the dealings in shares of the company by the trustees, or the sales thereof effected to employees in accordance with the respective trusts. It is not perhaps surprising that sales of shares to employees appear to have been made at the market price thereof, or at any rate sufficiently near thereto to satisfy the Revenue that no charge to tax would arise on the employee as a result thereof.

Mr. Braham, for Mr. Best, pointed out that there were really three quite distinct periods in the life of the trusts. The first period lasted from their inception until August 1977, when the company become a wholly-owned subsidiary of Fisons plc. During this period he observed that the original purpose of the trusts was to some extent carried into execution by the sale of shares to employees, but he was inclined not to accept that a sale of a share to any employee at the market value might nevertheless be of benefit to him. Without arguing that point further, I do not think that anything can be made to turn on that point. The second period lasted from the end of the first period until 1 April 1979, when all the employees were absorbed by Fisons plc. During this period the income of the funds was distributed between the employees, and Mr. Braham accepted that that was taxable remuneration in their hands. The third period is the period after 1 April 1979, when the final distribution took place.

On 29 March 1979, the trustees of each fund by deed directed that the trust period applicable to each fund should upon the execution of that deed forthwith cease and determine as regards the whole of the respective trust property. And by allocation resolutions in each case dated 21 December 1979, the trustees resolved that out of the terminal fund as defined in the respective Schedules there should, as at the date thereof, be allocated in respect of each eligible employee as therein defined whose name appeared in the first column of the Schedule thereto the sum set opposite his or her name in the second column.

Thus it was that the Respondent, Mr. Best, became entitled to a sum of £11,533 out of the general fund and a sum of £6,578 out of the Harry Jarrom Fund. This case raises the question whether those sums were taxable in his hands, and, if so, in respect of what year or years of assessment. The relevant assessments, some of them being further assessments, were all made on 4 March 1985. Nothing I think turns at this stage on the precise allocation, but they cover a period from the financial year 1958–59 to that of 1978–79.

Mr. Best appealed to the Special Commissioners, and his case was heard by a single Special Commissioner on 30 and 31 January and 1 February 1984. He gave his reserved decision on 16 February 1984. Therein he came to two conclusions; namely, (i) that the sums to which Mr. Best became so entitled

A were indeed emoluments of his employment with the company, but (ii) that such emoluments could not be attributed to any one or more years of assessment, and so were not emoluments for any chargeable period or periods. From that decision the Inspector of Taxes now appeals to this Court.

The relevant statutory provisions are simple and extremely well known. The Income and Corporation Taxes Act 1970, s 181, provides as follows:

B "The Schedule referred to as Schedule E is as follows:—

SCHEDULE E

1. Tax under this Schedule shall be charged in respect of any office or employment on emoluments therefrom which fall under one, or more than one, of the following Cases—

Case I: where the person holding the office or employment is C resident and ordinarily resident in the United Kingdom, any emoluments for the chargeable period . . . and tax shall not be chargeable in respect of emoluments of an office or employment under any other paragraph of this Schedule."

Then, s 526(5) defines "chargeable period" as meaning "an accounting period of a company or a year of assessment".

D Finally perhaps one should refer to the Taxes Management Act 1970, s 35, to make the point that none of the earlier assessments is formally out of time. Section 35 provides:

"(1) Where income to which this section applies is received in a year of assessment subsequent to that for which it is assessable, assessments to income tax as respects that income may be made at any E time within six years after the year of assessment in which it was received. (2) The income to which this section applies is any income which is chargeable to tax under Schedule E, but which is not taken into account in an assessment to income tax for the year of assessment in which it is received."

So the two matters for consideration present themselves very directly as a F result of the 1970 Taxes Act. As to the first—whether the payments are emoluments from the taxpayer's employment with the company—there can be no question but that this is a question of fact upon which the decision of the Special Commissioner is final unless it can be shown, in accordance with the *Edwards* v. *Bairstow*[1] test, however one likes to formulate it, that the true and only possible conclusion from the primary facts found by the Special G Commissioner is to the contrary: see *Tyrer* v. *Smart*[2] 52 TC 533.

Mr. Braham attempted to discharge this onus by pointing to various cases in which it has been held that payments made to a person after he has ceased to hold the office or employment wholly noncontractually have not been emoluments of the office which he formerly held. He cited two cases

(1) 36 TC 207. (2) [1979] 1 WLR 113.

dealing with non-contractual pensions: *Stedeford* v. *Beloe*[1] 16 TC 505, and *Beynon* v. *Thorpe,* 14 TC 1. With all respect to Mr. Braham, I do not think that one can get much help from these cases. The essentially different nature of a pension from reward for services was well put by Rowlatt J. in the latter case at pages 11 and 12:

> "But it seems to me upon the facts—and this is I think most important—that these payments cannot be regarded as supplementary salary for the services as they were rendered but are payments in respect of the termination of the services in respect of the period which he will live after the services have been rendered. Of course, as was pointed out by Lord Justice Atkin in *Cowan's* case[2] (and Lord Sterndale also took the same view), you may have a sum paid after the termination of the services which nevertheless is for the services. After the services are all over, you may say the services call for a supplement to the salary and may give the man another £50 or £500 or £5,000 in respect of the last year's work. But this is not that case at all, because these sums vary in amount according to the length of time which the man continues to live. If he only lived one year, he would only have got £1,000: he has lived five or six and he has had £5,000 or £6,000. It is quite clearly a payment not by way of increment of salary for his past labours treated as salary and applicable to current labours, but it is in the nature of a payment to a person whose services have ceased because they have ceased and because, although they have ceased in his retirement, he is entitled in his retirement to have something. That is the nature of the payment."

The third case Mr. Braham cited under this head—namely, *Cowan* v. *Seymour*, 7 TC 372—was decided upon the grounds that the true conclusion from the primary facts was that the payment was in the nature of a testimonial to the taxpayer for what he had done in the past while his office, which had then terminated, was in existence (see *per* Lord Sterndale M.R., at the top of page 380 of the report). What Mr. Braham could not go on to say was that that was parallel to the situation in the present case, for para 3 of the Case Stated is in these terms[3]:

> "Frank Robert Dixon FCA, a member of the firm which had acted as the company's accountants for many years, and at the relevant times one of the trustees of each of the two trusts referred to . . ., gave evidence before me. Mr. Dixon's account of the manner in which the trustees of both funds allocated shares in the capital and income to former employees of the company is summarised at pages 9–10 of my decision. In his evidence (which I accepted) Mr. Dixon made it clear that in distributing the net assets of the funds the trustees never considered any former employee on his merits as an individual and that the personal qualities of individual former employees did not in any way affect the amount of their allocated share of capital and income."

Accordingly, on this point I reach the very simple conclusion that the Respondent has not shown any reason whatsoever for upsetting the conclusion of the Special Commissioner on this, the first, point. If necessary, however, I would go much further on this point, because I do not think that the converse conclusion, even if it had been reached by the Special Commissioner, could have been upheld for one moment. There are the following three factors which, taken together, seem to me to be absolutely

(1) [1932] AC 388. (2) 7 TC 372. (3) Pages 708G–709A *ante*.

A conclusive in favour of the payments being rewards for past services: (i) Everybody who was eligible participated. It is, I think, significant that the three cases cited by Mr. Braham on this point where contrary conclusions were reached were cases where the payment was made to a single individual. In such a case it is always very much easier to say that something special relating to that individual other than his employment or office was the reason B for the payment. This certainly does not apply in the present case. (ii) The persons who received payments were persons who were defined in each case as eligible employees: apart from being employees of the company over a defined period of time, there was no other qualification of any description required of them. If ever there was a case where the previous employees received the sums paid to them merely "as such", this is clearly that case. C (iii) As was made clear by the evidence of Mr. Dixon, of the company's accountants, the trustees did not introduce any other qualifications into the distribution, whether related to the personal merits of the employees or otherwise. Their sole preoccupation appears to have been to evolve a scheme of distribution among all those properly entitled upon a fair and equitable basis.

D Taking these matters together, it appears to me that the situation differs from that in *Brumby* v. *Milner*[1] 51 TC 583, in only one way; namely, that the sums were paid after the termination of employment rather than during that employment. But this, for present purposes, is a difference without a distinction when, as here, unaccompanied by any other reason for the making of the payments apart from service as an employee.

E I turn now to the second question which arises: namely, given that the payments in question are emoluments arising from Mr. Best's employment by the company, is it possible to attribute a year or years of assessment to such payments? The learned Special Commissioner decided this question in the negative, and I have a great deal of sympathy with him in this conclusion. But I find Mr. Potter's simple submission that this conclusion is logically F indefensible wholly convincing. If paid for service as an employee, it must be paid in respect of some period of service, whether that be a definable special period or whether, on the other hand, the payments have to be regarded as spread over the whole of the period of service of the employee. Of course, having regard to the precise facts of this case it may be (and, indeed, I think it is) extremely difficult to say in respect of precisely what period of service G these payments were made; that is to say, the additional emoluments were paid. But that they must be attributed to some is, in my view, inescapable.

That there is nothing in principle objectionable to the apportionment of emoluments in this manner—that is to say, in respect of a period of time anterior to their payment—is quite clearly shown by *Dracup* v. *Radcliffe* 27 TC 188, and *Heasman* v. *Jordan*[2] 35 TC 518. However, the facts of each of H these cases are so far removed from those in the present case that I do not think any guidance is, for present purposes, to be found therein.

As I have already noted, the learned Special Commissioner appears to have regarded the extreme difficulty of apportionment in the present case as being conclusive. I do not think this is correct. Like Roxburgh J. in *Heasman*

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(1) [1976] 1 WLR 29. (2) [1954] 3 WLR 432.

v. *Jordan* I regard the matter as being a pure question of fact. So regarding the matter, I think that something may well turn upon the evidence which has already been given by Mr. Dixon, which may well have contained matters which throw light on this difficulty. All that the Case Stated discloses is that the trustees in both cases, while of course fulfilling the terms of the relevant Schedule in each case, effected an apportionment between the employees which they considered fair. If, in effecting that calculation, there in fact entered into their consideration, in any shape or form, the total length of service of the employee, then I think that would have a distinct bearing, although it might not be conclusive, on the period of apportionment. Similarly, if they restricted their considerations to service after 1975, or 1977, as the case may be, this again, while possibly not conclusive, would obviously have a great bearing on how the problem should be approached.

Quite apart from these considerations, there is the question of how one year should be taken with another. It is not sufficient to determine the span of years in question. Although equality is equity, this in many situations means proportionate, and not true, equality: see, e.g., *Re Unit 2 Windows Ltd.*, [1985] 3 All ER 647. So there is at any rate a considerable case for saying that any extra remuneration should bear a constant ratio to the employee's salary throughout the relevant period, whatever that turns out to be. As an additional factor (I do not pretend that these are exhaustive) it appears to me that it would, in the context of emoluments over the period which is likely to be here in question, be reasonable to consider the effects of inflation. But it may be that, in any event, if the increases bore a steady relationship to the employee's salary from time to time that would involve a sufficiently rough and ready taking of those effects into consideration.

However, as I consider that all these are matters of fact, upon which the evidence already given in this case but not stated with sufficient detail in the Case Stated may have a bearing, I think the correct order, as suggested by Mr. Potter, is that I should return the matter to the Special Commissioner to decide, in accordance with the guidance given in this judgment, over what period the additional emoluments must be deemed to have been earned, and how they are to be apportioned over the various financial years in that period.

Appeal allowed, with costs.

The taxpayer's appeal was heard in the Court of Appeal (May, Balcombe and Woolf L.JJ.) on 6 and 8 October 1987 when judgment was reserved. On 30 October 1987 judgment was given against the Crown, with costs.

D.C. Potter Q.C. and *Michael Hart Q.C.* for the Crown.

Andrew Park Q.C. and *Richard Bramwell* for the taxpayer.

The following case was cited in argument in addition to the cases referred to in the judgment:—*Hochstrasser* v. *Mayes* 38 TC 673; [1960] AC 376; [1960] 2 WLR 63.

May L.J:—This is an appeal against an order of Walton J. made on 20 January 1986 and entered on 18 February 1986 reversing in part the decision

A of a Special Commissioner upon an appeal by the Revenue by way of Case Stated under s 56 of the Taxes Management Act 1970.

On 30 and 31 January and 1 February 1984 the Special Commissioner heard the appeals of the taxpayer against 21 assessments to income tax under Schedule E set out in the Income and Corporation Taxes Act 1970 for the fiscal years 1958–59 to 1978–79 all inclusive (the "Employment Years").

B On 2 August 1984 the Special Commissioner determined the appeals by discharging the assessments for the years 1958–59 to 1977–78 all inclusive and by reducing that for 1978–79 to the agreed figure of £8,111, being the excess over £10,000 of the aggregate monies in dispute and accepted by the taxpayer as liable to tax pursuant to ss 187 and 188 of the 1970 Act.

The relevant statutory provisions are limited. Under Case I of Schedule C E in s 181(1) of the Act (although amended in immaterial respects in relation to foreign emoluments in 1974 and again in 1977), tax under the Schedule is chargeable in respect of any office or employment on any emoluments therefrom for a chargeable period. Section 183(1) defines "emoluments" as including "all salaries, fees, wages, perquisites and profits whatsoever". Section 526(5) defines "chargeable period" as "an accounting period of a D company or a year of assessment". In the instant case, as the taxpayer is not a company, we are thus concerned with years of assessment.

The background to this case can be shortly stated in the words of the Special Commissioner in the Case Stated which I regretfully adopt. The taxpayer was employed from a date in the fiscal year 1958–59 to 1 April 1979 (in the fiscal year 1978–79) by A. Gallenkamp & Co. Ltd. ("the Company"). E On the latter date he (and all the other employees of the Company) transferred to the employ of the Company's parent company. Just before that transfer, and in anticipation of it, the trustees of two trusts for the benefit of the Company's employees exercised their powers to bring into effect provisions leading to the winding-up of the trusts and the distribution of their net assets. In the course of the next fiscal year, 1979–80, the taxpayer became F entitled, pursuant to the exercise of discretions vested in the trustees of each of the said trusts, to two sums totalling £18,111, a part of the trust funds. On those facts the taxpayer accepted liability to income tax for the year of assessment 1978–79 in respect of the said two sums under s 187 of the Income and Corporation Taxes Act 1970, that is to say to tax only on the excess over £10,000 (s 188(3)). The Revenue, however, took the view that the sums were G emoluments of or from the taxpayer's employment with the Company within the charge to tax under s 181 (to which the benefit of no special relief is attached). The questions for the Commissioner's decision were therefore:

(i) Whether, in relation to the taxpayer's employment with the Company, the payments were "emoluments therefrom" within s 181(1), Sch E, para 1: and, if so,

H (ii) Whether, in relation to the words "for the chargeable period" in Case I of Sch E,

(a) the payments should be treated as income of different chargeable periods and spread accordingly over the whole of the period

of the taxpayer's employment—the course actually adopted by the Revenue; or

(b) the year of assessment 1978–79 (the last year of such employment) was the sole chargeable period and the whole of the payments constituted income of that year; or

(c) the payments could not be attributed to any one or more of the years of assessment during which the taxpayer was employed by the Company and there was accordingly no chargeable period within the meaning of the statute.

In so far as the last sub-paragraph is concerned, the issue was whether the receipt of the £18,111 by the taxpayer should properly be attributed to the fiscal year 1979–80 ("the Distribution Year"), during which period there was no employment, that is to say no source for any emolument which would mean that the receipt could not be chargeable to tax.

The Special Commissioner first held that the monies received by the taxpayer from the trustees were emoluments from his employment. This point is no longer disputed. But the Special Commissioner then held that the emoluments could not be attributed to any one or more of the relevant Employment Years from 1958 to 1979. It followed that there could be no chargeable period for the reason I have indicated.

The Revenue then asked for a Case Stated and appealed the Special Commissioner's findings against them. It seems that the taxpayer in his turn also argued before Walton J. that the monies he had received were not emoluments from his employment. The Judge rejected this contention and, as I have said, it is no longer persisted in.

On the other point, however, the learned Judge allowed the appeal against the Special Commissioner's decision. He expressed his reason for allowing the appeal in these terms([1]):

"... given that the payments in question are emoluments arising from [the taxpayer's] employment by the Company, is it possible to attribute a year or years of assessment to such payments? The learned Special Commissioner decided this question in the negative, and I have a great deal of sympathy with him in this conclusion. But I find [counsel for the Crown's] simple submission that this conclusion is logically indefensible wholly convincing. If paid for service as an employee, it must be paid in respect of some period of service, whether that be a definable special period or whether, on the other hand, the payments have to be regarded as spread over the whole of the period of service of the employee. Of course, having regard to the precise facts of this case it may be (and, indeed, I think it is) extremely difficult to say in respect of precisely what period of service these payments were made; that is to say, the additional emoluments were paid. But that they must be attributed to some is, in my view, inescapable."

He went on to say that he regarded the matter as being a pure question of fact and one which the Special Commissioner had to determine notwithstanding that the latter had expressly said that this was very difficult, if not impossible.

([1]) Page 729E *ante*.

A The taxpayer now appeals, seeking to have the learned Judge's decision on the second principal point set aside and the Special Commissioner's order reinstated.

For the purposes of this judgment I think it unnecessary to refer to the detailed terms of the two relevant trust deeds and Deeds of Variation. These details are very helpfully set out in the learned Judge's judgment to which B reference can be made if necessary. Under the first trust deed as amended over the years, the employees of the company eligible to become beneficiaries upon the determination of the trust were in general those who were employees on both 31 December 1977 and the Termination Date (29 March 1979). Under the second trust deed as similarly amended, the eligible employees were those who were such on both 31 December, 1975 and the C Termination Date. The resolutions of the trustees of each fund allocating specific sums to the respective eligible employees were not made until 21 December 1979.

As will have been seen, the Special Commissioner relied on what is known as the "source doctrine". There is no doubt that it exists and is established by authority: it was not challenged by the Revenue in this appeal. D See Whiteman and Wheatcroft on Income Tax, 2nd Ed., para. 1–28:

> "... most types of income are classified by reference to the source from which they come. From this it was held to follow if a taxpayer ceased to possess a particular source of income he could not be taxed on delayed receipts from that source unless these were referable to, and could be assessed in respect of, a period during which he possessed the E source."

The reason the learned Judge gave for allowing the second part of the appeal, which I have quoted, reflected a submission made to him by counsel for the Revenue and repeated before us. The submission was based on what was said to be both logic and authority. It was contended that:

> "An emolument which is a reward for services is an emolument for F that period during which the services were rendered. Where the period of the services extends into two or more years, then a fair apportionment on all the facts is necessary. In the present case the emoluments were a reward for services rendered during the period of employment, which was either the whole 21 Employment Years or at least, in the alternative, the period of eligibility stipulated for each trust".

G The authorities relied on were principally *Hunter* v. *Dewhurst* 16 TC 605, *Dracup* v. *Radcliffe* 27 TC 188, *Heasman* v. *Jordan*(1) [1954] Ch 744, 35 TC 518 and *Board of Inland Revenue* v. *Suite*(2) [1986] AC 657.

Hunter v. *Dewhurst* was also relied on by Counsel for the Appellant taxpayer before us. It concerned the correct treatment for income tax purposes of payments received by three retiring directors of a limited H company. The relevant Article of the company's articles provided that if any director, who had held office for not less than five years, should resign, then the company should pay him or his representatives by way of compensation for loss of office a sum equal to the total remuneration received by him in the preceding five years. All the three directors concerned had held office for not

(1) [1954] 3 WLR 432. (2) [1986] STC 292.

less than five years. Each of the first two directors involved, Arthur Foster and Joseph Foster, simply resigned and received from the company as "compensation" a payment calculated in accordance with the relevant Article. When their cases reached the Court of Appeal the latter held that the payments received by them were emoluments from their employment and assessable in the year of receipt, rather than "compensation for loss of office" as had been the decision of the Special Commissioners and Rowlatt J. on their appeals by way of Case Stated. It had been argued that if payments were emoluments, then they should be distributed or spread over not less than the five years referred to in the Article. In rejecting this contention Lord Hanworth, M.R. said, at page 630([1]):

> "The last point that I need to refer to is the one which was put forward very cogently by Mr. Grant, namely, that if the sum is payable it must be distributed over the years during which the qualification for it lasted, that is to say, not less than five years. To my mind, interesting as that argument may be, it is fallacious. There are certain conditions to be fulfilled before the sum as a totality falls to be paid, but when the conditions have been fulfilled the sum as a total is to be paid. There is no indication that it is to be distributed over the number of years served. It seems that after the appropriate period of five years service in the one company or the other had been completed, the director became entitled to receive this sum, if and when his directorship came to an end, or he died, but he might continue to be a director for another three or four or five years, and are you to say when ultimately the sum is paid, that is distributable over the number of years respectively during which the service as a director has been fulfilled? I do not think so. It seems to me that the conditions, once they are fulfilled, entitle the director to a lump sum by way of deferred payment, and that deferred payment cannot be split up into component parts, for there is no scheme or system laid down in article 109 whereby that can be done."

In his judgment Lawrence L.J. said, at page 632:

> "Now the sum which was paid to the Respondent, in my judgment, arose and accrued in the last year of the office of director and is therefore properly included in the assessment which was made upon him for the year of assessment, 1925–1926, as a profit from the office in that year, and is not distributable, as has been suggested, either over the whole term of service of the Respondent or over the last five years of such service."

Finally, Romer L.J. at page 633 said:

> "Now, supposing that a director is employed upon the terms that he is to be paid in each year of his service a sum of £1,000 and in the last year of his service a sum of £5,000 in addition to the £1,000, no one I think could doubt in such a case that the £5,000 was a profit of his office, paid to him in respect of his office that it was liable to Income Tax, and was to be treated for the purposes of tax as forming part of his salary for the last year of his office. . . . The case before us is precisely that case, with two exceptions. Firstly, that the sum is not fixed, but has to be ascertained by reference to events which will not be determined until the last year of

([1]) 16 TC 605.

office—that can make no difference at all—and secondly, that article 109 expresses that the sum to be paid in the last year of office is to be compensation for loss of office. Now, do those words make any difference? In my opinion they do not."

The Court of Appeal reached the same conclusion in respect of the third director involved, Commander Dewhurst, although the facts of his case were substantially different. On a further appeal the House of Lords held by a majority that the sums he had received were truly compensation for loss of office and not income assessable to income tax. In these circumstances counsel for the Revenue before us, whilst accepting that the facts of the Commander's case had been different from his two co-directors, nevertheless contended that the House of Lords had clearly indicated a view different from that of the Court of Appeal, and that at the highest the passages from the judgments in the Court of Appeal which I have quoted should be treated as no more than *obiter dicta,* if not as actually wrong in law.

However the Law Lords in the majority in Commander Dewhurst's case expressly said that the case had to be decided on its own special circumstances and left open the question of the correctness or otherwise of the decision of the Court of Appeal in the cases of the other two directors. In any case the difference was as between compensation for loss of office on the one hand and an emolument from employment on the other: no view was expressed in the House of Lords about the validity of the view of the Court of Appeal that the emolument, if such it was, could not be spread over the five-year period and I regard the judgments in the Court of Appeal on this point as part of the ratio of the Court's decision and thus at least clearly persuasive on us when we have to consider the similar point in the instant appeal.

In *Dracup* v. *Radcliffe*[1] the Appellant was appointed a director of a company on 18 May 1942. An assessment was raised for the year 1942–43 on remuneration voted to her on 28 July 1942 in respect of her services from her date of appointment to the end of the company's year on 30 June 1942, and on the proportion to 5 April 1943, of the remuneration for the year to 30 June 1943, voted to her on 27 July 1943. The Appellant contended that the assessment should be based on the remuneration voted on 28 July 1942, and no more. Dismissing her appeal, MacNaghten J. thought that the case raised merely a question of fact to which the answer was clear. I respectfully agree and do not think the learned Judge sought to apply any relevant principle of law. He dealt with the case entirely on its own facts which were very different from those in the instant case.

In *Heasman* v. *Jordan*[2] the Appellant taxpayer was employed by a firm of aircraft manufacturers; he entered their employment on 21 May 1941 and was paid on a monthly basis. During the years 1941–45 the members of the monthly staff worked long hours for six and a half days a week and without normal holidays, for which they received no overtime pay on the understanding that they would receive compensation later. As a result of a resolution of the board of directors of the company dated 27 June 1945, the Appellant received, in July 1945, a special bonus payment of £1,250 expressed to be a mark of "appreciation of the loyalty and industry of the monthly staff during

(1) 27 TC 188. (2) 35 TC 518.

the war years in the form of a gratuity". On the taxpayer's appeal against an assessment under Schedule E for the year in which the bonus was received, Roxburgh J. held that there was no statutory presumption one way or the other; it was a question of fact in each case. On the facts of the case before him he held that it was clear that the bonus had not been intended to be a reward for services in the year of receipt only, but for the Appellant's services during the war since his appointment on 21 May 1941. He therefore remitted the case for adjustment of the assessment accordingly.

In my opinion this decision is no authority for the wide principle contended for in the instant appeal. I think that it merely reiterated that it is a question of fact in each case. On the facts of the two cases to which I have just been referring it is wholly understandable that they should have been decided as they were. In so far as is relevant to the present appeal I do not think that in *Board of Inland Revenue* v. *Suite*(1) the Privy Council did any more than agree with the factual approach adopted in both the *Dracup*(2) and *Heasman* cases.

On behalf of the Appellant taxpayer before us, Counsel submitted that the learned Judge had been wrong in stating the principle as he had. Emoluments for purposes relevant to this case, it was argued, can be put into one of three categories:

(1) For specific services or services rendered in a specific period or periods and thus properly assessable as income for the period or periods in which the services were rendered;

(2) those which arise from the employment but are not paid for services in the employment. These can only be taxed for the year of assessment in which they are paid: whether they can be so assessed is subject to an operation of the source doctrine;

(3) those which arise from the employment and are to some extent remuneration for services, but only services generally, not for any specific services in any specific period.

In support of these submissions we were referred first to *Brumby* v. *Milner*(3) 51 TC 583. Walton J. held that the present case differed only in one way; namely that the sums were paid after the termination of the employment rather than during it. He held, however, that for present purposes this was a distinction without a difference when, as here, the payments were unaccompanied by any other reason for making them than service as an employee.

The facts of *Brumby's* case were indeed very similar. A public company set up a trust for the benefit of its employees. It was a genuine profit sharing scheme. There was power to terminate on one year's notice and then to distribute the net balance of the trust fund among the employees and pensioned ex-employees in such proportions as the trustees should determine otherwise in equal shares. Ultimately the House of Lords decided that the payments made on the determination of the trust arose from the recipients' employment and nothing else. It was because of this authority that the taxpayer in the instant appeal no longer argues the first point, namely that the relevant receipt was not an emolument from the employment.

(1) [1986] AC 657. (2) 27 TC 188. (3) [1976] 1 WLR 29.

A However in *Brumby's* case the taxpayer had been assessed for only one year, namely that of the year of receipt, and this was at a time when his employment was still in existence. Therefore there was a source to which the payment and receipt could be related. There was no suggestion that the amount received should be spread over the years of service in any way. It will be apparent that there is a substantial difference in the facts of the instant B case. For when the relevant monies were received, in the Distribution Year, the taxpayer's employment had ceased. Hence there was no source for the monies and thus it is contended that they were not assessable.

That an emolument from an employment is not necessarily one for service or services is shown by the decision in *Hamblett* v. *Godfrey*(1) [1987] STC 60. That case concerned payments of £1,000 made to GCHQ employees C for relinquishing trade union membership. The taxpayer in that case said (rightly) that her £1,000 was not remuneration for services, and argued that therefore it was not an emolument. This contention was upheld by the Special Commissioners.

However, on appeal, Knox J. held to the contrary that the payment was an emolument, that it was from the employment and that it was accordingly D assessable under Sch E. The Court of Appeal upheld the learned Judge's decision. At page 71 of the report Neill L.J. said;

> "Thus these passages, as well as those to which Purchas L.J. has already referred in greater detail demonstrate to my mind that emoluments from employment are not restricted to payments made in return for the performance of services."

E We were referred to a number of other cases in which payments found to be emoluments from a taxpayer's employment were nevertheless held not to have been paid for service as an employee in that employment. In each case the payments were assessed once only in the year of the receipt of money or the relevant perquisite. It was never argued that they could or should be spread over a period of years on the basis of the learned Judge's challenged F reasoning in this case. Thus these cases are not direct authority in support of the submission that the learned Judge was wrong. However, if his reasoning could be supported, I find it surprising that the point was not taken in these cases. To have spread the payments and receipts over a period of years could only have been for the benefit of the taxpayer. See *Edwards* v. *Roberts* 19 TC 618, *Dale* v. *de Soissons*(2) 32 TC 118, *Abbott* v. *Philbin*(3) [1961] AC 352 and G *Tyrer* v. *Smart*(4) [1979] 1 WLR 113.

In my respectful opinion, therefore, the learned Judge's conclusion that an emolument from an employment must of necessity and as a matter of law be attributed to a period of periods of that employment is erroneous. I think that the year or years of assessment to which to attribute such an emolument is a question of fact to be decided in the light of all the circumstances of the H particular case. From the very nature of an emolument from an employment it may well be that in most cases this has indeed to be attributed to a year or particular years of the employment. But this does not necessarily follow. In the instant case the Special Commissioner has made a finding that there was no justification on the facts to attribute all or any part of the relevant receipts

(1) 59 TC 694. (2) [1950] 2 All ER 460. (3) 39 TC 82. (4) 52 TC 533.

to the year of assessment 1978–79 (the last employment year), nor for apportioning them between all the years back to 1958–59. The Special Commissioner has in effect made a finding that the receipt of the relevant monies was attributable to the Distribution Year, but that as the taxpayer was not then employed, there was no source in that year, and thus no liability to tax. That is a finding which cannot be disturbed on appeal save on *Edwards* v. *Bairstow*[1] principles, which no one suggests are applicable. In any event I respectfully agree with the finding of the Commissioner which accords with common-sense. I further agree with the contention put in the course of argument that *prima facie* a receipt of an emolument is assessable in the year it was received, unless grounds for attributing it to a specific previous period or periods exist. The Special Commissioners has held that none existed in the instant case and I agree.

Finally, the correctness of the Special Commissioner's view can perhaps be tested by asking how any apportionment would be made if it had to be made. Clearly the process would be a very difficult one. On the evidence the Trustees had to assess the amounts to be paid to each recipient on the basis of their informed assessment, not based on any strict arithmetical grounds, of a fair distribution. This despite the fact that they had previously obtained several computer printouts showing the effect of applying various formulae to ascertainable factors such as length of service and seniority, and then of scaling down maximum benefits in various ways. If the Trustees themselves acted so, I think that it would be impossible to attribute the monies which they ultimately resolved to pay to some one or more years of the taxpayer's employment on any rational basis which the courts could support.

In this case, in the first instance the Revenue attributed the taxpayer's relevant receipt to the Distribution Year. When they appreciated their difficulty under the source doctrine they sought to apportion the receipt over the whole 21 years of the taxpayer's employment. In argument Counsel for the Revenue sought to suggest that if this were incorrect, then the receipt should be attributable either to the eligibility periods under the respective trust deeds, or finally to the day when the trusts were terminated and the Trustee's obligations to determine the various entitlements arose. However if the Revenue's first or second choice cannot be substantiated, I for my part would be averse to giving them a third, or possibly a fourth opportunity to get it right.

For all these reasons I would allow the taxpayer's appeal, set aside Walton J.'s Order and reinstate the decision of the Special Commissioner.

Balcombe L.J.:—I have had the advantage of reading in draft the judgment of May L.J. and agree with him that this appeal should be allowed. As we are differing from the judgment of Walton J. I add a few words of my own.

I accept the final submission of Mr. Andrew Park, Q.C., Counsel for the taxpayer before us, that the logical sequence of the questions which fall to be answered in this case is as follows:

(1) Was the sum of £18,111 paid to the taxpayer by the trustees of the employees' Trust Funds pursuant to resolutions dated 21 December

(1) 36 TC 207.

A 1979 (i.e. during the fiscal year 1979–80) an emolument from his employment by the Company? The taxpayer has not appealed from the finding that this was an emolument, so that the answer to this question is in the affirmative.

(2) To which year or years of assessment should this emolument be attributed? This is the sole issue which we have to decide.

B (3) Did the source of income exist during the year or years in question? The Revenue now accept that if the payment is to be attributed to the fiscal year 1979–80 then there was no source in that year and the "source doctrine" precludes a charge to income tax under Schedule E.

Accordingly I return to the second question. The learned judge dealt with this question in the following passage from his judgment (Transcript C P.16C-G)([1]):

"I turn now to the second question which arises: namely, given that the payments in question are emoluments arising from Mr. Best's employment by the Company, is it possible to attribute a year or years of assessment to such payments? The learned Special Commissioner decided this question in the negative, and I have a great deal of sympathy D with him in this conclusion. But I find Mr. Potter's simple submission that this conclusion is logically indefensible wholly convincing. If paid for service as an employee, it must be paid in respect of some period of service, whether that be a definable special period or whether, on the other hand, the payments have to be regarded as spread over the whole of the period of service of the employee. Of course, having regard to the E precise facts of this case it may be (and, indeed, I think it is) extremely difficult to say in respect of precisely what period of service these payments were made; that is to say, the additional emoluments were paid. But that they must be attributed to some is, in my view, inescapable."

Unlike the learned Judge, I am quite unable to accept that it logically F follows that if a payment is made to an employee for services generally, and not for some specific services or for services during a specific period, then that payment must be made in respect of some period of service. Far from this conclusion being inescapable, it seems to me that, approaching the matter without reference to the decided cases, a payment which is, whether in whole or in part, for services generally, should be attributed to the year in which it is G paid unless there is material which enables one to say that it should be attributed to some other period or periods.

In the present case the Special Commissioner made the following finding of fact as to the basis on which the Trustees of the Funds arrived at the payment of £18,111 to the taxpayer([2]):

"Between April and December 1979 the trustees of each Fund H arrived at the allocations to be made to their respective Eligible Employees in accordance with paragraph 2 of the Schedule. In so doing, they were at pains to arrive at a division which was as fair as possible, and which would be seen in that light by the beneficiaries. To this end, several computer printouts were obtained showing the effect of applying

([1]) Page 729E *ante*. ([2]) Page 716A *ante*.

various formulae which attached different respective weights to length or service with the Company and salary levels, and the effect of limiting or scaling down the maximum benefits in various ways. Both sets of trustees concluded that none of the printouts produced a wholly acceptable pattern, but that one of them provided a useful basis for further discussions. In the event both sets of trustees agreed on substantial departures from the figures yielded by applying the formula underlying the computer printout which appeared to be the most appropriate, and in particular they agreed on a cut-off point, thus releasing funds for distribution pro rata to points lower down the scale, thereby reducing differentials. In the result, the total of the allocations made to Mr. Best (£18,111) was some £3,300 greater than it would have been if both sets of trustees had simply adopted the figures produced by the best of the computer printouts."

From these findings it seems to me quite impossible to say that the payment can be attributed to any particular period or periods of the taxpayer's service with the company. I accept Mr. Park's submission that the payment in this case, although in some part by way of remuneration for services—and thus distinguishable from cases such as *Hamblett* v. *Godfrey*(1) [1987] STC 60, where the sum in question, although an emolument, was not in any sense a payment for services—was, in so far as it was in particular connection with any specific services or any specific period.

This conclusion is supported by the authorities. In *Henry* v. *Foster; Hunter* v. *Dewhurst* 16 TC 605, payments had been made to a director of a company when he resigned from office, which it was held by the Court of Appeal constituted a profit of the office of director and assessable to income tax under Sch E. The assessment had been made in respect of the last year of office, when the sum in question had been paid, but the taxpayer argued that it should be attributed to the whole (or, because of the particular way in which the sum was calculated, the last five years) of his service as a director. The Court of Appeal dealt with this argument in the following passages from the judgments:

Per Lord Hanworth, M.R. (at pp 630–1)(2):

"The last point that I need refer to is the one which was put forward very cogently by Mr. Grant namely, that if the sum is payable it must be distributed over the years during which the qualification for it lasted, that is to say, not less than five years. To my mind, interesting as that argument may be, it is fallacious. There are certain conditions to be fulfilled before the sum as a totality falls to be paid, but when the conditions have been fulfilled the sum as a total is to be paid. There is no indication that it is to be distributed over the number of years served. It seems that after the appropriate period of five years service in the one company or the other had been completed, the director became entitled to receive this sum, if and when his directorship came to an end, or he died, but he might continue to be a director for another three or four or five years, and are you to say when ultimately the sum is paid, that it is distributable over the number of years respectively during which the service as a director has been fulfilled? I do not think so. It seems to me that the conditions, once they are fulfilled, entitle the director to a lump sum by way of deferred payment, and that deferred payment cannot be

(1) 59 TC 694. (2) 16 TC 605.

A split up into component parts, for there is no scheme or system laid down in article 109 whereby that can be done."

Per Lawrence L.J. (at p.632)([1]):

"Now the sum which was paid to the Respondent, in my judgment, arose and accrued in the last year of the office of director and is therefore properly included in the assessment which was made upon him for the
B year of assessment, 1925–1926, as a profit from the office in that year, and is not distributable, as has been suggested, either over the whole term of service of the Respondent or over the last five years of such service."

(In fairness to the learned Judge, I should say that he was not referred to this case by either party).

C In *Abbott* v. *Philbin*([2]) [1961] AC 352 an employee had been given an option to purchase shares in the company by which he was employed. It was held that the option was an emolument received by him by virtue of his employment, and the question arose whether he should be assessed for the year of assessment in which he received the option, or on the profit he made during the year of assessment when he exercised the option. The majority in
D the House of Lords held that the taxable receipt lay in the acquisition of the option, and accordingly the taxpayer should be assessed on its monetary value (if any) at the date of its acquisition and for the year of assessment which included that date. In the course of his speech Lord Reid said (at page 372):

"If a reward is given in the form of an option and the option is itself the perquisite, it would generally be sufficiently related to the year in
E which it is given to be properly regarded as a perquisite for that year."

Since in that case the options had been granted to certain employees of the company, it is reasonable to infer that they were granted, in part at any rate, by way of reward for services generally rendered to the company by those employees.

Heasman v. *Jordan* 35 TC 518 is an example of a case where on the facts,
F it was clear that the payments in question were attributable to particular years of service, and so were properly apportioned between the years of assessment in which those years of service fell. See in particular the judgment of Roxburgh J. at page 528:

"Now, what are the facts here? The bonus was not calculated with reference to output in the year of assessment, nor were all members of
G the staff in one salary group paid equal amounts. The bonus was correlated with the length of service of the particular member of the staff during the war years, and it was limited to the monthly staff to the exclusion of the weekly staff. Where a particular member of the staff had been transferred during the war period from weekly payment to monthly payment of remuneration, only his monthly service was taken into
H consideration. The bonus was given in pursuance of a promise which had been reiterated in many directions over many years. The very terms of the letter which accompanied the payment seem to me clearly to show that the bonus was not intended to be a reward for services rendered in that particular year of assessment only."

([1]) 16 TC 605. ([2]) 39 TC 82.

Dracup v. *Radcliffe* 27 TC 188 is another example of a case which turned on its particular facts. A

I do not need to refer to the other authorities mentioned by May L.J., save to say that in respect of *Edwards* v. *Roberts* 19 TC 618, *Dale* v. *De Soissons*[1] 32 TC 118 and *Tyrer* v. *Smart*[2] [1979] 1 WLR 113, it is surprising, to say the least, that the argument now advanced by the Revenue and accepted by the Judge was not in any of those cases advanced by the taxpayer, to whose manifest advantage it would have been to have had his benefit apportioned over a number of years of assessment, corresponding to his period of service. B

Finally, it seems to me that, if the sum of £18,111 in this case is to be apportioned as having been paid in respect of some period or periods of the taxpayer's service with the company, it should be possible for the court to state, for the guidance of the Special Commissioner who has to make the apportionment, the principles which he should apply in so doing. This I find it quite impossible to do in the light of the finding by the Special Commissioner, to which I referred above, as to the basis on which the Trustees of the Funds arrived at their decision. Mr. Charles Potter, Q.C. for the Revenue, submitted that there are three possible bases for an apportionment: C D

(a) Over the years of eligibility. In the case of one fund (the General Fund), to be eligible to benefit from the distribution a person had to have been employed by the company at the termination date (29 March 1979) and have been so employed on 31 December 1977. In that case the period of eligibility was some 15 months. In the case of the other (Harry Jarrom) Fund, the period of eligibility was from 31 December 1975 to 29 March 1979, some 39 months. E

(b) Over the whole period of the employment of each individual by the company. In the case of the taxpayer this amounted to 21 years and was the Revenue's second choice in this case.

(c) To a particular date, viz. 29 March 1979, the day on which the trust terminated and when an employee finally completed his qualification. F

These widely differing possibilities, none of which is obviously preferable to any of the others, demonstrates to me the impossibility in the present case of attributing the payment of £18,111 to any year of assessment other than that in which it was paid. That is the year to which it is *prima facie* attributable, and it is only the application of the "source doctrine" which prevents it being assessed for that year. G

Accordingly I agree that the appeal should be allowed, the order of Walton J. set aside and the Special Commissioner's decision restored.

Woolf L.J.:—I also agree this appeal should be allowed. I do however recognise the force of Walton J.'s reasoning and initially I was of the view that it was correct. H

As Viscount Simonds pointed out in *Abbott* v. *Philbin*[3] [1961] AC 352 at page 367 it is a "notoriously difficult problem as to the year to which for the purposes of this tax a payment should be ascribed, if it is not expressly

(1) [1950] 2 All ER 460. (2) 52 TC 533. (3) 39 TC 82.

ascribed to any particular year". It is therefore important as stated in both the judgments of May and Balcombe L.JJ., which I have seen in draft, to adopt the *prima facie* approach that an emolument is assessable for the year of assessment in which it is received unless there are grounds for attributing it to some other period. Where, however, an emolument in respect of an employment is received in a year of assessment which commenced after the date of termination of that employment, this could be regarded in itself as being grounds for attributing the payment to an earlier year of assessment during which the employment existed since what is being assessed is the emolument from that employment. This approach accords with the scheme of the Income and Corporation Taxes Act 1970. Emoluments from any office or employment would be charged under s 181 for a chargeable period or periods falling within the period of employment and payments to a past holder of employment could be chargeable under s 187 of the Act, subs (2) of which defines the payment to which the section applies in wide terms but not in terms which would necessarily apply to all emoluments paid after the termination of the employment if they were not inevitably chargeable under s 181 contrary to the contention of the Revenue. The terms of subs (2) of s 187 (with my emphasis) are as follows:

> "This section applies to *any payment* (not otherwise chargeable to tax) *which is made*, whether in pursuance of any legal obligation or not, *either directly or indirectly in consideration or in consequence of, or otherwise in connection with, the termination of the holding of the office or employment or any change in its functions or emoluments,* including any payment in commutation of annual or periodical payments (whether chargeable to tax or not) which would otherwise have been made as aforesaid."

None of the authorities referred to by Counsel for the taxpayer or for the Revenue debar such an approach. They do not deal with emoluments received by an employee in a year of assessment after the employment ceased. At most it can be said about the authorities that it is surprising that if the approach now adopted by the Revenue and which was accepted by the Judge is correct no hint of this appears in any earlier decision dealing with this difficult subject. However this is not the first time and it will not be the last that if the Revenue are correct in the arguments which they advance they have to concede that they have only recently identified the proper approach.

However, if the approach is correct, then it is difficult to identify any scope for the application of the so-called "source doctrine". A doctrine, the existence of which Mr. Potter did not seek to dispute, and which, as Mr. Andrew Park pointed out, is now of some longstanding and apparently still applied by the Revenue in respect of some other categories of former employees.

Furthermore if the solution contended for by the Revenue and accepted by the learned Judge is adopted, there has to be some method by which the emolument can be attributed to an earlier chargeable period or periods during which the employment still existed. Mr. Potter submitted that which period or periods was applicable was a question of fact to be determined by the Special Commissioner on the case being referred back to him as was ordered by the Judge. Mr. Potter profferred three possible choices of decision as being available to the Special Commissioner: (a) the payments should be spread equally over the period of employment; (b) the payments should be spread equally over the years during which the Appellant became qualified to

receive the payment; or (c) the date of termination of the employment which was the date on which the Appellant became eligible to receive the payment. Of these three choices Mr. Potter was unable to identify the one which produced the right answer or any principle or presumption or guide which would assist in providing the correct result and he candidly conceded that his preferred choice changed from time to time. May and Balcombe L.JJ. have referred to the difficulties which the Special Commissioner found in seeking to perform this exercise before he came to his decision, and this appeal has made clear that if the learned Judge's decision is right absurd situations could arise in cases where, as here, there really is no material upon which a rational allocation of the payment can be made to an earlier chargeable period or periods during which the employment existed. The task would not merely be a difficult one (Special Commissioners are frequently faced and are used to dealing with extremely difficult tasks) but one which would be completely haphazard. As the period or periods over which the payment is spread can affect the quantum of tax which is payable this consequence is highly undesirable. Particularly because, as here, there can be a number of employees in a similar situation, so unless appropriate administrative steps are taken different Commissioners could select different periods for different employees on identical facts and their decisions would be unimpeachable and incapable of being disturbed on appeal.

Fortunately this Court is not compelled to uphold an approach to this appeal which would have such highly undesirable consequences. As the judgments of May and Balcombe L.JJ. make clear, the earlier decisions on this difficult subject, while not conclusive, are wholly consistent with the conclusion reached by the Special Commissioner. The existence of the source doctrine makes it possible for an emolument received after the termination of the employment to be not chargeable under s 181 where, as here, there are no circumstances, apart from the termination of the employment, suggesting any chargeable period other than the chargeable period during which the payment was made. The cases where it will be not possible to identify any earlier chargeable period should be few but in those cases the correct solution is not to require the Special Commissioners to come to a decision for which there is no logical justification but to treat the payment as falling into charge in the year of assessment when it is paid albeit that this has the result that no tax will be assessable thereon under s 181. It is on this basis that I agree, for the reasons given in the judgments of May and Balcombe L.JJ., that this appeal must be allowed.

Appeal allowed, with costs here and below.

The Crown's appeal was heard in the House of Lords (Lords Mackay of Clashfern, Keith of Kinkel, Brandon of Oakbrook, Oliver of Aylmerton and Goff of Chieveley) on 28, 29 and 30 November 1988 when judgment was reserved. On 23 February 1989 judgment was given unanimously against the Crown, with costs.

John Chadwick Q.C. and *Alan Moses* for the Crown.

Andrew Park Q.C. and *Richard Bramwell* for the taxpayer.

A The following cases were cited in argument in addition to the cases referred to in the judgment:—*Grainger* v. *Maxwell* 10 TC 139; [1926] 1 KB 430; *Purchase* v. *Stainer's Executors* 32 TC 366; [1952] AC 280; *Carson* v. *Cheyney's Executor* 38 TC 240; [1959] AC 412; *Abbott* v. *Philbin* 39 TC 82; [1961] AC 352; *Dracup* v. *Radcliffe* 27 TC 188; *Edwards* v. Roberts 19 TC 618; *Clayton* v. *Gothorp* 47 TC 168; [1971] 1 WLR 999; *Dale* v. *de Soissons* 32 B TC 118; [1950] 2 All ER 460; *Ede* v. *Wilson* 26 TC 381; [1945] 1 All ER 367; *Tyrer* v. *Smart* 52 TC 533; [1979] 1 WLR 113; *Yuill* v. *Wilson* 52 TC 674; [1980] 1 WLR 910; *Cowan* v. *Seymour* 7 TC 372; [1920] 1 KB 500; *Beynon* v. *Thorpe* 14 TC 1; *Stedeford* v. *Beloe* 16 TC 505; [1931] 2 KB 610; *Hofman* v. *Wadman* 27 TC 192.

C **Lord Mackay of Clashfern**—My Lords, I have had the advantage of reading in draft the speech about to be delivered by my noble and learned friend Lord Oliver of Aylmerton. I agree with his reasoning and conclusion that this appeal should be dismissed.

In the course of the hearing of this appeal their Lordships found that on occasion the report of a case in Tax Cases may appropriately be referred to D even when the case is also reported in the Official Reports. Accordingly I consider that for the future in this House counsel should be entitled if they think that the more convenient course to use the report of such a case in Tax Cases rather than in the Official Reports but if they decide to do so the references to the case in the Official Reports should also be given.

Lord Keith of Kinkel—My Lords I have had the opportunity of E considering in draft the speech to be delivered by my noble and learned friend Lord Oliver of Aylmerton. I agree with it, and for the reasons given by him would dismiss the appeal.

Lord Brandon of Oakbrook—My Lords, for the reasons given in the speech of my noble and learned friend, Lord Oliver of Aylmerton, I would dismiss the appeal.

F **Lord Oliver of Aylmerton**—My Lords, This appeal is concerned with the assessability to income tax under Schedule E of distributions made by the trustees of two trust funds established for the benefit of the employees of a trading company which was taken over by a larger organisation, such distributions having been determined upon and made after the cessation of the relevant employment. The company, A. Gallenkamp and Co. Ltd., was G an old established family company carrying on the business of manufacturing laboratory equipment. Towards the latter part of the 1950s, the directors, partly with a view to making the company less vulnerable to take-over and partly to provide additional incentive for its employees, established a trust fund for the benefit of employees. By a trust deed dated 3 December 1957 and made between the company of the one part and three trustees (the H company's chairman, its solicitor and its accountant) of the other part, it was provided that during a lengthy trust period, defined by reference to the life of the survivor of all descendants then living of his late Majesty, King George V, the trustees should hold the trust fund (being such sums as should from time to time be advanced by the company for the purposes of the deed) on trust to

raise thereout and apply such sums as should be necessary for the subscription or purchase of such fully-paid shares in the company as the company should direct. It is unnecessary to recite the trusts of the deed in any detail beyond saying that the beneficiaries were confined to employees who had not themselves sold or transferred shares to the trustees and that provision was made for shares purchased by the trustees to be offered to employees of the company, for the income in each year to be divided at the company's discretion among such qualified employees as the company should determine and, in so far as not so applied, for it to be invested as an accretion to capital and for the trustees in their discretion at any time to determine the trust. There was also reserved to the company a wide power in its discretion to alter or modify the trusts or provisions of the deed.

In 1961 the trustees purchased from a Mrs. Jarrom, the widow of a former managing director, a substantial parcel of shares which were segregated and made the subject of a separate trust which closely followed the pattern of the 1975 deed, save that income was distributable at the trustees' rather than the company's discretion and that the employees and directors eligible to benefit were limited to those with 10 or more years' service. The reason for this, it appears, was that Mrs. Jarrom had expressed a wish that a separate fund should be established in memory of her late husband, Harry Jarrom, and that it should be for the benefit of long-serving members of the company's staff.

On 25 August 1977 the company became a wholly owned subsidiary of Fisons plc. and following this the trustees anticipated that there might come a time in the future when the company's work force would be absorbed by the parent company and they might either find themselves with no beneficiaries or find themselves unable effectively to restrict the beneficiaries to employees who had given service to the company. They accordingly set about making arrangements to wind-up the trusts, arrangements which, in 1979, were accelerated by the knowledge that the parent company planned to transfer all the employees of the company to its own employment on 1 April 1979. By deeds dated 15 March 1979, both the trusts were varied, the material alterations for present purposes being (1) the insertion, for the protection of the trustees on any distribution, of a clause enabling them to rely conclusively on a signed statement of the secretary of company containing particulars of the employees on any particular date and containing information regarding length of service, salary and other data relating to any employee and (2) the substitution, by way of a schedule, of new trusts to take effect on the termination of the trust period. So far as material the provisions to the schedule of the 1957 deed were as follows:

> "1. In this schedule:
>
> (1) ...
>
> (2) The "termination date" means the date of expiration or earlier termination of the trust period.
>
> (3) "Eligible employee" means a person who was at the 31 December 1977 and is at the termination date an employee of the company (including a director holding salaried employment or office with the company) but who has not at any time before the termination date sold or transferred any share in the company to the trustees for the time being of the principal deed.

A (4) . . .

(5) The terminal fund means the net moneys remaining held by the trustees . . . after payment of or provision for . . . liabilities . . .

2. The trustees shall within the nine months immediately following the termination date pay or provide for all liabilities mentioned in the definition of the terminal fund and apply the terminal fund by allocating B thereout in respect of each eligible employee such a sum as the trustees shall in their absolute and unfettered discretion think fit but so that

A. No eligible employee shall be entitled to receive as of right any sum allocated to him.

B. The trustees shall apply all sums allocated to eligible employees in one or more of the following ways and such application C shall be made within three months of the allocation in question (the choice of application to be in the absolute and unfettered discretion of the trustees) namely:

(i) By paying the same to the eligible employee in each case or where the eligible employee is dead, to his personal representative as an accretion to his estate; (ii) By purchasing from an insurance D company . . . a non-commutable non-assignable annuity policy in his name the annuity whereunder is payable as from his attainment of age 65 (or in the case of a woman age 60) or, if such age has already been attained at the date of purchase, is payable as an immediate annuity.

(3) Every allocation and application shall be made in writing and E pursuant to a unanimous resolution of the trustees.

(4) The trustees before making any payment shall be entitled to deduct or make provision for all taxation payable by the trustees in respect thereof.

(5) Subject to the trusts aforesaid, the trustees shall hold the terminal fund upon trust to divide and pay the same to and amongst all F the eligible employees in shares proportional to their salaries for the year ended 31 December 1978 . . . and any payment so falling to be made to an eligible employee who has died before it has been made shall be paid to his legal personal representatives"

The schedule to the amended deed regulating the Harry Jarrom Trust was in similar terms save that eligible employees were limited to those who G had been in the service of the company on 31 December 1975.

These alterations having been effected, the trustees, by deeds dated 29 March 1979, directed that the trust period in relation to each fund should thereupon terminate in relation to the whole of the trust property. It thus became necessary, unless the ultimate trust in default was to take effect, for the trustees to allocate the funds among the eligible employees before the end H of December 1979. On 1 April 1979 all the company's employees were transferred to the employment of the parent company and their employment by the company ceased. On the previous day, a notice had been posted on the company's notice board informing employees of the existence of the trusts, announcing their winding-up and outlining the procedure which would be

followed. For many employees this may well have been the first occasion on which they were aware of the existence of trusts. A

The trustees were concerned that the division of the funds should be conducted as fairly as possible and various computer print-outs were obtained showing the effect of applying various formulae which attached different weights to length of service and salary scales. None of these was actually adopted, but they were used to form the basis for ultimate allocation, B although, by adopting a lower cut-off point to reduce differentials, there was a substantial departure from the figures yielded by the print-outs. By written resolutions dated 21 December 1979 the trustees of both funds resolved on the allocation of the funds among some 770 employees (633 in the case of the Harry Jarrom trust fund) in accordance with the decision at which they had ultimately arrived. As a result there became payable to the taxpayer an C aggregate sum of £18,111 from the two funds being as to the major part capital before provision for tax and as to the balance interest after provision for tax at 45 per cent. On 22 February 1980 letters were dispatched to each qualified employee stating the amount allotted and on 18 March 1980 the trustees passed formal resolutions for the application of the funds in accordance with the allocation. A small number of allocations was made in D the form of annuity purchases but the majority were applications of cash, including those to the taxpayer, Mr. Best, who was a senior employee who had been in the service of the company continuously since 23 April 1957.

On 4 March 1983, the Inspector of Taxes raised assessments on the taxpayer in respect of each year from the year 1958–59 to the year 1978–79 (inclusive) in sums which represented the Inspector's calculation of an E appropriate proportion of the taxpayer's total allocation from the funds for each year of his service, the assessment for the year 1978–79 being in a sum of £13,728 which was intended as an alternative assessment raised on the footing that the whole allocation was chargeable for that year and to be reduced appropriately if the remaining assessments were confirmed on appeal to the Commissioners. The taxpayer appealed to the Special Commissioner who, on F 16 February 1984, allowed the appeal and, at the request of the Crown, stated a case for the High Court. The underlying basis of the Special Commissioner's conclusion was that although the sums allocated to the taxpayer constituted an emolument from his employment which would otherwise be taxable under Case I of Schedule E they escaped the charge to tax because they could not be attributed to any year of assessment other than the year 1979–80 in which the G taxpayer's entitlement arose; and that, since in that year there was no employment of the taxpayer and consequently no source from which the emolument arose, there could be no charge to tax under Schedule E, Case I, although it was not disputed and had never been disputed that there was a liability under s 187 of the Income Tax and Corporation Taxes Act 1970 but subject to the exemption provided in s 188 of that Act. On 20 January 1986, H Walton J. allowed the Crown's appeal, holding that emoluments from an employment must be paid in respect of some period of service which must either be a definable period or, failing that, the whole period of the employment. He accordingly remitted the matter to the Commissioner to determine, as a question of fact, over what period the sums allocated should be deemed to have been earned and how they should be apportioned. From I this decision the taxpayer appealed to the Court of Appeal, which unanimously allowed the appeal and upheld the conclusion of the Special Commissioner.

A My Lords, the relevant statutory provisions fall within a small compass. Section 181 of the Income and Corporation Taxes Act 1970 provides (so far as material) as follows:

"(1) The Schedule referred to as Schedule E is as follows:

SCHEDULE E

1. Tax under this Schedule shall be charged in respect of any office
B or employment on emoluments therefrom which fall under one, or more than one, of the following Cases

Case I: Where the person holding the office or employment is resident and ordinarily resident in the United Kingdom, any emoluments for the chargeable period ... and tax shall not be chargeable in respect of emoluments of an office or employment under any other paragraph of
C this Schedule."

Section 183(1) provides that the expression "emoluments" shall "include all salaries, fees, wages, perquisites and profits whatsoever." "Chargeable period" is defined in s 526(5) as "an accounting period of a company or a year of assessment" and "year of assessment" is defined by the same section as meaning "with reference to any income tax, the year for which such tax was
D granted by any act granting income tax".

The only other provisions which ought to be mentioned since they form the foundation of one of the Crown's submissions are ss 29 and 50 of the Taxes Management Act 1970. Sections 7 and 8 of that Act contain machinery for the making of returns by persons chargeable to income tax for any year of assessment and s 29(1) provides for an assessment to be made by a tax
E Inspector. If it appears to the Inspector that there are chargeable profits which have not been included in a return "he may make an assessment to tax to the best of his judgment" (s 29(1)(b)). Alternatively, if an Inspector "discovers" either that profits which ought to have been assessed to tax have not been so assessed or that an assessment to tax is insufficient, he may make an assessment "in the amount, or the further amount, which ought in his
F ... opinion to be charged" (s 29(3)). Section 50 regulates the procedure on an appeal to the Commissioners of Income Tax and subs (6) provides that if on such an appeal it appears to the majority of the Commissioners present at the hearing "by examination of the Appellant ... or by other lawful evidence, that the Appellant is overcharged by any assessment, the assessment shall be reduced accordingly, but otherwise every such assessment
G shall stand good."

The provisions of the Income and Corporation Taxes Act 1970 to which I have referred underline the annual nature of income tax. For an emolument to be chargeable to income tax under Schedule E not only must it be an emolument *from* an employment but it must be an emolument *for* the year of assessment in respect of which the charge is sought to be raised. The
H argument for the taxpayer is a very simple one. Granted, it is said, that the payment to which the taxpayer became entitled out of the trust funds was a profit which derived from his previous employment with the company and thus an emolument from that employment, the only chargeable period *for* which it could possibly be said to have been paid is the year of assessment 1979–80. It is a well established principle deriving from the nature of income

tax as an annual tax, that a receipt or entitlement arising in a year of assessment is not chargeable to tax unless there exists during that year a source from which it arises (see, for instance, *Brown* v. *The National Provident Institution*[1] [1921] 2 AC 222). The principle is conveniently expressed in *Whiteman & Wheatcroft on Income Tax,* 2nd ed. (1976) at p.21, paras. 1–28, as follows:

> "Most types of income are classified by reference to the source from which they come. From this it was held to follow that if a taxpayer ceased to possess a particular source of income, he could not be taxed on delayed receipts from that source unless they were referable to, and could be assessed in respect of, a period during which he possessed the source".

There is, it is argued, no ground for attributing the payment in the instant case to any period other than that in which the taxpayer became entitled to and received it, and since in that period he had ceased to be employed and thus to possess the source from which the entitlement arose, the sum cannot be taxable under Schedule E for that period, although it is not contested that the payment was one made in connection with the termination of his employment and so taxable under the provisions of s 187 of the Act.

The argument of the Crown can, I think, be fairly summarised in the following five propositions:

1. The trusts were instituted as a reward for the services of employees of the company and the payments made to the taxpayer and other ex-employees were found as a fact by the Special Commissioner to be a "reward for their services."

2. A reward for services is the same as remuneration and can only be remuneration for a period during which services are being performed under the contract of service.

3. It follows that the emolument must be for a chargeable period during which the employment continued and in the absence of any clear ascription to any particular year or years of the employment it can only be "for" the whole period of the employment.

4. The Inspector was accordingly entitled to apportion the payment to the best of his ability in the exercise of the judgment which he is called upon to exercise under s 29(1)(*b*) of the Taxes Management Act 1970 or the opinion which he has to form under s 29(3) of that Act.

5. Having regard to the provisions of s 50(6) of the Act, the assessment must stand unless the taxpayer can point conclusively to some other period of apportionment or some more appropriate period of attribution.

In effect, the submission of the Crown amounts to this: that it is in the very nature of an emolument from an employment that it cannot be otherwise than "for" a chargeable period during which the employment continued and it is this that is at the root of the argument, although Mr. Chadwick would, I think, say that he does not have to go this far because he has a finding of fact in his favour which necessarily entails the consequence that the payment to

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(1) 8 TC 57.

A the taxpayer was made for some chargeable period during which the taxpayer's contract of employment was in being.

Although before the Special Commissioner and in the High Court the taxpayer had contested that the sum paid constituted an emolument from his employment, the decision of this House in *Brumby* v. *Milner* (1) [1976] 1 WLR 1096 effectively precludes further argument on this point and the B question has not been pursued either before the Court of Appeal or before your Lordships. Thus the only question which has now to be determined is whether the payments made to the taxpayer comprised or included emoluments for all or any of the chargeable periods 1958–59 to 1978–79 inclusive for which he has been assessed. Nevertheless, although the payment to the taxpayer is accepted to be an emolument from his employment, it is still C necessary for the purposes of answering the only remaining question to determine the nature of the emolument, particularly in the light of the Special Commissioner's finding of fact on which the Crown relies. I turn therefore to that finding. In *Brumby* v. *Milner* in the Court of Appeal [1976] 1 WLR 29, Lord Russell of Killowen in delivering the judgment of the Court said, at p. 36:

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> "We do not consider that the provision for terminal payments can be considered as, so to speak, a throw-away provision bearing no colour of reward for services. The very existence of the discretion to allocate is against this inference. It appears to us that the scheme was one scheme based fundamentally on reward for services by employees, and the fact that after the final payment there was no more by way of bonus to look E for does not relevantly distinguish that final payment."

That was a case the facts of which were very similar to those of the instant case save that there was no question but that the employment was continuing when the payment was made.

So far as material for present purposes the Commissioner's finding was expressed in a passage in which, after quoting the excerpt from the Court of F Appeal's judgment just referred to, he continued: "After careful consideration I find that those words summarise also my view of the facts of the present case, so far as the source of the payment is concerned." A little later he observed "The company was obviously very prosperous and its support for any application for shares amounted in my view to a reward for services."

Mr. Chadwick argues that this amounts to a distinct finding of fact that G the payments made to the taxpayer were remuneration for the services which he rendered to the company and a finding that, since there were no such services rendered in the year in which the taxpayer's entitlement arose, they were remuneration for previous years of service and assessable as such.

My Lords, for my part I find myself unpersuaded that it is possible to deduce from the Special Commissioner's reference to a "reward for services" H a finding that the payment either was or was intended to be, as it were, additional remuneration for services rendered to the company in respect of the previous years in which the taxpayer was employed.The expression "reward for services" in this context probably derives from the decision of this House in *Hochstrasser* v. *Mayes*(2) [1960] AC 376 in which Viscount Simonds,

(1) 51 TC 583. (2) 38 TC 673.

at p. 388 cited with approval the judgment of Upjohn J. in the same case [1959] Ch. 22, 33 where he said:—". . . payment must be made in reference to the services the employee renders by virtue of his office, and it must be something in the nature of a reward for services, past, present or future".

This was merely restating in slightly different terms a test propounded by Viscount Cave L.C. in *Seymour* v. *Reed*(1) [1927] AC 554, 559, where he spoke of an emolument as including "all payments made to the holder of an office or employment as such,that is to say, by way of remuneration for his services". It has, however, to be remembered that in *Hochstrasser* v. *Mayes* both Upjohn J. and Viscount Simonds were speaking in the context of a case in which the only question in issue was whether an indemnity given by an employer formed in effect additional remuneration for the employee's services in the year in question. Lord Radcliffe in the same case pointed out that all the various expressions which had been used to test whether particular payments arose "from" an employment (such as payments "made to an employee as such" or "in his capacity as an employee" or "by way of remuneration for his services") were no more than glosses on the statutory language which might be illustrative but could not be treated as definitive. "For my part", he observed [1960] AC 376, 391–392, "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". In an earlier case of *Bridges* v. *Hewitt* [1957] 1 WLR 674, 691 Morris L.J., referred to an emolument as embracing the "conception . . . that some taxable remuneration may accrue to a person by reason of his having or exercising an office or employment of profit". Again, in *Laidler* v. *Perry*(2) [1966] AC 16, 31, Lord Reid, observed that although the word "reward" had been used in many cases, it was not apt to include all the cases which can fall within the statutory words and he gave as an example a gift made to an employee in the hope or expectation that it would produce good service in the future. Lord Morris of Borth-y-Gest in the same case said, at p. 33 that the facts showed that the employee had received the taxable benefit only "because he was a staff employee". "The reasons for the distribution are to be found in the employer-employee relationship." Similarly Lord Hodson (pp. 33–34) referred to the employment as being the "causa causans" of the receipt in question. It is perhaps worth mentioning that in that case, although the extent of the benefits conferred on employees was directly related to the length of their respective periods of employment there was no question but that they were taxable as emoluments for the year of receipt.

Of course, emoluments include, and indeed normally consist primarily of, sums paid by way of periodic remuneration for services, but it is, I think, clear that that concept is not an essential ingredient of the term. It is worth mentioning that in *Brumby* v. *Milner*(3) [1975] 1 WLR 958, Walton J., whose decision was affirmed both in the Court of Appeal and in this House, adopted Lord Radcliffe's test in *Hochstrasser* v. *Mayes*(4) [1960] AC 376 and expressly rejected the submission that, in order to qualify as an emolument, the sum had to be paid "in respect of services rendered by" the employee. "In return for . . . being an employee" meant, he observed, exactly what it said, although, as he went on to point out, at p. 969 the distinction may seem a semantic one. An employee renders services so that, in some circumstances at least, "in return for being an employee" may be expanded into "in return for

(1) 11 TC 625. (2) 42 TC 351. (3) 51 TC 583. (4) 38 TC 673.

being a person who renders services" and then contracted again into "in return for rendering services." In this House, [1976] 1 WLR 1096 the test adopted both by Lord Simon of Glaisdale and Lord Kilbrandon was whether the profit arose "from the employment or from something else," quoting Lord Reid in *Laidler* v. *Perry* [1966] AC 16. But perhaps the most striking example, which really conclusively negatives the notion of periodic remuneration as an essential ingredient of an emolument, is the recent case of *Hamblett* v. *Godfrey*(1) [1987] 1 WLR 357, where a sum paid to an employee at G.C.H.Q. for relinquishing his right to remain a member of a trade union was held to be a taxable emolument from his employment. In the light of these authorities, I cannot read the phrase "reward for services" as anything more than a conventional expression of the notion that a particular payment arises from the existence of the employer-employee relationship and not, to use Lord Reid's words in *Laidler* v. *Perry*(2) [1966] AC 16, 30, from "something else." I cannot attribute to the Special Commissioner in the instant case the distinct finding of fact for which the Crown has contended and indeed the Commissioner's inability to find any ground for attributing the payment to any year of the taxpayer's service is inconsistent with the suggestion that he regarded himself as having made any such finding. It is, in addition, to be noted that the Special Commissioner adopted Lord Russell's reasoning "so far as the source of payment is concerned." He was at that stage considering only the question of whether the payment was an emolument, not the nature of the emolument.

That, however, is not the end of the case for the question remains whether, finding of fact or no finding of fact, there is necessarily subsumed in the concession that the payment constituted an emolument from the employment a conclusion that it must therefore be "for" a chargeable period within the aggregate period during which the employment subsisted, so that the Commissioner should, in any event, either have upheld the assessment or reallocated the payment in some other manner. My Lords, I can see no reason in logic or authority why it should be nor does such a concept emerge from the various paraphrases of the statutory language to which I have already referred. In the Court of Appeal it was said that there is a *prima facie* presumption that an emolument is paid "for" the year of assessment in which the payee becomes entitled to receive it. I would prefer, however, to say simply that the period to which any given payment is to be attributed is a question to be determined as one of fact in each case, depending upon all the circumstances, including its source and the intention of the payer so far as it can be gathered either from direct evidence or from the surrounding circumstances. In the course of his judgment in the Court of Appeal May L.J. conducted a careful review of the relevant authorities and it would be a work of supererogation to repeat it here. Suffice it to say that *Hunter* v. *Dewhurst* 16 TC 605, is an example of a case where although the payment was calculated by reference to a specified length of past service, it was clearly shown, on the facts to be referable to the year in which the payee became entitled to it, whilst *Heasman* v. *Jordan* (3) [1954] Ch 744 and *Board of Inland Revenue* v. *Suite* [1986] AC 657 are examples of cases in which the facts clearly established the payment in question to be referable to a period other than the year of assessment in which the entitlement arose. I gratefully accept and adopt the conclusion expressed by May L.J. in his judgment [1988] 1 WLR 784 at p. 792 when he said:

(1) 59 TC 694. (2) 42 TC 351. (3) 35 TC 518.

"In my respectful opinion, therefore, the judge's conclusion that an emolument from an employment must of necessity and as a matter of law be attributed to a period or periods of that employment is erroneous. I think that the year or years of assessment to which to attribute such an emolument is a question of fact to be decided in the light of all the circumstances of the particular case. From the very nature of an emolument from an employment it may well be that in most cases this has indeed to be attributed to a year or particular years of the employment. But this does not necessarily follow."

In the instant case, the Special Commissioner could, on the facts, find no feature of any significance which would indicate that the payment made to the taxpayer fell to be attributed either to the last year in which he was employed or to all or any of the previous years during his employment by the company. The Court of Appeal could find none and, for my part, I can find none. The mere fact that the seniority of the taxpayer as an employee was a matter taken into account in arriving at the amount of the distribution does not appear to me to be any indication that the payment determined upon and made in the year of assessment 1979–80 (because that was the only period within which, in accordance with the trusts declared, it had to be resolved upon) can properly be treated as made for or in respect of any other period. I would accordingly dismiss the appeal.

Lord Goff of Chieveley—My Lords, I have had the advantage of reading in draft the speech delivered by my noble and learned friend, Lord Oliver of Aylmerton, and for the reasons he gives, I would dismiss the appeal.

Appeal dismissed, with costs.

[Solicitors:—Solicitor of Inland Revenue; Messrs. Penningtons.]

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