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Case No: CA 2020 000291

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM UPPER TRIBUNAL
Mr Justice Adam Johnson and Judge Raghavan
[2021] UKUT 0082

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 13 May 2022

Before:

LADY JUSTICE SIMLER
LORD JUSTICE PHILLIPS
and
SIR LAUNCELOT HENDERSON

- -

Between:

STEPHEN HOEY & OTHERS	**Claimants/ Appellant**
- and -	
COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Defendant/ Respondent**

- -
- -

Rory Mullan QC (instructed by **RPC LLP**) for the **Claimants** and **Appellant**
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Hearing dates: 28, 29, 30, 31 March & 1 April 2022

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Approved Judgment

This judgment was handed down by the Judge remotely by circulation to the parties' representatives by email and released to the National Archives. The date and time for hand down is deemed to be 13 May 2022 at 10.30

Lady Justice Simler, Lord Justice Phillips, Sir Launcelot Henderson:

1. This is the judgment of the court, to which all its members have contributed.

2. In this judgment we deal first with the claim for judicial review, and thereafter with the various issues that arise on the statutory appeal from the decision of the Upper Tribunal reported as *Hoey v HMRC* [2021] UKUT 0082, [2021] STC 792. The judgment is arranged in five sections as follows:

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I. Introduction

3. During the three tax years in issue in this case (from 6 April 2008 to 5 April 2011), Mr Hoey worked as an IT contractor in the UK for a variety of UK based entities (together referred to as "the End Users") under arrangements with two offshore entities that employed him (together referred to as "the Employers"). There were other taxpayers who participated in the same or similar arrangements. A number of these taxpayers are claimants in the judicial review and followers in the statutory appeals. We refer to them collectively as "the Claimants".

4. Under the arrangements, the Employers paid a significant part of Mr Hoey's remuneration into employee benefit trusts ("the EBTs"). The trustees of the EBTs then made regular interest free loans in an equivalent amount to him in respect of the services he provided to the End Users. In practice it was not expected that the loans would have to be repaid. The arrangements were part of a marketed tax avoidance scheme believed to allow the Employers to make payments through the EBT to Mr Hoey without deducting income tax (or national insurance contributions) under the Income Tax (Pay As You Earn) Regulations 2003 (referred to below as "the PAYE Regulations"). The arrangements were disclosed to The Commissioners for Her Majesty's Revenue and Customs ("HMRC") under the DOTAS legislation; and no income tax was declared payable or paid by Mr Hoey, or the Employers, on the Employers' payments of contributions (which were ultimately received as loans) into the EBTs. There is no suggestion that any part of the arrangements which comprised the tax avoidance scheme was a sham.

5. HMRC issued Mr Hoey with discovery assessments in relation to the contributions to the EBTs (primarily on the basis that they were earnings from employment and liable to income tax) on 18 February 2013 and 5 March 2014 (for the years of assessment 2008/09 and 2009/10 respectively) and made a closure notice in relation to the tax year 2010/11 on 22 December 2015. These are the assessments challenged by Mr Hoey, both by way of statutory appeal under section 31 of the Taxes Management Act 1970 ("TMA") and by way of judicial review.

6. HMRC's primary basis for the assessments was that the contributions to the EBT were taxable as employment income under sections 6, 7, 9, 11 and 13 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA").

7. Although this was originally contested, following the judgment of the Supreme Court in *RFC 2012 plc (in liquidation)(formerly Rangers Football Club plc) v Advocate General for Scotland* [2017] UKSC 45, [2017] 1 WLR 2767, on 12 June 2019, Mr Hoey conceded that the principle established in *Rangers* applied so that the amounts paid by way of EBT contributions for onward loans to him, were earnings from employment and chargeable to income tax on that basis. As the Supreme Court held at [41]:

> "As a general rule, therefore, the charge to tax on employment income extends to money that the employee is entitled to have paid as his or her remuneration whether it is paid to the employee or a third party. The legislation does not require that the employee receive the money; a third party, including a trustee, may receive it. …"

The payments were therefore a component of remuneration for services provided in the employment, and as such constituted taxable employment income subject to deductions in respect of PAYE. The Supreme Court held that the tax charge on employment income had primacy over any specific tax charge on employment-related loans or trust income. Accordingly, in *Rangers* the UK based taxpayer company making the payments into the trust of taxable emoluments should have made the necessary PAYE deductions.

8. Notwithstanding his concession, Mr Hoey's case is that the principal obligation to pay tax on the employment income represented by the EBT contributions is on the

employer. Ordinarily the obligation to deduct PAYE on employment income does fall on an employer when making a payment of employment income. However, the tax can be collected directly from the employee (upon whom the economic burden falls in any event) where a decision or direction to that effect is made. In a case where the obligation to deduct or account remains on the employer (and is not transferred) the employee's self-assessment (if required to make one) should show his or her liability to income tax on the employment income but should then claim the PAYE amount deducted by the employer, as a credit for the PAYE that has been paid (referred to as the "PAYE credit").

9. Moreover, as offshore entities (and absent a taxable presence in the UK) there was no obligation on the Employers to operate PAYE. In these circumstances, section 689 ITEPA treats a person in the UK for whom the employee works as a deemed employer making notional payments of employment income and therefore obliged to deduct or account to HMRC for PAYE on the notional employment income paid. HMRC proceeded on the basis that the End Users were deemed employers subject to PAYE obligations under the Regulations pursuant to section 689(2) in these circumstances. The End Users did not actually make any payments of employment income to Mr Hoey (or other contractors) and, unsurprisingly, they made no deductions of PAYE. Nor was the employment income ever declared in Mr Hoey's own tax returns or self-assessments for the years in question because of the avoidance scheme in which he participated. Indeed, Mr Hoey did not and cannot have proceeded on any assumption, expectation or understanding that the income tax due on payments of contributions to the EBTs had been deducted or accounted for to HMRC by the End Users (or anyone else for that matter).

10. By letter dated 13 October 2017, Andrew Finch, an officer of HMRC, wrote to Mr Hoey informing him that:

> "HMRC retain a discretion under s.684(7A)(b) of ITEPA 2003 not to require a person to comply with the PAYE regulations where it would not be appropriate for that person to do so. In the circumstances of your use of the tax arrangements, I have no reason to believe that the end user of your services was aware of or party to the avoidance and I consider it inappropriate for the end-user of your services to be required to comply with the PAYE regulations in relation to your employment income. As such, you remain liable to pay the tax due…"

Similar letters were issued subsequently to the other Claimants by Scott McFarlane, an officer of HMRC, in May 2019. The decision to relieve the End Users of liability under the PAYE Regulations by exercising the power in section 684(7A)(b) ITEPA (which we shall refer to as the "7A power") meant, according to HMRC, that no PAYE credit was available to Mr Hoey or the Claimants, who remained liable for the income tax due under the assessments on this basis.

11. Mr Hoey disputed the scope, application and legality of the 7A power exercised by HMRC in his case. He also contended that exercising this power did not have the effect of withdrawing his accrued right to the PAYE credit. While accepting that he had received payments of earnings and was liable to income tax on those earnings, he argued that the contributions made to the EBT were notional payments of PAYE

income treated as made by the End Users who were obliged to pay the PAYE tax due. In turn that meant Mr Hoey should have been assessed *as if* this tax had been paid; in other words, the PAYE credit should have remained available to him. He contended that HMRC have no general discretion to waive the obligation to pay PAYE tax, and the only circumstance where the credit would cease to be available was where HMRC made a relevant direction under the express provisions of the PAYE Regulations. Absent such a direction, he remained entitled to a PAYE credit and since the central issue at stake was the amount of tax he was liable to pay under the assessments, he maintained that the statutory tribunals had jurisdiction to determine all these issues.

12. HMRC relied on a second basis of assessment to income tax under the Transfer of Assets Abroad ("TOAA") provisions in section 714 (and following) of the Income Tax Act 2007 ("ITA 2007"). Until the hearing in this court, HMRC maintained that this charge takes priority. However, as we shall explain below, they now concede (properly in our view) that the charge to income tax under ITEPA takes priority. In short, HMRC contended that, by virtue of the extended definitions of "transfer" and "assets" in sections 715 to 717 ITA 2007, Mr Hoey's entry into employment contracts with the foreign Employers was a relevant transfer for TOAA purposes, with the result that income of the Employers then became payable to him, which he had the power to enjoy. Accordingly, a charge to income tax arose under sections 720 and 721 ITA 2007.

13. Mr Hoey challenged the application and effect of the TOAA provisions in his case. He contended that no income accrued to the Employers, or if it did, such income was subject to properly deductible expenses incurred wholly and exclusively for the Employers' trade (namely, the contributions to the EBTs which were payments of remuneration for his services). He also sought to rely on the "motive defence". Finally, he argued in any event, that the TOAA provisions, as applied to his case, unjustifiably interfered with his EU law right to free movement of capital under Article 63 of the TFEU.

14. By a decision of Judge Richards, dated 27 October 2017, Mr Hoey's case was designated a lead appeal under Rule 18 of the Tribunal Procedure (FTT) (Tax Chamber) Rules 2009. The effect of the designation is that the decision in his case is binding on related cases (including the Claimants' appeals).

15. Mr Hoey's appeal was heard by the First-tier Tribunal (Judge Gillett) ("the FTT") in July 2019. By a decision dated 29 July 2019 (reported as *Hoey v HMRC* [2019] UKFTT 489 (TC)), the FTT dismissed the appeal. The FTT's essential holdings were as follows:

(i) The FTT rejected the challenge to the validity of the discovery assessments by Mr Hoey, holding that they had been made in time and had full effect.

(ii) The FTT held that there was nothing in the statutory provisions that gave it general jurisdiction to consider matters of public law and, in particular, the operation of the PAYE Regulations. Nor was this a case where it was necessary to consider public law points in order to be able to consider the issues that were properly within its jurisdiction. It could not therefore deal with the question whether "HMRC exercised any discretion…under section 684(7A) correctly, legally or reasonably".

(iii) The FTT held the 7A power overlapped with the "redirection regulations" (regulations 72, 72F and 81 of the PAYE Regulations), and there was nothing in the wide words of the provision restricting the use of the 7A power to situations not covered by the redirection regulations. HMRC had the discretion contended for, and the FTT had no jurisdiction over whether it was properly exercised.

(iv) The FTT dealt with the TOAA provisions in part on an *obiter* basis because it held that the charge did not strictly apply in view of the concession that the contributions to the EBT were taxable as employment income. Nonetheless, these provisions applied to the arrangements entered into by Mr Hoey because the creation of the employment contracts between Mr Hoey and the Employers constituted the transfer of an asset abroad by Mr Hoey, a UK resident, to the Employers, who were persons abroad for these purposes. The quantum of the "income" of the person abroad was nil however, because the Employers' payments to the EBT were expenses incurred "wholly and exclusively" for the purposes of their trade, leaving no profit for Mr Hoey to enjoy and on which the TOAA provisions could bite. Consequently, there was no liability to tax on this basis. The FTT also held that Mr Hoey had no available "motive defence".

(v) Finally, and although not necessary to the decision in these circumstances, the FTT held that the EU law right to free movement of capital was interfered with by the TOAA scheme, but the interference was justified and proportionate for anti-avoidance aims.

16. Mr Hoey and HMRC appealed, cross-appealed and relied on respondent's notices on the main issues decided adversely to them by the FTT. Mr Hoey's appeal, as before, challenged the validity of the discovery assessments and the exercise of the 7A power. He raised again the argument that the exercise of the power did not and could not have the effect of withdrawing his accrued right to the PAYE credit, and challenged the conclusions on jurisdiction. HMRC's cross appeal challenged the FTT's approach to the quantum of the charge under the TOAA legislation, and contended that the FTT was obliged to determine the applicability of the TOAA charge as a live issue in the case. The FTT applied the wrong legal test and did not address the inevitable duality of purpose the Employers must have had (given their tax avoidance purpose) in paying contributions to the EBTs. Had the decision been correctly made, the payments would have been disallowed as expenses not incurred wholly and exclusively for the purpose of the trade. Further, HMRC contended that Mr Hoey failed to discharge the burden of proving deductibility, and in any event, the FTT's findings were unsupported by the evidence necessary to support them and erroneous in point of law in accordance with *Edwards v Bairstow* [1956] AC 14. On the EU aspect of the decision, HMRC contended that the FTT erred in law in holding that the TOAA provisions infringed the free movement of capital; and Mr Hoey challenged the FTT's conclusion that any such interference was justifiable and proportionate.

17. The hearing in the Upper Tribunal took place in October 2020. By a decision of the Upper Tribunal dated 12 April 2021 (Adam Johnson J and Judge Raghavan) ("the UT"):

(i) The UT dismissed Mr Hoey's appeal challenging the validity of the discovery assessments.

(ii) The UT dismissed his appeal on the FTT's jurisdiction to determine the lawfulness of the exercise of the 7A power, but made *obiter* findings adverse to HMRC about the proper interpretation of that power as a matter of statutory construction, and the effect of its exercise on the PAYE credit provisions in the PAYE Regulations. In particular, the UT held that the wide 7A power only applies prospectively and cannot be exercised retrospectively. It cannot therefore overturn the effect of obligations which have already been incurred. Accordingly, Mr Hoey was entitled, on this premise, to the PAYE credit as the 7A power was ineffective to remove the PAYE liability from the End Users *after* those liabilities had been incurred.

(iii) The UT held that the FTT was wrong to consider it unnecessary to deal with the TOAA charge, which took priority over the ITEPA charge. Although there were errors of law in relation to the application of the provisions giving rise to the "motive defence", these were immaterial because the only reasonable conclusion on the facts was that the motive defence was not available to Mr Hoey to avoid the TOAA charge.

(iv) The UT upheld the FTT's finding that the amount of relevant "income" of the person abroad was nil on the findings it made and for the reasons given by the FTT.

(v) The UT also addressed the EU arguments (though not necessary to their decision) and held, contrary to the FTT's decision, the TOAA charge did not interfere with the EU right to free movement of capital, which was not engaged on the facts of the case. However, if it did, such interference would not have been justified as a proportionate response to the tax avoidance objective of the arrangements.

18. Following the FTT decision but before the UT appeal was heard, Mr Hoey (and the Claimants) issued a claim for judicial review (on 14 August 2019) of HMRC's decision not to collect tax on his employment earnings from the End Users, contending that there was no power available to HMRC to forgive tax in this way or retrospectively to interfere with accrued rights to the PAYE credit. Further, he argued that the 7A power was not exercised lawfully because there was a failure to have regard to relevant considerations only; the power frustrated the policy of the PAYE Regulations and only the specific redirection regulations could have been used; and there was a breach of a procedural legitimate expectation. Permission to apply for judicial review was refused on paper by Jay J on 26 February 2020. At a renewed oral hearing on 23 April 2020, Andrews J refused permission to apply for judicial review for reasons given in an extempore judgment at the hearing.

19. Mr Hoey appealed against the order of Andrews J refusing permission to apply for judicial review, and both sides challenged (Mr Hoey by appeal and HMRC by respondent's notice) all issues decided adversely to them. Leave to pursue all points on a second appeal to this court was granted by the UT on 28 June 2021, save that Mr Hoey was refused permission by the UT to appeal the finding that the discovery assessments were validly made and was further refused leave to do so in this court, by order of Lewison LJ. Further, by order dated 13 August 2021, Holroyde LJ gave permission to apply for judicial review and directed that such statutory appeals as were pursued following the grants of permission to appeal by the UT should be heard

together with the judicial review claim. Because this court has jurisdiction to address all issues raised, whether on the statutory appeal or by way of judicial review, the jurisdiction question is strictly academic. However, since it is a point of wider application that may affect other cases, we are persuaded that we should address it.

20. Although as will be apparent from the foregoing summary, a large number of sub-issues are raised by both sides in relation to each broad head of challenge, the following main issues accordingly arise in the judicial review and on the statutory appeal and cross-appeal:

    i) What is the proper construction of section 684(7A)(b) ITEPA and can the 7A power be used by HMRC in the circumstances of Mr Hoey's case, to "deprive" him (and the Claimants) of the PAYE credit?

    ii) Was the power lawfully exercised in any event?

    iii) Does the FTT have jurisdiction to review (or otherwise address) the exercise by HMRC of the power in section 684(7A)(b) ITEPA?

    iv) Is there a separate liability to income tax under the TOAA charge and, if so, did the FTT err in law in determining that the Employers' profits (that determine the quantum of any charge to tax under the TOAA provisions of the ITA 2007) are nil?

    v) Do the remaining questions of EU law arise and, if so, is there any unjustifiable and disproportionate interference with EU law rights to free movement of capital?

21. Mr Hoey and the Claimants were represented by Mr Mullan QC. For HMRC, Mr Grodzinski QC dealt with the PAYE and jurisdiction issues; Ms Nathan QC dealt with the TOAA charge and other issues arising in that regard. They were supported in those arguments by junior counsel, Mr Hill, Ms Lemos and Mr Dhorajiwala. We are grateful to all counsel and those instructing them for the obvious care with which this case was prepared and ably presented.

22. Having completed this introduction, we summarise the facts in a little more detail and then turn to consider the main issues raised by the appeals.

The facts

23. The FTT dealt carefully and comprehensively with the facts at [10] to [79]. The following summary of the facts is taken largely from that judgment.

24. Mr Hoey is an IT specialist and, as was common in that sector at that time, in order to obtain work, he provided his services either as an independent contractor or through a third-party provider employing a number of such contractors, which was referred to as an "umbrella company".

25. As part of the arrangements with which we are concerned, Mr Hoey engaged the services of an intermediary, Dynamic Management Solutions Ltd ("DMS"), who introduced him to Penfolds Limited, an Isle of Man company ("Penfolds"), in 2007, and he entered into an employment contract with Penfolds. In September 2009 Penfolds

suggested he transfer his employment to Hamilton Trust ("Hamilton"), a Guernsey based trust company, which he did. DMS, and a subsequent intermediary, Cascade, were Mr Hoey's prime points of contact throughout the arrangements. In Mr Hoey's case the End Users were AXA Investment Managers Ltd, Aviva Investors and Threadneedle Investments. These are all UK based entities. The Claimants also entered into arrangements with Penfolds, then Hamilton, under which they (in common with the other users of the schemes) were responsible for obtaining their own work from different end user clients, all based in the UK.

26. The End Users made no direct payments of remuneration to Mr Hoey for his services. The same was true in relation to the Claimants. There were intermediaries (DMS, Cascade and others, all UK based entities) who were interposed between Penfolds and Hamilton on the one hand, and the End Users on the other. The End Users paid sums to the intermediaries in respect of the services provided by the contractors.

27. On the basis that Penfolds and Hamilton had no presence in the UK, they were not strictly required to operate PAYE. However, both did voluntarily operate PAYE in respect of the small amount of wages paid directly to Mr Hoey and the Claimants. By contrast, the contributions paid by the Employers to the EBTs were asserted by them at the time not to be taxable remuneration of Mr Hoey. Instead, these amounts were treated as interest-free loans (with no expectation that they would be repaid). This meant that Mr Hoey should have included, in his self-assessment tax returns, the income tax payable in respect of the benefit of the interest forgone on the loans received from the EBTs (see section 175 ITEPA, under which the value of the interest forgone is treated as earnings from an employee's employment).

28. The first iteration of the scheme involved an entity called Assignment Solutions and was disclosed to HMRC pursuant to the Disclosure of Tax Avoidance Scheme (DOTAS) legislation (contained primarily in Part 7, Finance Act 2004) on 29 September 2004. It was allocated a DOTAS scheme reference number (SRN) 71676485. The Penfolds iteration of the scheme (which was the second iteration) used the same DOTAS SRN without a separate notification of the arrangements. Hamilton was the third iteration of the scheme. It was disclosed to HMRC by Kingston Smith LLP on 2 October 2009 and was allocated DOTAS SRN 23237278. The third iteration of the scheme was modified in response to the "anti-forestalling" provisions of Part 7A, ITEPA and the Hamilton Trust Anti-Forestalling "loan cleansing" scheme was disclosed to HMRC on 15 August 2011 by Mr Hall of RSM Tenon Group Plc.

Territoriality

29. Although not raised as an issue below (in any forum) Mr Hoey and the Claimants have suggested in their skeleton argument that Penfolds and Hamilton *may* have had a UK presence. No evidence has been produced to support this contention. In fact, the DOTAS forms submitted by Kingston Smith LLP in relation to the third iteration of the arrangements stated:

> "an offshore entity will employ individuals who are tax resident in and work in the UK. The offshore entity <u>will not have a UK presence or be resident in the UK</u>" and "Class 1A NIC will not be payable on these loans as the employer has no UK residence or presence. Class 1 secondary contributions will not be payable

> on any salary paid to employees as the employer has no UK residence or presence".

30. We simply note at this stage that the features that led the House of Lords to hold that the taxpayer company in *Clark (Inspector of Taxes) v Oceanic Contractors Inc* [1983] 2 AC 130 had a UK presence are absent: the Claimants have not said that the offshore Employers themselves had a UK office or postal address and there is no evidence of either. Rather, they have asserted in writing that "*providing a workforce in the UK to UK based end-users*" *may* mean that the offshore Employers have a UK taxable presence that brought them within the PAYE regime.

II. The judicial review: the exercise of the 7A power and its impact on the PAYE credit

The relevant legislation

31. The tax system has been described as involving three stages: stage 1 is liability, stage 2 is assessment and stage 3 is methods of recovery (see *Whitney v Inland Revenue Commissioners* [1926] AC 37 at 52 (Lord Dunedin). The term "liability" has a potentially wide meaning and can refer both to the charge to tax and the obligation to pay. It has at times been used interchangeably by the Claimants. We use it in its strict (*Whitney* stage 1) tax sense to mean "liability to pay tax".

Liability to pay tax

32. The provisions in ITEPA which give rise to the liability to pay tax on the contributions to the EBTs are sections 6, 7, 9, and 13. Section 6 of ITEPA describes the nature of the charge to tax on "employment income" which is further defined in section 7(2) and includes, at section 7(2)(a), "earnings within Chapter 1 of Part 3". The term "earnings" is defined "in relation to an employment" in section 62 and includes:

> "(a) any salary, wages or fee, (b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or (c) anything else that constitutes an emolument of the employment."

33. Section 9 of ITEPA defines the amount of employment income charged to tax. Section 13(1) provides that the person liable for any tax on employment income under Part 3 is the "taxable person" as defined. If the tax is on general earnings, the taxable person is "the person to whose employment the earnings relate."

34. Section 23 of ITA 2007 provides that "amounts of income on which the taxpayer is charged to income tax for the tax year" are to be included in the calculation of the "liability of a person … to income tax" for that year.

35. There is no dispute that Mr Hoey is the taxable person for the purposes of ITEPA and received earnings in relation to his employment with the Employers as defined. Accordingly, the amounts of employment income on which he is charged form part of the calculation of his liability to income tax in each relevant tax year.

Assessment

36. In general, every person who is chargeable to income tax for any year of assessment is required to give notice to HMRC that he or she is so chargeable under section 7 of TMA. There are exceptions to this requirement where all the income from a source, and payments made of, or on account of, that income have been taken into account in the making of deductions or repayments under the PAYE Regulations. In these circumstances the requirement to notify HMRC of chargeability to income tax under section 7 of TMA does not apply.

37. However, and notwithstanding section 7 of TMA, any person issued with a notice under section 8 of TMA must declare his employment income in his return, even if it has already been accounted for under PAYE. Although there are some categories of income excluded from this requirement in section 9(1A) TMA, there is no blanket exclusion for employment income. This means that once an employee is within the self-assessment regime, he or she must determine whether or not the employer has in fact operated PAYE in order to complete an accurate self-assessment return. Generally, this presents no difficulty because payslips and the P60 should set out amounts deducted (and by inference accounted for to HMRC) under the PAYE Regulations.

38. Section 8 and 9 of TMA set out the obligation on a taxpayer to file a personal tax return that includes a self-assessment or calculation of the amount in which he or she is "chargeable to income tax". Section 8(1) provides:

> "**8. Personal return.**
>
> (1) For the purpose of establishing the amounts in which a person is chargeable to income tax and capital gains tax for a year of assessment, and the amount payable by him by way of income tax for that year, he may be required by a notice given to him by an officer of the Board –
>
> (a) to make and deliver to the officer, a return containing such information as may reasonably be required in pursuance of the notice, and
>
> (b) to deliver with the return such accounts, statements and documents, relating to information contained in the return, as may reasonably be so required.
>
> (1AA) For the purposes of subsection (1) above –
>
> (a) …
>
> (b) the amount payable by a person by way of income tax is the difference between the amount in which he is chargeable to income tax and the aggregate amount of any income tax deducted at source and any tax credits to which section 397(1) or 397A(2) of ITTOIA 2005 applies.
>
> (5) In this section and sections 8A, 9 and 12AA of this Act, any reference to income tax deducted at source is a reference to

> income tax deducted or treated as deducted from any income or treated as paid on any income."

39. Section 9(1) of TMA provides that every return under section 8 (or 8A) "shall include a self-assessment" that is to say:

> "(a) an assessment of the amounts in which, on the basis of the information contained in the return and taking into account any relief or allowance a claim for which is included in the return, the person making the return is chargeable to income tax and capital gains tax for the year of assessment; and
>
> (b) an assessment of the amount payable by him by way of income tax, that is to say, the difference between the amount in which he is assessed to income tax under paragraph (a) above and the aggregate amount of any income tax deducted at source and any tax credits to which section 397(1) or 397A(2) of ITTOIA 2005 applies.
>
> …"

40. As will be apparent, these provisions, in particular sections 8(1AA)(b) and 9(1)(b), also require the taxpayer to include the "amount payable by a person by way of income tax". This is the difference between the amount in which he or she is chargeable to income tax and the aggregate amount of any income tax deducted at source. Income tax deducted at source is defined as "income tax deducted or treated as deducted from any income or treated as paid on any income" by section 8(5) of TMA.

41. One of the issues between the parties is whether the reference to "income tax deducted or treated as deducted" means that the amount payable takes into account only amounts actually deducted under PAYE and not amounts treated as deducted under regulations 185 and 188 (which are set out below). HMRC's case is that regulations 185 and 188 have no role to play in establishing a person's liability to income tax under sections 8 or 9 of TMA; but do have a role to play in the calculation of the amounts to be paid by or on behalf of the taxpayer under sections 59A and 59B of TMA. The Claimants on the other hand, contend that they have an important role to play in establishing the amount of a person's liability to income tax under sections 8 and 9 of TMA and accordingly, there is jurisdiction to address the lawfulness of the 7A power as exercised here, in the statutory tribunals.

42. Section 28A of TMA deals with closure notices and section 29 deals with discovery assessments. It is unnecessary to set these out. Section 31 of TMA provides for appeal rights and subsections (b) and (d) apply here, as follows:

> "**31 Appeals: right of appeal**
>
> (1) An appeal may be brought against –
>
> (a) any amendment of a self-assessment under section 9C of this Act (amendment by HMRC during enquiry to prevent loss of tax),

> (b) any conclusion stated or amendment made by a closure notice under section 28A or 28B of this Act (amendment by HMRC on completion of enquiry into return),
>
> (c) …
>
> (d) any assessment to tax which is not a self-assessment."

43. Section 48 defines an appeal for the purposes of (among others) sections 49D, 49I and 50 of TMA as "any appeal under the Taxes Acts" which includes the TMA. Under section 49D the taxpayer is permitted to notify an appeal made to HMRC to the tribunal, and once notified, the tribunal must decide "the matter in question", in other words "the matter to which the appeal relates" (section 49I of TMA). Section 50(6) and (7) set out the powers of the tribunal on an appeal notified to it, to reduce or increase the assessment or self-assessment if it decides that the taxpayer is overcharged or under charged by a self-assessment or other assessment.

44. Part IV of TMA deals with payment of tax, and its provisions effectively transform the liability to tax into an obligation to pay, or debt due to HMRC. Section 59A deals with "payments on account of income tax" and makes provision for determining how these are calculated, including where in the previous year of assessment, the amount of tax assessed exceeds the amount deducted at source.

45. Section 59B provides:

> "**59B. Payment of income tax and capital gains tax.**
>
> (1) Subject to subsection (2) below, the difference between –
>
> > (a) the amount of income tax and capital gains tax contained in a person's self-assessment under section 9 of this Act for any year of assessment, and
> >
> > (b) the aggregate of any payments on account made by him in respect of that year (whether under section 59A of this Act or otherwise) and any income tax which in respect of that year has been deducted at source,
>
> shall be payable by him or (as the case may be) repayable to him as mentioned in subsection (3) or (4) below but nothing in this subsection shall require the repayment of any income tax treated as deducted or paid by virtue of section 246D(1) of the principal Act, section 626 of ITEPA 2003 or section 399(2), 400(2), 414(1), 421(1) or 530(1) of ITTOIA 2005.
>
> (2) The following, namely –
>
> > (a) any amount which, in the year of assessment, is deducted at source under PAYE regulations in respect of a previous year, and

> > (b) any amount which, in respect of the year of assessment, is to be deducted at source under PAYE regulations in a subsequent year, or is a tax credit to which section 397(1) or 397A(2) of ITTOIA 2005 applies,
>
> shall be respectively deducted from and added to the aggregate mentioned in subsection (1)(b) above.
>
> …
>
> (8) PAYE regulations may provide that, for the purpose of determining the amount of the difference mentioned in subsection (1) above, any necessary adjustments in respect of matters prescribed by the regulations shall be made to the amount of tax deducted at source under PAYE regulations."

46. The difference between the figures at section 59B(1)(a) and (b) is what is stated to be "payable" by the taxpayer concerned.

Collection and recovery

47. Part 11 of ITEPA provides for the assessment, collection and recovery of income tax in respect of PAYE income. "PAYE income" is defined to include, amongst other things, any "PAYE employment income" and includes "any taxable earnings from an employment in the year...": see section 683 of ITEPA. Accordingly, there is and can be no dispute that Mr Hoey received PAYE income.

48. In an ordinary employer/employee situation, when making payments of remuneration to an employee, an employer must deduct or pay PAYE tax in accordance with the employee's tax code (see regulation 21 PAYE Regulations). This provision caters for most cases where an employer makes salary or wage payments to an employee.

49. Sometimes an employer will make other kinds of payments, termed "notional payments". These are defined in regulation 2 PAYE Regulations by reference to section 710 (2) of ITEPA. Section 710 of ITEPA provides:

> "(1) If an employer makes a notional payment of PAYE income of an employee, the employer must, *subject to and in accordance with PAYE regulations*, deduct income tax at the relevant time from any payment or payments the employer actually makes of, or on account of, PAYE income of the employee.
>
> (2) For the purposes of this section –
>
> (a) a notional payment is a payment treated as made by virtue of any of sections 687, 689 and 693 to 700, other than a payment whose amount is given by section 687(3)(a) or 689(3)(a), and

> (b) any reference to an employer includes a reference to a person who is treated as making a payment by virtue of section 689(2).
>
> (3) Subsection (4) applies if, because the payments actually made are insufficient for the purpose, the employer is unable to deduct the full amount of the income tax as required by subsection (1).
>
> (4) The employer must, *subject to and in accordance with PAYE regulations*, account to the Commissioners for Her Majesty's Revenue and Customs at the relevant time for an amount of income tax equal to the amount of income tax the employer is required, but is unable, to deduct. " (Emphasis added)

Sections 710(1) and (2) treat as notional payments any payments treated as made under section 689 of ITEPA and require the notional employer to deduct and/or account for PAYE on the notional payment.

50. Section 689 of ITEPA deals with the situation where the person or entity paying remuneration is based offshore and therefore cannot be made liable to deduct or account for the PAYE tax, but there is an end user of the employee's services based in the UK. It treats the end user of the services as making a payment of employment income and that end user becomes liable to make payments under the PAYE Regulations as if it were the employer. If the employer, or end user, is liable to account for the tax to HMRC then in broad terms, regulations 185 and 188 of the PAYE Regulations mean that the employee is entitled to treat the PAYE tax as having been paid and claim it as a credit against his or her own liability to pay tax.

51. HMRC have proceeded on the basis that section 689(2) of ITEPA applies in this case because Mr Hoey worked for the End Users in the UK rather than for Penfolds and/or Hamilton. The point matters because, if as a matter of fact, the Employers had a presence in the UK at the material times, the End Users could not have been required to deduct or account for PAYE tax on the notional payments, and HMRC's exercise of the 7A power to relieve them of any obligation to comply with the PAYE Regulations would be of no effect. HMRC consider that the Employers paid Mr Hoey but were not UK resident and not required to operate PAYE. They did not in fact deduct or account for income tax on the contributions to the EBTs. Consequently, absent a decision or determination to the contrary, the End Users were deemed "employers" by virtue of section 710(2)(b) of ITEPA, and the contributions to the EBTs were "notional payments" treated as paid by the End Users and in respect of which the End Users were required to deduct or account for PAYE.

The power to make PAYE regulations

52. The power and duty to make PAYE regulations in respect of the assessment, charge, collection and recovery of income tax relating to "all PAYE income" is given to HMRC by section 684(1) of ITEPA. Section 684 was amended (before the PAYE Regulations were made) by section 145 of the Finance Act 2003, to include (among other things) "provision 4A", subsection 7A, and an amendment to section 710(1) and (4) of ITEPA

to add the words "*subject to and in accordance with PAYE regulations*" as they appear in paragraph 49 above (italicised for emphasis).

53. Section 684(2) (as so amended) confers wide-ranging powers on HMRC to provide for matters set out in a non-exhaustive "List of Provisions" that *may* (not must) be included in PAYE regulations made by HMRC. These include authorising the recovery from the payee rather than the payer of any amount that an HMRC officer considers should have been deducted by the payer, as set out in provision 4A as follows:

> "1. Provision –
>
> (a) for requiring persons making payments of, or on account of, PAYE income to make, at the relevant time, deductions or repayments of income tax calculated by reference to tax tables prepared by the Commissioners for Her Majesty's Revenue and Customs, and (b) for making persons who are required to make any such deductions or repayments accountable to or, as the case may be, entitled to repayment from the Board.
>
> …
>
> 4A. Provision authorising the recovery from the payee rather than the payer of any amount that an officer of Revenue and Customs considers should have been deducted by the payer.
>
> …"

54. Section 684 (7) makes clear that PAYE regulations have effect despite anything in the Income Tax Acts (which includes the TMA). This ensures that PAYE can operate irrespective of anything in the Income Tax Acts. In particular, this means that notwithstanding the obligation to pay tax normally falls on the person who is liable to tax, under the PAYE regulations, the obligation to pay by deducting at source, is placed on the employer, while leaving the employee's liability to tax on employment income under section 13 of ITEPA undisturbed.

55. Significantly for our purposes, section 684(2) (as amended) also provides the vires for excluding payers from the operation of PAYE regulations in such circumstances as may be specified, in particular as follows:

> "(7A) Nothing in PAYE regulations may be read –
>
> (a) as preventing the making of arrangements for the collection of tax in such manner as may be agreed by, or on behalf of, the payer and an officer of Revenue and Customs, or
>
> (b) as requiring the payer to comply with the regulations in circumstances in which the Inland Revenue is satisfied that it is unnecessary or not appropriate for the payer to do so.

> (7B) References in this section and section 685 to income tax in respect of PAYE income are references to income tax in respect of that income if reasonable assumptions are (when necessary) made about other income.
>
> (7C) In this section and section 685 –
> "payer" means any person paying PAYE income and "payee" means any person in receipt of such income;
> "specified" means specified in PAYE regulations.
>
> (8) In this Act and any other enactment (whenever passed) "PAYE regulations" means regulations under this section."

56. HMRC rely on section 684(7A)(b) as giving them the 7A power to remove the requirement on the End Users to comply with the PAYE Regulations, with the result that Mr Hoey's underlying liability to pay the income tax due on the contributions to the EBTs remains and there is no PAYE credit available to Mr Hoey (or to any of the Claimants).

57. In the ordinary case, regulation 21(1) PAYE Regulations provides that on making a relevant payment to an employee during a tax year, "*an employer must deduct or repay tax in accordance with these regulations by reference to the employee's code, if the employer has one for the employee*".

58. Regulation 62 deals with the obligation to deduct or account where notional payments are concerned, and applies if an employer, or "other payer" treated by regulation 12 as an employer, makes a relevant payment which is a notional payment. In such a case, regulation 62(2) provides that the employer:

> "(2) … must so far as possible, deduct tax required to be deducted in respect of a notional payment … from any relevant payment or payments which the employer actually makes to the employee at the same time as the notional payment. …
>
> (4) If the employer cannot deduct the full amount of tax as required by paragraph (2) from another relevant payment made at the same time as the notional payment, the employer must, so far as possible, deduct the tax from any payment or payments which the employer makes later in the same tax period.
>
> (5) If the relevant payments actually made are insufficient to enable the employer to deduct the full amount of tax due in respect of notional payments, the employer must account [to HMRC] for any amount which the employer is unable to deduct."

59. If any of the PAYE obligations are not met by the employer (or deemed employer), the redirection regulations can be used to transfer the liability to deduct and/or account for PAYE to the employee. These include regulations 72(5), 72F and 81(4). The redirection regulations each contain express provisions requiring notice to be given to the affected employee and providing prescribed appeal rights for the employee. In the

absence of a direction made by HMRC under one of the redirection regulations, Mr Hoey contends that he is entitled to treat the PAYE tax as having been paid by the End Users, who are deemed employers for these purposes, and to reduce his own liability to tax under the assessments by the corresponding PAYE credit under regulations 185 and 188 to which he remains entitled.

60. Regulation 185 deals with self-assessment (so is relevant to the closure notice for 2010/11) and regulation 188 deals with discovery assessments (and is therefore relevant to the 2008/09 and 2009/10 discovery assessment appeals). Regulations 185 and 188 are central to Mr Hoey's case, and in the relevant versions, provided as follows:

> "**185. Adjusting total net tax deducted for purposes of sections 59A(1) and 59B(1) TMA**
>
> (1) This regulation applies for the purpose of determining –
>
> (a) the excess mentioned in section 59A(1) of TMA (payments on account of income tax: income tax assessed exceeds amount deducted at source),
>
> (b) the difference mentioned in section 59B(1) of TMA (payments of income tax and capital gains tax: difference between tax contained in self-assessment and aggregate of payments on account or deducted at source).
>
> (2) For those purposes, the amount of income tax deducted at source under these regulations is the total net tax deducted during the relevant tax year ("A") after making any additions or subtractions required by paragraphs (3) to (5).
>
> (3) Subtract from A any repayments of A which are made before the taxpayer's return and self-assessment is made under section 8 or 8A of TMA (personal return and trustee's return).
>
> (4) Add to A any overpayment of tax from a previous tax year, to the extent that it was taken into account in determining the taxpayer's code for the relevant tax year.
>
> (5) Add to A any tax treated as deducted, other than any direction tax, but –
>
> (a) only if there would be an amount payable by the taxpayer under section 59B(1) of TMA on the assumption that there are no payments on account and no addition to A under this paragraph, and then
>
> (b) only to a maximum of that amount.
>
> (6) In this regulation –
>
> "direction tax" means any amount of tax which is the subject of a direction made under regulation 72(5), regulation 72F or

regulation 81(4) in relation to the taxpayer in respect of one or more tax periods falling within the relevant tax year;

…

"tax treated as deducted" means any tax which in relation to relevant payments made by an employer to the taxpayer in the relevant tax year –

(a) the employer was liable to deduct from payments but failed to do so, or

(b) the employer was liable to account for in accordance with regulation 62(5) (notional payments) but failed to do so;

"the taxpayer" means the person referred to in section 59A(1) of TMA or the person whose self-assessment is referred to in section 59B(1) of TMA (as the case may be)."

"**188. Assessments other than self-assessments**

(1) In this regulation, "assessment" means an assessment other than one under section 9 of TMA (self-assessment).

(2) The tax payable by the employee is –

A – (B – C)
where

A is the tax payable under the assessment;

B is the total net tax deducted in relation to the employee's relevant payments during the tax year for which the assessment is made, adjusted as required by paragraph (3); and

C is so much, if any, of B as is subsequently repaid.

(3) For the purpose of determining the tax payable by the employee, and subject to paragraphs (4) and (5) –

(a) add to B any tax which –

(i) the employer was liable to deduct from relevant payments but failed to do so, or

(ii) the employer was liable to account for in accordance with regulation 62(5) (notional payments) but failed to do so;

(b) make any necessary adjustment to B in respect of any tax overpaid or remaining unpaid for any tax year; and

(c) make any necessary adjustment to B in respect of any amount to be recovered as if it were unpaid tax under section 30(1) of TMA (recovery of overpayment of tax etc) to the extent that –

(i) HMRC took that amount into account in determining the employee's code, and

(ii) the total net tax deducted was in consequence greater than it would otherwise have been.

(4) No direction tax is to be included in calculating the amount of tax referred to in paragraph (3)(a).

(5) If a direction is made after the making of the assessment, the amount (if any) shown in the notice of assessment as a deduction from, or a credit against, the tax payable under the assessment is to be taken as reduced by so much of the direction tax as was included in calculating the amount of tax referred to in paragraph (3)(a).

(6) Instead of requiring payment by the employee, HMRC may take the tax payable by the employee into account in determining the employee's code for a subsequent tax year.

(7) In this regulation

"direction" means a direction made under regulation 72(5), regulation 72F or regulation 81(4) in relation to the employee in respect of one or more tax periods falling within the tax year in question;

"direction tax" means any amount of tax which is the subject of a direction;

"tax payable under the assessment" means the amount of tax shown in the assessment as payable without regard to any amount shown in the notice of assessment as a deduction from, or a credit against, the amount of tax payable."

61. There is an obligation on individuals like Mr Hoey who make a tax return under section 8 of TMA, to pay whatever tax is due for a tax year of assessment as provided for by sections 59A and 59B of TMA. Regulations 185 and 188 are referred to as giving rise to a PAYE credit because, where these provisions operate, they reduce the amount of tax which has to be paid by the employee under sections 59A and 59B. In this way regulations 185 and 188 can operate to protect employees from negligent employers who fail to pay HMRC the tax which they have not deducted under PAYE from an employee's remuneration.

62. Against that background and having set out the relevant legislation, we turn to address the arguments advanced on the first issue, the meaning, scope and effect of the 7A power.

The proper meaning and scope of section 684(7A)(b) and its effect on the Claimants

63. The Claimants' central submission is that the 7A power, properly construed, cannot be exercised to impose liability to pay or account for PAYE tax on the Claimants. First, however widely it is expressed, forgiving an end user of an obligation to comply with its obligations under the PAYE Regulations cannot impact on the Claimants' own rights and obligations. Clear words are needed to confer discretion on HMRC to decide who should be liable to pay tax, and even if there is power to relieve one person of an obligation contained in the PAYE Regulations, there is no power to impose liability or an obligation to pay on another person. Secondly, as a matter of language together with the presumption against retrospectivity, the natural reading of subsection (7A)(b) is that it only operates prospectively, to relieve a person of their future obligation to pay and does not operate to relieve a past obligation, much less one which has ceased to apply. Thirdly, the 7A power cannot operate as an alternative to the express redirection regulations that can be used to transfer liability, especially where these incorporate specific safeguards protecting the employee taxpayer and affording express appeal rights. A general power cannot be used in these circumstances, still less to circumvent such safeguards. In any event, the 7A power is not in point as the End Users' obligations do not arise under the PAYE Regulations, but under section 710 of ITEPA, and the 7A power is not a power to forgive obligations arising under ITEPA.

64. Mr Mullan developed these arguments by reference to the purpose and policy of the PAYE code (evolved over 70 years) with the core purpose of ensuring the primary obligation to pay for and account for PAYE lies with the person making payments and not with the employee providing services. A general discretion enabling HMRC to reverse this fundamental policy, as and when they see fit, is at odds with this core purpose. Moreover, the principle of legality applies, and reflects the constitutional position that HMRC have no power to levy tax or impose obligations to pay tax. The substance and effect of HMRC's decision is to deprive the Claimants of an accrued right to treat tax as paid and does impose a significant liability on them. The constitutional principle cannot give way to a technical reading of the tax code, divorced from practical reality, absent very clear words. There is no discretion to forgive tax, including tax that would be due under section 222 of ITEPA. A narrow construction of the 7A power is appropriate for all these reasons: the 7A power is intended to deal with minor unfairness and administrative convenience, but not substantive liability. It enables HMRC to disapply the PAYE Regulations prospectively in outlier cases, where it would be disproportionate to legislate specifically but it is "inappropriate" or "unnecessary" for the general rules to be applied. This enables pragmatic flexibility in appropriate cases (such as short term and casual employment), consistently with the scope of HMRC's care and management powers. Where the redirection regulations can be used, they must be used, and the 7A power cannot trump those regulations, not least given their express safeguards.

65. Like Andrews J, we do not accept these submissions. Our reasons are as follows.

66. We start with the well-established approach to statutory construction, as recently explained by the Supreme Court in *R (O) v Secretary of State for the Home Department* [2022] UKSC 3. The exercise of statutory construction is an objective search for the meaning of the words used by Parliament read in their particular context. External aides to interpretation play a secondary role, although Explanatory Notes, prepared under the authority of Parliament, may cast light on the meaning of particular statutory provision:

see [29] and [30]. Where relevant, the principle of legality may apply so that Parliament cannot override fundamental rights or the rule of law by general or ambiguous words or confer power on another body to do so. In performing the interpretative task, the court will have regard to well-established prima facie assumptions and presumptions, so far as applicable; but the weight to be attached to such presumptions will vary depending upon the circumstances of the case and the nature of the rights affected by the legislation under consideration: see [41].

67. Here, contrary to a thread running through Mr Mullan's submissions, the principle of legality is simply not engaged. HMRC do not have tax levying (or forgiving) powers and none is claimed. The 7A power does not impose or transfer liability to tax. Liability to income tax on employment income rests throughout on Mr Hoey (and the Claimants) under the provisions of primary legislation in section 13 of ITEPA. Nor does the 7A power entail choosing whom to tax: the liability is that of the recipient of the employment income. The exercise of the 7A power simply enables HMRC to collect the tax from the individual who has the liability to pay the tax due, instead of collecting it from the source of the payment (the employer). This important proposition was re-stated in *McCarthy v McCarthy & Stone plc* [2007] EWCA Civ 664, at [42] by Sir Andrew Morritt C:

> "42. As is well known the PAYE system is designed to recover tax due on income of an employee from its source, that is the employer, and in anticipation of liability which arises at the end of the year of assessment in which it is paid. Accordingly, it is hardly surprising that the PAYE Regulations do not impose any liability on the employee. That is done by the primary legislation, namely ITEPA, to which I have referred, and the general machinery for collection contained in the Taxes Management Act 1970 ("TMA")…"

68. Nor is there anything in ITEPA suggesting that the purpose of the PAYE Regulations is to forgive the employee in respect of his or her own income tax liability when PAYE has not in fact been deducted or accounted for by an employer or deemed employer. There is no policy discernible in the PAYE Regulations by which the tax in relation to an employee's PAYE income always falls to be collected from the employer. To the contrary, the availability of directions under the redirection regulations (including regulations 72F and 81) show this to be incorrect.

69. The presumption relied on by Mr Mullan, that a general power must give way to a specific power, especially where the specific power contains safeguards not provided for by the general power, does not arise in this case either. In this case there is in fact no conflict between the redirection regulations in secondary legislation, and the 7A power in primary legislation that caters for other circumstances.

70. Parliament has, within a single section of primary legislation (namely section 684 of ITEPA), both given HMRC the duty to make the PAYE Regulations and the power to decide, where appropriate, that the employer (actual or deemed) is not required to comply with them. Moreover, while section 684 (1) imposes a mandatory duty to make PAYE Regulations, there is nothing in the words of section 684 (2) to indicate that the PAYE Regulations must be exhaustive or occupy the whole field. Indeed, the contrary appears from the words "*PAYE Regulations may, in particular, include any such*

provision as is set out in the following list." Furthermore, provision 4A which gives vires for the making of redirection regulations and subsection (7A) were introduced at the same time, and these separate provisions in primary legislation are expressly addressed to different (but potentially overlapping) situations. The situation expressly contemplated in provision 4A concerns circumstances where it is considered that the payer should have deducted the tax. By contrast, subsection (7A)(b) is concerned with the situation in which the officer considers that it is not appropriate to require any compliance by the payer with the PAYE regime. Mr Hoey's case is not a deduction case at all. To the contrary, as he accepted, because these were notional payments by a deemed employer (subject to the territoriality point which we shall address below), there was no obligation on the End Users to deduct, but rather an obligation to account under regulation 62(5). Provision 4A makes no mention of accounting. These provisions have overlapping aims and overlapping applications. The redirection regulations are plainly not exclusive; nor are the PAYE Regulations the exclusive machinery for assessment and collection of tax in respect of an employee's employment income. This is not a case of specific legislation displacing a general provision. The scheme of this legislation enables HMRC to use the 7A power granted in primary legislation as a separate and free-standing tool, provided the criteria for its exercise are met.

71. Further, while it is true that regulations 72, 72F, and 81 provide safeguards for the affected employee, including express rights of appeal, these correspond closely with the basis on which the direction is made, and afford no wider protection than that available in relation to the 7A power. For example, the right of appeal in regulation 81A(1) is a right of appeal limited to the question of what is or is not a notional payment. By contrast, Parliament has chosen not to attach any right of appeal to the exercise of the 7A power, leaving judicial review as the appropriate route for challenge. This avenue of challenge does not leave the taxpayer in a worse position: whereas the statutory appeal rights do not permit a challenge to the lawfulness of the officer's decision to exercise the redirection power, such a challenge is permitted on judicial review. It is also true that HMRC must give notice to the affected employee of a direction under the redirection regulations, and there is nothing in section 684(7A) requiring similar notice to be given. However, HMRC guidance makes clear that as part of their public law duty to act fairly, HMRC must give the employee the opportunity to make representations before the 7A power is exercised. That is precisely the opportunity given to Mr Hoey by the letter of 13 October 2017.

72. Returning to the language of the 7A power, it could not have been expressed more plainly and clearly. There is no expressed limit to the circumstances in which an HMRC officer can decide that it is "inappropriate" for the payer to comply with obligations under the PAYE Regulations. The provision recognises that, despite the detail of the PAYE Regulations, HMRC may form the view in the circumstances of a particular case, that it is not appropriate to expect an end user (or other employer) to comply with the deduction and/or accounting obligations in the PAYE Regulations.

73. As Mr Grodzinski QC submitted, sections 684 (7A)(a) and (b) are dealing with different aspects of the same problem – a situation where for whatever reason the payer ought to be relieved of its obligations under the PAYE machinery. Certain outlier situations, such as short-term or casual employment, are likely to fall within subsection (a). Since subsection (b) was also enacted, this provision must have an additional purpose and

cater for different situations. Given its broad terms, it was clearly intended to apply whenever it is considered appropriate to relieve an employer from PAYE requirements and is not limited to outlier situations as Mr Mullan contended. Its focus is inevitably on the payer, and neither subsection makes any reference to the payee. This is unsurprising in circumstances where exercise of the 7A power has no impact whatever on the underlying liability to tax of the payee recipient of the PAYE income, which remains undisturbed.

74. The question for the officer in a subsection (7A)(b) case is simply whether, in the circumstances of the case, he or she is satisfied that it would be unnecessary or inappropriate for the payer to comply with the PAYE Regulations. Two points follow from the plain words of the provision. First, because the words "unnecessary" and "not appropriate" are used in the alternative by the drafter, it is clearly contemplated that an officer may be satisfied that it would be inappropriate to expect compliance with the PAYE Regulations, even where compliance is otherwise necessary. Secondly, by empowering the officer to decide what is appropriate, Parliament has decided that it should be within the discretion of the officer to decide when compliance with the PAYE Regulations is not appropriate. Nonetheless, this is not an untrammelled power. It must be exercised in accordance with well-established principles of public law, including the obligation to act *Wednesbury* rationally and the *Padfield* obligation not to act inconsistently with the purpose of the legislation.

75. The remaining arguments developed by Mr Mullan by reference to the principles and purpose of the PAYE regime, including the presumption against retrospectivity, do not alter this conclusion or lead to a more restrictive interpretation of the 7A power.

76. Before we address the retrospectivity argument it is convenient to consider whether the redirection regulations (regulations 72, 72F or 81) could or should have been used by HMRC to make a direction transferring liability in this case. This was an unusual situation, as Mr Grodzinski submitted, not least because the End Users were UK based, dealt with UK based intermediaries to secure the services of contractors, like Mr Hoey, and paid fees to the intermediaries, no doubt assuming that the intermediaries would ensure that the contractors received pay for their services. Alongside those arrangements, there were offshore entities who employed Mr Hoey under a contract of employment, although this has never been produced; they voluntarily operated PAYE on the small salary element, but not on the loan element of the remuneration they paid; and there is nothing in the evidence to suggest that the End Users knew of the existence of the Employers, the detail of the contractual arrangements or the need to account for tax on the notional payments (as we shall discuss below).

77. On the premise that the End Users were deemed employers treated as having made notional payments, and since the End Users made no actual payments from which to deduct tax, their only obligation under the PAYE Regulations was to account for the tax due on the notional payments under regulation 62(5). The obligation to account under regulation 62(5) is a continuing one, irrespective of whether it can be enforced. We note that section 710 of ITEPA also distinguishes between the obligation to deduct from actual payments and the obligation to account where notional payments are concerned.

78. Where the employer (or deemed employer) fails to deduct or account for the PAYE due, HMRC can make directions transferring liability under the redirection regulations.

Taking these in turn, under regulation 72 there are two alternative conditions that must be met: A applies where the employer took reasonable care to comply and failed to deduct due to an error in good faith; B applies where the employee received payments knowing the employer had wilfully failed to deduct. In both cases, there must be a failure to deduct and this regulation does not apply in a situation where the employer has made no payments from which deductions could have been made. The power to make a direction under regulation 72F applies where the employer fails to deduct, and the employee has received a relevant payment and tax on that payment has been self-assessed or paid under section 59A TMA. Again, there is no dispute that this regulation does not apply here.

79. Regulation 80 applies where the employer has not deducted tax from the earnings before paying those earnings to the employee, or has deducted tax but failed to account for it to HMRC, or where the employer has made notional payments of PAYE but has not accounted for or paid the tax on the notional payments. In any of these cases, HMRC may determine the amount of the unpaid tax to the best of their judgment, and serve notice of their determination on the employer. HMRC could have made such a determination under regulation 80 and served notice of it on the End Users here. Had that been done, and if any part of the tax determined under regulation 80 remained unpaid after 30 days from the date on which the determination became final and conclusive, condition B in regulation 81(3) would have applied (because the unpaid tax would have represented amounts for which the End Users were required to account under regulation 62(5) (notional payments)). Accordingly, in those circumstances, HMRC could (in accordance with regulation 81(4)) have directed that "*the employer is not liable to pay the amount of tax which appears to them should have been but was not— ... (b) accounted for under regulation 62(5)*". In other words, HMRC could have made a direction transferring liability to the employee recipient of the PAYE income.

80. On behalf of HMRC, Scott McFarlane explains in his witness statements why, on the unusual facts of this case, there was good reason for HMRC not to have exercised the specific powers available to make a regulation 80 determination in respect of any end users, followed by a direction under regulation 81. Leaving aside the practical difficulty that HMRC did not know who the end users were for any of the Claimants (apart from those using the services of Mr Hoey, who supplied the names of his End Users in 2015, in the course of the litigation), and assuming that regulation 80 determinations could have been made against all end users, the end users would have had appeal rights under regulation 80(5) and would almost certainly have exercised them on the reasonable basis that they did not know (and could not have been expected to know) that section 689 of ITEPA potentially applied to them. HMRC would have been forced to engage in potentially costly and lengthy litigation against the end users. If successful, that would have left the end users to pursue the Claimants (who were undoubtedly liable to pay the tax on the employment income they received) for restitution of the tax paid. If ultimately unsuccessful against the end users, HMRC would then have been in a position to pursue the individuals through a regulation 81 direction.

81. Returning to the question of retrospectivity, it is common ground that the underlying rationale for the presumption against retrospectivity is fairness. In *Wilson v First County Trust Ltd* [2003] UKHL 40, [2004] 1 AC 816 at [19], Lord Nicholls approved the following statement of the principle made by Staughton LJ in *Secretary of State for Social Security v Tunnicliffe* [1991] 2 All ER 712 at 724:

> "… the true principle is that Parliament is presumed not to have intended to alter the law applicable to past events and transactions in a manner which is unfair to those concerned in them, unless a contrary intention appears. It is not simply a question of classifying an enactment as retrospective or not retrospective. Rather it may well be a matter of degree – the greater the unfairness, the more it is to be expected that Parliament will make it clear if this is intended."

82. Adopting that approach, we see nothing unfair or objectionable in the 7A power operating both prospectively and retrospectively. This is not a case in which new legislation enacted after the relevant events, has altered the legal consequences of those events. The PAYE Regulations do not impose liability to tax on employment income as we have already emphasised. That is done by primary legislation in ITEPA, and the obligation to pay the tax on his or her earnings if tax is not deducted at source, is on the employee, as sections 59A and 59B of TMA make clear. Nor can it be said that there is an unfair deprivation of a vested or accrued right to a credit at all. The PAYE credit is only ever a contingent credit when PAYE income is earned. It can be disapplied whenever a direction is made by an HMRC officer under any of regulations 72(5), 72F(1) or 81(4), including where an employer has not deducted the tax but has taken reasonable care to comply with the PAYE Regulations; or where the employer has not accounted for tax on notional payments.

83. Moreover, redirection decisions made under the PAYE Regulations can lawfully be made well after the relevant payments of PAYE income are made, whether that be actual or notional payments. There are no specific time limits for the making of directions under the redirection regulations. Further, the disapplication of the PAYE credit under regulations 185(5) and 188(3) by any of these directions (under regulations 72, 72F or 81) will only take effect in relation to the employee's obligation to pay, which will only take effect 30 days after a closure notice or discovery assessment (absent the exercise of appeal rights) by virtue of section 59B(5) and (6) of TMA. It is also possible for HMRC to make directions transferring liability under the redirection regulations after a discovery assessment has been made, as regulation 188(5) makes clear. In other words, the PAYE credit is by no means a vested or accrued right at the time the PAYE income is earned. The disapplication of the PAYE credit also operates retrospectively in the sense that it disapplies the credit after the PAYE income was paid to the employee and the original obligation to deduct or account arose. Thus, the 7A power, which also has the effect of removing a contingent credit, operates no more retrospectively than the powers to disapply the credit in the redirection regulations do.

84. For these reasons, to construe 7A as limited to prospective application only is inconsistent with the language and purpose of the PAYE Regulations. The plain language of the 7A power simply requires the officer to ask whether it is appropriate (knowing all that the officer knows) to expect the end user to comply with the PAYE Regulations by accounting for the employee's income tax. In a typical case, HMRC are likely only to become aware of the situation giving rise to the need to consider making transfer directions well after PAYE income has been paid. Moreover, to limit the exercise of the 7A power to a situation in which HMRC are aware of all the facts in advance and can only operate it with prospective effect would seriously curtail the

scope of the power. In our judgment there is nothing in the language or purpose of this provision to warrant such a conclusion.

85. Mr Mullan submitted that even if the obligation to account for tax placed on an employer by regulation 62(5) is disapplied, or can be disapplied by exercise of the 7A power, it has no effect on the employer's separate obligation to account pursuant to section 710(4) of ITEPA. We reject this submission. Both section 710(4) and 710(1) expressly provide that the employer's obligation to deduct or account is "*subject to and in accordance with PAYE regulations* ..." (words introduced at the same time as the 7A power was introduced). Accordingly, the obligation in section 710(4) only takes effect, subject to and in accordance with the relevant PAYE Regulations, namely regulation 62(5). If the accounting obligation in regulation 62(5) is disapplied by the exercise of the 7A power, the section 710(4) obligation can have no independent life. The same is true of section 222 ITEPA (the grossing-up provision when the employee fails to make good the amount accounted for). If the employer is relieved of the obligation to comply with regulation 62(5) and in turn, the obligation in section 710(4) ceases to apply, the charge under section 222 simply does not arise.

86. It follows that we disagree with paragraphs 118 and 119(2) of the UT decision. In these paragraphs the UT held:

> "118. The argument has prompted us to reflect on the precise scope of the 7A discretion, as it applies to a case such as this, where the direction was made after the point in time when the obligation to make the deduction had already arisen. We can well see that if the obligation to deduct were relieved, before the liability to deduct has occurred, reg 185 and reg 188, which envisage that there was an obligation to deduct tax, clearly have nothing to bite on. No PAYE credit under those regulations can then arise. *But if the 7A disapplication is made after the deduction has been made, reg 185 and reg 188, and the credit they give rise to, will already have crystallised*. …
>
> 119(2). So construed, the direction results in adverse retrospective effects. Those adverse effects do not of course fall on the subject of the direction: where the deduction obligation is removed after the event, the employer, or person treated as employer for PAYE purposes will be relieved. It is the employee who suffers from the removal of the deduction obligation after it has arisen. Tax that, under the law as it stood at the time, ought to have been deducted was not. *Tax, which therefore the employee was not expecting to be liable to pay for, becomes liable.*" (Emphasis added)

87. The passages we have emphasised highlight a number of errors. First, no deduction was ever made by the end users in this case, nor did they account for any tax; and the Claimants cannot have thought they had done so. Indeed, if any of the Claimants thought such a deduction was made, they would have declared it in their self-assessment returns pursuant to section 8 of TMA. Secondly, if a deduction was in fact made, the notional PAYE credit which lies at the heart of the Claimants' case does not arise at all. The whole point of this credit is to operate where a deduction has *not* been made, but

where nonetheless the employee can claim a PAYE credit for the amount that should have been (or is to be treated as having been) deducted. Thirdly, the reason why the Claimants did not expect to pay the tax was not because of the availability of the PAYE credit. It was because they believed that the avoidance scheme worked and the EBT contributions were not chargeable to income tax and so did not have to be included in their self-assessment returns. That was regardless of the PAYE credit. Their liability to tax is the consequence of the scheme failing and by virtue of primary legislation, and not the PAYE Regulations or the disapplication of the employer's obligation to deduct and/or account for the tax on the PAYE income.

88. To the extent that exercise of the 7A power may have unfair or adverse effects in a particular case, the words of subsection 684(7A)(b) enable the officer to make a broad assessment of what is appropriate in all the circumstances of the particular case, including taking account where relevant, of any question of retrospective unfairness or adverse effects. But on the facts of this case, where there is no evidence that any of the end users could or should have had knowledge of the arrangements and the Claimants never claimed the PAYE credit in the first place, there was no unfairly retrospective exercise of the power.

Territoriality point – section 689(1)(c)

89. This is a new point that should have been raised at first instance to enable relevant findings of fact to be made. As advanced in Mr Mullan's skeleton argument, the point appeared to be that the Employers (Penfolds and/or Hamilton) *may* have had a UK trade presence (though the positive case being advanced was not clearly stated). No such argument was advanced below (whether before the FTT, the Administrative Court or the UT); the point was not investigated in the evidence; and findings were of fact were not accordingly made. Scott McFarlane's first witness statement addressed this point, and the fact that, in order to consider the application of section 689 of ITEPA to the end users, HMRC had to consider whether the Employers were required to operate PAYE. He explained that he arrived at the conclusion that the Employers were not within the territorial scope of the PAYE Regulations, not least in reliance on disclosures made in the DOTAS forms. These included the description of Penfolds as, "an Isle of Man company" which "will be resident in the Isle of Man for tax purposes and will not trade in the UK"; and Hamilton, as an offshore entity employing individuals who are tax resident and work in the UK, but which would "not have a UK presence or be resident in the UK." Had Mr Mullan sought permission to rely on the argument as advanced in writing, we would have refused permission on this basis.

90. In oral argument Mr Mullan suggested, for the first time, that the voluntary operation of PAYE by the Employers in respect of the small salary element of the contractors' earnings meant that the Employers had surrendered to the jurisdiction of the PAYE regime. Mr Mullan produced no authority to support this novel contention. *Clark v Oceanic* does not provide any support for this proposition: it sets out the relevant test as whether there is a trading presence in the UK. There is no evidence that the Employers had a UK tax presence applying this test. The arrangements depended on the use of UK based intermediaries, and absent evidence, it certainly cannot be assumed that the offices and postal addresses of such intermediaries could be treated as those of the Employers. No positive case has otherwise been advanced. Despite their voluntary operation of PAYE on part of the earnings, no doubt to lend respectability to the

arrangements, we can see no foundation for any suggestion that the PAYE Regulations did in fact apply to them. Accordingly, this argument is without any merit either.

Was the power lawfully exercised in any event, and with what result?

91. Whatever the scope of the 7A power, the Claimants contend that its exercise in their cases was unlawful and procedurally unfair in any event. Before addressing their arguments, it is convenient to describe the development of HMRC's policy in relation to the exercise of the 7A power and how the impugned decisions were made. This is dealt with in the witness statements (and exhibits) of Scott McFarlane.

92. Mr McFarlane identified two internal HMRC policy documents addressing the exercise of the 7A power. First, a guidance note produced following a Contentious Issues Panel (issued to the counter avoidance group team delivery leads on 22 September 2017) dealing with exercise of the 7A power where avoidance schemes use offshore employers and UK end users who would be liable to comply with the PAYE Regulations and account for tax and NICs unless the PAYE Regulations were disapplied. We refer to this document as "the CIP guidance"). The CIP guidance set out the background, key features of an offshore employment based contractor loan scheme, and why HMRC might exercise discretion under section 684 (7A)(b), stating:

> "We will consider use of the discretion where contractors have used contractor loans schemes with an offshore employer and where it is reasonable to assume the end user would not have been aware of or involved in the tax avoidance scheme. If HMRC possess evidence that the end user was aware that the contractor was using an avoidance scheme with an offshore employer to receive their remuneration for services provided to the end user, without deduction of tax, we will not use the discretion as the end user should have known they might need to operate PAYE."

The CIP guidance set out a number of non-exhaustive factors relevant to determining whether it might be reasonable to conclude that the end user was not party to or aware of the tax avoidance. These included the existence of a UK intermediary between the end user and offshore employer which would generally point towards the end user being unaware of any "unorthodoxy in the arrangements".

93. The CIP guidance made clear that it would be for the individual case worker to decide whether or not to use the 7A power based on the particular circumstances of the case. It also stated that the case worker should inform the individual contractor in writing that a provisional view that the power should be exercised had been taken, explaining why and that, as a consequence, the contractor would not be entitled to a PAYE credit and would therefore need to pay the whole of the tax due. It continued:

> "The written notification should invite the contractor to make written representations if they consider HMRC have misunderstood the scheme or circumstances... The case worker should take account of any representations the customer makes about this decision and should review the case further if the customer provides additional facts or evidence which might

> impact on the appropriateness or otherwise of using [the power]…"

The CIP guidance referred to the possibility of a regulation 80 determination being issued on a protective basis at the same time as exercise of the 7A power in appropriate cases.

94. The second policy document is HMRC's Avoidance Handling Process manual ("the AHP manual") which reformatted and re-released the CIP guidance (again for internal not public use) on 19 December 2018. It made no substantive changes, but certain passages were relied on by Mr Mullan as reflecting a different emphasis. The AHP manual includes the following passage:

> "HMRC has publicly stated that it expects employers and engagers of contractors to undertake reasonable due diligence to establish whether they have obligations under PAYE. However, contractor loan schemes are often complex and frequently interpose several layers between the offshore employer and the end user client designed to disguise the nature of the arrangements. Where a contractor loan scheme is used, the nature and operation of the scheme may therefore mean that reasonable due diligence would be insufficient for the end client to identify an obligation to operate PAYE."

In a case with facts like those of the Claimants' cases, the AHP manual states:

> "HMRC can consider whether it is appropriate for PAYE Regulations to apply to an end client, or whether to exercise discretion under 684(7A)(b) to determine that the end client is not required to comply with the PAYE Regulations. If HMRC exercises this power, they will collect from each tax payer the income tax due on the taxable amount received through their use of the contractor loan scheme. This is because there will be no entitlement to have an amount treated as tax deducted at source in respect of that taxable income. So where there has been an assessment, any amount of the liability to income tax which has not already been accounted for under PAYE will be payable by the tax payer."

Later in the AHP manual it states that:

> "HMRC does not need to know the identity of the end client to be able to use the power … provided HMRC has sufficient information about the way the scheme operates so that it is reasonable to assume that the end client was unaware of and not complicit in the avoidance arrangements."

It also set out the circumstances when HMRC would not generally use the discretion where:

> "1. HMRC possesses evidence that either: a. the end client was aware that the tax payer was using an avoidance scheme with an offshore employer, or b. reasonable due diligence by the end client should have meant that they were aware that the tax payer was using an avoidance scheme with an offshore employer …"

95. In Mr Hoey's case, in 2017, Andrew Finch (a technical consultant who worked for HMRC across contractor loan schemes for several years before his retirement in May 2019), sought a recommendation from Scott McFarlane as to the exercise of the 7A power in accordance with the CIP guidance. Mr McFarlane recommended that this power should be considered for Mr Hoey and, subject to the facts of each case, for other users of the schemes. On 11 October 2017, Mr Finch emailed Mr McFarlane to state that he had considered the information that had been provided and agreed with Mr McFarlane's recommendation.

96. Mr Finch wrote to Mr Hoey by letter dated 13 October 2017 confirming the position and concluding by stating: "*Should you wish to make any representations to me about the knowledge or involvement of the end user of your services in light of what he set out above, please would you let me have these within the next 30 days*." Mr Hoey was represented by Reynolds Porter Chamberlain ("RPC") at that time. RPC responded by letter dated 3 November 2017 asking Mr Finch to explain how and why he considered that Mr Hoey remained "*liable to pay the tax due*" and why the PAYE credit was not available. However, despite the invitation to make representations about the knowledge of the End Users of Mr Hoey's services, no representations were made, whether at that time or subsequently. Mr Finch responded by letter dated 23 November 2017 explaining that the effect of the exercise of the 7A power was that the End Users would not be required to comply with the PAYE Regulations in relation to notional payments of PAYE income treated as made by them by virtue of section 689 of ITEPA. This letter yielded no response from RPC about the knowledge or involvement of the End Users in Mr Hoey's avoidance scheme.

97. A similar process was followed in relation to the other Claimants as Mr McFarlane has explained. Again, no representations were made about the knowledge or involvement of the end users.

98. Mr Mullan complained that there has been a lack of candour on the part of HMRC about how the CIP guidance (and AHP manual) came to be adopted because no information or disclosure has been given as to the formulation of the policy by the Contentious Issues Panel, or what led HMRC to consider some factors relevant and others not. He criticised the failure to explain why the CIP policy was adopted rather than using existing statutory powers, or why it was decided it was not appropriate to contact End Users directly. He submitted that these are material omissions because the policy was adopted with Mr Hoey's circumstances very much in mind. Since HMRC have not disclosed evidence of how the policy was formulated, the inference must be that irrelevant considerations were taken into account: namely, the failure to make a timely regulation 80 determination must have been the real reason for creating an alternative route to the same result through exercise of the 7A power.

99. This ground of challenge has not been pleaded. In any event, we reject its underlying premise. It is not the case that whenever a public law decision is challenged and the public body concerned discloses a relevant policy, there is a concomitant obligation to

disclose all information relating to the formulation of that policy as part of the duty of candour. The lawfulness of the CIP guidance has not been challenged in this case, and we do not begin to see the relevance of the material Mr Mullan complained has been withheld. It is inherent in good decision-making that policies are adopted in the interests of consistency, provided they do not fetter the discretion of the decision maker. The mere fact HMRC adopted a policy here affords no basis for impugning their approach. In any event, it seems to us that the lawfulness of the CIP guidance (and AHP manual) must be judged on its terms. As Mr Grodzinski submitted, either it fails to take into account relevant considerations or it does not. But on any view, such an assessment does not require any analysis of the deliberations of those who formulated the guidance in the first place. A policy was adopted in this case, and the only question is whether the decisions to exercise the 7A power in the Claimants' cases, in light of the policy, was lawful.

100. Mr Mullan also submitted that the 7A power was used for an improper purpose: it was not used to relieve the end users of their liability but was used to correct HMRC's error in failing to issue timely regulation 80 determinations. Even if this submission had any legal force (which we doubt because we cannot see that this would have been improper in any event), it is unsustainable in light of Mr McFarlane's evidence. He set out the factors he took into account in deciding to exercise the 7A power. His consideration included, as he explained, "*the burden that regulation 80 would impose on the end users and that, in the circumstances... that was an inappropriate burden*." He confirmed that he arrived at that view "irrespective of whether HMRC had issued or could issue regulation 80 determinations" and his conclusion was, in the absence of evidence that the end users were aware of the arrangements, and since the Claimants entered into the tax avoidance arrangements, that it was inappropriate for the end users to be required to comply with the PAYE Regulations. There is nothing to undermine this evidence. Accordingly, we reject this argument.

101. As for the impugned decisions themselves, Mr Mullan submitted, in light of the CIP guidance and the AHP manual, that there is an acknowledged duty of reasonable due diligence on the end users who cannot simply assume they do not need to operate PAYE. Whatever their actual knowledge, the end users were required to find out what their PAYE obligations were. An end user provided with a contractor's services can reasonably be expected to ask who the contractor is, and whether there are any consequential PAYE tax liabilities. HMRC did not ask the end users about their liability – they only asked the Claimants what the end users knew – despite HMRC's duty to investigate properly whether the end users had actual or constructive knowledge. He challenged HMRC's failure to take any steps to discover the knowledge of the end users. Instead, they unreasonably and irrationally put the onus on the Claimants to find out what the end users knew. Moreover, Mr Mullan criticised Mr Finch's letter of 13 October inviting representations as unclear and ambiguous.

102. Again, we do not accept these arguments. There was no ambiguity about what was being asked of Mr Hoey by Mr Finch in the 13 October letter. The 7A power was expressly referred to and the decision-making process was explained, including the relevance of what the end users did or did not know. That is why Mr Hoey was invited to make representations. Even now, none of the Claimants have provided a witness statement in these proceedings, still less stated that they informed their own end users of their employment situations and/or the arrangements. The two witness statements

relied on by the Claimants to suggest that the end users must have had the requisite knowledge (from Mr Hamilton and Mr Williamson, both participants in the loan arrangement scheme) do no such thing and have little probative value. Neither provided services to the End Users in Mr Hoey's case (or to our knowledge, in any of the Claimants' cases), and their own personal circumstances were materially different, as Scott McFarlane has explained (for example, Mr Hamilton was a director of his end user). In any event, even if some employees told their particular end users about the arrangement, that affords no basis to infer that that was done by Mr Hoey or any of these Claimants given their failure to file their own witness statements setting out their case on this issue.

103. As for the due diligence obligations relied on by Mr Mullan, we struggle to see what the End Users could or should have asked in this unusual case. The "Supplier Agreement" in Mr Hoey's case refers to the client as Aviva Investors (one of the End Users), who is not a party to the agreement, but is the client to whom computer consultancy services are supplied. The parties are Oldbury and Cascade. Cascade is described as the "supplier by its representative, Stephen Hoey". There is no mention in the agreement of Penfolds, Hamilton or any other intermediary. The agreement is described as a contract for the provision of services by the supplier (Cascade by Mr Hoey). It states that services will be provided at a "pay rate" of "£550 plus VAT per day". Not only are the arrangements opaque and on the face of it inconsistent with any sort of worker or employee contract, but there is an express contractual prohibition on Mr Hoey telling Aviva Investors anything about the terms of the agreement (except where strictly required for the purposes of the services). In short, there was nothing to put the End Users on notice of any "unorthodoxy in the arrangements".

104. Equally, we can discern no inconsistency between the approach adopted by Scott McFarlane in exercising the 7A power in these cases, and the guidance set out in the AHP manual by reference in particular to the passages highlighted by Mr Mullan. Mr McFarlane was amply entitled to conclude, on the facts known, that the end users, exercising reasonable due diligence, could not have been aware that they were required to operate PAYE. Even if questions were asked by Aviva Investors in Mr Hoey's case, and a thorough due diligence process had revealed the existence of multiple intermediaries and an offshore employer, we have no reason to doubt that Aviva Investors would have been told that Mr Hoey was employed by the Employers who were operating PAYE on his salary payments, deducting PAYE and NICs. It is highly unlikely that the avoidance scheme and loans would have been disclosed. Even if the loans were disclosed, there would have been no reason for the End Users to conclude that such loans were in fact payments of earnings until the *Rangers* decision. Even then, the point was only conceded by the Claimants in July 2019. In those circumstances, we accept Mr McFarlane's evidence: he reasonably formed the view that due diligence by the end users would not have identified a liability to deduct PAYE under the arrangements which the Claimants had participated in, even if the end users had asked the Claimants to explain their arrangements.

105. Ultimately the question for us on this part of the case is whether the HMRC officers took a lawful approach to the exercise of the 7A power. They were required to acquaint themselves with the facts and the relevant considerations. It is not for the court to decide on the manner and intensity of the enquiry to be undertaken. We can intervene only if no reasonable decision maker could be satisfied, on the basis of the enquiries made, of

the merits of the decisions. This test is not met. We consider that the approach of the HMRC officers was lawful: they took into account the relevant considerations as we have explained, and their decisions were not based on irrelevant considerations. Mr Hoey and the Claimants were given the opportunity to provide evidence that the end users were aware of the arrangements and/or the need to operate PAYE, but as we have observed, no such evidence was ever provided.

106. Mr Mullan also challenged the exercise of the power on the basis of an asserted procedural legitimate expectation derived from the public statement in HMRC's Compliance Operational Guidance at paragraph COG915255, that liability would only be transferred through express powers in regulations 72, 72F and 81. Relying on *R (on the application of Aozora GMAC Investment Ltd) v Revenue and Customs Commissioners* [2019] EWCA Civ 1643 at [3], he submitted that this created an expectation as to the procedure that would be used in transferring liability, and at least until HMRC announced a change of policy going forward, the Claimants were entitled to rely on it.

107. We reject this argument, not least because of the terms of the statement itself. HMRC's Compliance Operational Guidance manual, paragraph COG915255 states:

> "The *Demibourne* case confirmed that:
>
> Where an employment relationship exists, the employer is responsible for deducting tax from payments made to the employee in accordance with the PAYE Regulations."
>
> Prior to the amendment to the PAYE Regulations, HMRC did not have the discretion to choose whether to collect tax from the employer or the employee unless there had been a Direction to transfer PAYE to the employee under either Regulation 72 or Regulation 81 of the PAYE regulations.
>
> An employee is entitled under Regulation 185 of the PAYE Regulations, to treat as deducted any tax that the employer was liable to deduct whether or not that tax was actually deducted. However the Regulation 185(5) credit is restricted so that an employee is not repaid any amount they didn't actually pay or have deducted.
>
> Unless there had been a direction to remove the PAYE obligation from the employer under either Regulation 72 or Regulation 81 of the PAYE Regulations, the employee was entitled to recover tax paid through SA, subject to time limits and HMRC could not refuse to repay on the grounds they had not recovered the tax from the employer.
>
> Regulations 72E to G were introduced following *Demibourne* to extend the circumstances where HMRC could make a direction to remove a PAYE liability from an employer and prevent an employee claiming credit for tax the employer failed to deduct."

108. There is no clear, unequivocal, unqualified policy statement in this paragraph that limits the use of the 7A power in any way, still less stating that the 7A power will not be used in the current circumstances, or that only the specific redirection regulations will be used. On the contrary, COG915255 is dealing with a different situation, arising from the *Demibourne* case (where PAYE had been paid to HMRC but by the wrong legal person) and does not address the 7A power at all. It cannot have generated a legitimate expectation in the manner described. Even if it did, in circumstances where the end users would have had a strong (perhaps even an unanswerable) case for saying that it would be unfair not to use the 7A power contained in primary legislation to relieve them in this case, there is no basis for concluding that there would have been unfairness amounting to an abuse of power for HMRC to act inconsistently with it.

109. For all these reasons, the 7A power was available to HMRC in the circumstances of these cases, and was exercised lawfully. The exercise of the 7A power means that there is no PAYE credit available to Mr Hoey or the Claimants for the reasons we have given. Accordingly, we dismiss the claim for judicial review.

III. The jurisdiction to determine the validity of the PAYE credit following exercise of the 7A power

110. The FTT held that it did not have jurisdiction to consider matters of public law and the availability of a PAYE credit under the PAYE Regulations, and also that consideration of such issues was not necessary for resolution of the matters raised by the appeal that were within its jurisdiction. The FTT held that it could not therefore consider whether the 7A discretion was exercised correctly, legally or reasonably: see [128].

111. The UT dealt with this question at [81] to [108], having considered a number of other Upper Tribunal decisions which had grappled with the same arguments as those advanced by the parties in this case. The UT concluded at [107] as follows:

> "107.We conclude the PAYE credits under Regulations 185 do not affect the amount of tax payable with which sections 8 and 9 are concerned. Similarly, we conclude Regulation 188 does not affect the amount of tax payable with which an assessment under s29 TMA is concerned. As those self-assessment and assessment provisions are the only relevant sources of the FTT's jurisdiction, the effect of the PAYE credit is not something which falls within the FTT's jurisdiction."

112. Since the question of jurisdiction raised on this appeal is one of pure statutory construction, we do not set out the reasoning of the UT. Instead, we summarise the arguments advanced by Mr Mullan, which essentially repeated those advanced unsuccessfully below, and then set out our reasons and conclusions on this question.

The challenge to the UT's decision

113. Mr Mullan contended that as a matter of generality PAYE issues are regularly considered by tax tribunals and no exceptional extension of their jurisdiction is being invoked by the submissions made in this case. Unless a clear contrary indication appears, the FTT is the appropriate forum to determine a dispute about entitlement to a PAYE credit where that affects the amount of tax payable by the taxpayer concerned. A conclusion in favour of jurisdiction also enables HMRC to litigate assessments made

on an alternative basis in one forum, in a single hearing, ensuring that tax is collected from either the employer or the employee, and saving time and costs. Furthermore, the relevant appeal provisions, sections 31(1)(b) and (d) of TMA should be read broadly in light of cases like *MCX Dunlin (UK) Ltd v HMRC* [2021] EWCA Civ 186, [2021] STC 474: the term "assessment" is generic in the tax code, and the analysis applied in that case should apply in respect of every assessment to tax. The UT was wrong not to follow this analysis. Mr Mullan submitted that the UT's approach creates absurdity and fails to have regard to the purpose of the legislation.

114. Mr Mullan criticised the UT's failure to deal separately with regulations 185 and 188, by focussing only on regulation 185 and applying that reasoning to regulation 188, which it regarded as functionally similar. These are separate provisions: the former deals with self-assessments, leading to a closure notice; and the latter, with other assessments. Both are in issue in Mr Hoey's appeal, and the UT's approach was wrong. In summary, he contended that sections 8 and 9 of TMA impose an obligation on taxpayers to provide a self-assessment stating both the amounts for which he is chargeable to tax and significantly, "the amount payable by him". The amount payable by a person is the difference between the amount on which he is chargeable to tax and the amount of any income tax deducted at source: section 8(1A) of TMA. Tax deducted at source means "income tax deducted or treated as deducted from any income or treated as paid on any income": section 8(5) of TMA. The deeming provision in regulation 185(2) treats tax deducted at source as including amounts treated as deducted, and therefore as including PAYE that an employer should have deducted but did not, or should have accounted for, but did not. He contended that such amounts are included within the meaning of tax deducted at source in section 8 of TMA, and therefore within section 8(5), and the consequences of the deeming provision carry through. In relation to assessments other than self-assessments (including section 29 of TMA), the express words of regulation 188 provide that the tax payable should take into account tax which an employer should have deducted (or accounted for) but did not.

115. He submitted that there is no basis for a conclusion that, as a matter of construction, the amounts treated as having been paid are not relevant to an assessment. Moreover, he submitted that the relationship between sections 8 and 59B of TMA is irrelevant when considering other assessments outside the self-assessment regime. Fundamentally, he challenged the UT's approach as wrongly disregarding the "amount of tax which has to be paid" as an essential component of an assessment of whatever kind. A valid assessment requires the taxpayer to be told what tax he or she must pay. Since this is the issue Mr Hoey seeks to challenge, and is an essential part of each assessment under appeal, it is a matter within the statutory jurisdiction of the tax tribunals.

Discussion and conclusion

116. We do not accept Mr Mullan's submissions on the jurisdiction question and consider that the UT correctly rejected this part of the appeal for the reasons it gave. Our own reasons, which are essentially the same as those given by the UT, follow.

117. The First-tier Tribunal is a creature of statute, created by section 3 of the Tribunals, Courts and Enforcement Act 2007 "*for the purpose of exercising the functions conferred on it under or by virtue of this Act or any other Act*". Its jurisdiction is therefore entirely statutory and it has no inherent jurisdiction equivalent to that of the

High Court to consider public law arguments founded on common law, or even equivalent to the limited statutory jurisdiction exercised by the UT (under sections 15 and 18 of the 2007 Act which provide for a limited jurisdiction on judicial review): see *Trustees of the BT Pension Scheme v HMRC* [2015] EWCA Civ 713 at [142].

118. This does not mean that the tax tribunal can never determine issues of public law. It is now well-established that a court or tribunal that has no judicial review or supervisory jurisdiction may nevertheless be required to decide questions of public law in the course of exercising its given jurisdiction: see for example, the well-known case of *Wandsworth LBC v Winder* [1985] AC 461.

119. Further, it is not in dispute that there is no express right of appeal to the First-tier Tribunal conferred by any legislation in relation to the exercise of the 7A power or in relation to the availability or otherwise of a PAYE credit following exercise of this power. The only relevant right of appeal (and again this is common ground), is that provided by section 31 of TMA, which deals with appeals against assessments (including discovery assessments) and closure notices. Mr Mullan also accepted, correctly as we see it, that matters arising at *Whitney* stage 3 under sections 59A and 59B, which are concerned with collection, do not fall within the scope of an appeal under section 31 of TMA.

120. The question of jurisdiction is therefore a question of statutory construction of the relevant PAYE Regulations and their interaction with the TMA. The critical question turns on whether the PAYE credit arising under regulations 185 and 188 forms part of the amounts payable under the assessments, as Mr Mullan submitted; or whether as HMRC submitted, and as the UT found, the PAYE credit is only relevant to the subsequent collection stage. This in turn depends on whether the availability of the PAYE credit (under regulations 185 and 188) affects the amount of tax payable under sections 8 and 9 of TMA and/or section 29 of TMA, so that it is part of the subject matter of an appeal against those assessments and/or closure notices, as Mr Mullan contended; or whether those regulations do not affect the amount payable at the assessment stage, but relate only to adjustments made at the collection stage.

121. We start by reiterating the fact that the PAYE Regulations do not impose liability to tax on employment income. Liability is fixed by the provisions of ITEPA to which we have already referred (sections 6,7, 9, 11 and 13 of ITEPA). As the UT observed, PAYE is often and un-controversially described as a collection mechanism.

122. Consistently with the points just made, both the heading and opening words of regulation 185 make clear that it applies for a specific purpose, namely for the purpose of determining the excess mentioned in 59A(1) and the difference mentioned in section 59B(1) (see regulation 185(1)(a) and (b)). In other words, it applies at the section 59B stage, for making adjustments reflecting the difference between tax contained in the self-assessment and the aggregate of payments on account made by the taxpayer under section 59A or otherwise, and any tax deducted at source. It therefore operates at a subsequent stage, after the assessment stage is complete, and the calculations it requires do not form part of or affect the assessment itself. Significantly, it is not expressed to apply to sections 8(1AA)(b) or 9(1)(b) of TMA.

123. As for section 59B of TMA, it is clear from the structure of the TMA, the position of sections 59A and 59B within that structure (in a section dealing with payments, after

assessments and appeals, but before collection and recovery) and its language, that the adjustments in section 59B do not form part of or take place at the assessment stage under sections 8 and 9 of TMA. To conclude otherwise would mean that section 59B simply replicates the calculation in sections 8(1) and 9(1)(b), and we can see no reason for it to do so. Rather, section 59B takes the assessment as a starting point (referring back to the "chargeable" and "payable" amounts as defined in section 8(1AA)(a) and (b) and 9(1)(a) and (b) of TMA, consistently with the assessment stage having been completed) and transforms a taxpayer's "liability to tax" (at the assessment stage) into an amount to be paid (a debt due) to HMRC by stipulating certain adjustments to the amounts to be paid. The absence of any cross reference in sections 8 and 9 to section 59B provides further support for this conclusion. So far as the PAYE credit is concerned, the adjustments made by section 59B operate as a set off against the taxpayer's (already assessed) liability to tax, rather than being deducted at the assessment stage to assess what the liability is. Section 59A provides for payments on account of the debt due and plainly operates at that later collection stage. In other words, sections 59A and 59B do not concern or have effect at the assessment stage. They concern the collection stage.

124. Mr Mullan contended, however, that the express limitation of purpose in regulation 185(1) must be read in light of the requirement to treat as deducted notional payments made by a deemed employer because of the requirement to "*treat as real that which is only deemed to be so"* meaning that *"one must treat as real the consequences and incidents inevitably flowing from or accompanying that deemed state of affairs, unless prohibited from doing so*." (see *Marshall v Kerr* [1995] 1 AC 148 at 164E-G). But as Mr Grodzinksi submitted, and we agree, in light of the opening words of regulation 185(1), which expressly limit its application, it cannot be said that the inevitable consequence of the deeming is to require regulation 185 to be read as applying for the purposes of the assessment stage, rather than being limited to the collection stage in section 59B. Those express words, limiting the purpose for which regulation 185 applies, prevent the result for which Mr Mullan contended.

125. As for regulation 188, although it does not contain the same limiting words as regulation 185 (no doubt because 59A and 59B operate in the context of self-assessments and amendments to self-assessments by closure notices, and regulation 188 is expressly concerned with other categories of assessment, including in particular discovery assessments), it operates in the same way as regulation 185, performing an adjustment function, but in the context of other assessments. We agree with the UT that the two are functionally similar, and in particular that, like regulation 185, regulation 188 does not affect the amount of tax payable under the assessment but operates at the subsequent collection stage.

126. This conclusion follows from the fact that regulation 188(2) sets out the formula for calculating the "*tax payable"* by the employee as A-(B-C) where A is the "*tax payable under the assessment*", B is the total net tax deducted from A, and C is an amount to be added to or credited against B, as the tax that was deducted but subsequently repaid. It is immediately apparent that the product of the formula (the "tax payable" at the collection stage) is something different to A (the tax payable under the assessment); and that C (the PAYE credit which is added to B as a credit against it) is not part of the tax payable under the assessment but is an adjustment to it. This is further confirmed by the definition of the "tax payable under the assessment" in regulation 188(7) as

meaning "*the amount of tax shown in the assessment as payable without regard to any amount shown in the notice of assessment as a deduction from, or a credit against, the amount of tax payable*".

127. It is also consistent with the way regulation 188 operates in practice: for example, where a discovery assessment is made (which sets out the amount of tax payable under that assessment) and there is tax which should have been deducted or accounted for by the employer but was not, a direction under regulations 72 or 81 might or might not be made. If such a direction is made, the amount which should have been deducted but was not, or any amount which should have been accounted for but was not, is not added to the B amount and so no credit arises (see the mandatory effect of regulation 185(4)). If no direction is made, the credit does arise and the amounts of tax which the employer was liable to deduct, but failed to, or was liable to account for, but failed to will be added to the B amount at this stage. Where a direction is made after the discovery assessment is made, regulation 188(5) deals with the possibility that an amount of tax previously understood as having been deducted or accounted for was not deducted or accounted for, and depending on whether a direction is made or not, the PAYE credit is either removed (if the direction is made) or retained (if not). What is clear in each of these cases is that the direction has no effect on the amount of tax payable under the discovery assessment. Rather, it removes the amount of PAYE credit that, in the light of the direction, should not have been included, or was not included in the notice of assessment or in the assessment in the first place.

128. Sections 8 and 9 of TMA, properly understood, do not lead to a different conclusion. There are two components of an assessment under these provisions: the "amount chargeable" and the "amount payable". Under section 8(1AA)(b) "*the amount payable by a person by way of income tax is the difference between the amounts in which he is chargeable and the aggregate amount of any income tax deducted at source*". Income tax deducted at source is a defined term: section 8(5) TMA provides that in sections 8, 8A, 9 and 12AA any reference to income tax deducted at source is a reference to "income tax deducted, or *treated as deducted* from any income, or *treated as paid* on any income". HMRC accept that amounts of income tax that are actually deducted at source are included in this definition.

129. Mr Mullan went further and contended that by virtue of section 8(5), section 8(1AA)(b) must also refer to amounts treated as deducted at source pursuant to regulations 185 and/or 188 so that the amount payable in the assessment must take account of and give effect to the notional deductions. We do not accept this argument because, as we have explained, neither regulation 185 nor regulation 188 has a role to play in establishing a taxpayer's liability to income tax under sections 8 or 9 of TMA. As we have said, regulations 185 and 188 are functionally similar: they apply at the collection stage, and the adjustments they provide for do not affect the amount of income tax chargeable under the assessment. In short, there is no basis for concluding that section 8(5) includes the notional PAYE credit for amounts of PAYE tax that should have been deducted or accounted for but were not. In practice, at the sections 8 and 9 stage, no regulation 185 deemed deduction is or could have been established. Moreover, we accept, as Mr Grodzinski submitted, that section 8(5) has a clear function without needing to encompass deemed PAYE deductions. Examples given included section 710(6) of ITEPA (dealing with notional payments) and sections 414 and 530 of the Income Tax (Trading and Other Income) Act 2005 (dealing respectively with the

imposition of a tax charge for stock dividend income and the imposition of a tax charge on gains from contracts of life insurance), under both of which, put broadly, a person liable to tax is treated as having paid income tax.

130. For all these reasons, which are essentially the same as those given by the UT, as a matter of construction neither regulation 185 nor 188 affects the amount of tax chargeable or payable under sections 8 and 9 or section 29 of TMA. It follows that these regulations and the availability of a PAYE credit do not fall within the scope of an appeal under section 31 of TMA to the First-tier Tribunal. Since the self-assessment and assessment provisions are the only relevant sources of the tax tribunal's jurisdiction, the availability of the PAYE credit does not fall within the First-tier Tribunal's jurisdiction.

131. It follows that we reject Mr Mullan's submission that the tribunals below erred in law in concluding that they have no jurisdiction in relation to the availability of the PAYE credit. Where the legislation intends that an appeal may be brought to the First-tier Tribunal in relation to PAYE issues, express provision is made: see regulations 72B, 72C, 72G, 80(5) and 81A. In the absence of any express right of appeal concerning the availability of the PAYE credit under regulations 185 and 188, and since there is no route through the operation of sections 8, 9, 9A, 28A, 29, 31, 48, 48D and 50 of TMA by which a dispute about the operation of regulations 185 and 188 may be litigated in the First-tier Tribunal, an appeal to policy considerations and the need to avoid "absurd results" goes nowhere.

132. In any event, we do not regard this result as "unworkable" or as impeding access to justice, as Mr Mullan submitted. The attraction of the First-tier Tribunal as a *"one stop shop"* for all issues concerning the amount taxpayers should be required to pay to HMRC cannot alter the meaning and effect of a legislative scheme that, properly construed, requires certain issues to be litigated in the tax tribunal, others to be litigated by way of judicial review in the High Court and in specific circumstances the Upper Tribunal; and disputes about the amount to be collected by HMRC dealt with as a matter of enforcement in the civil courts (the County Court or High Court). The courts and tribunals cannot confer jurisdiction on a statutory tribunal any more than the parties can agree to do so. The question of jurisdiction can only be determined by reference to the particular statutory scheme in question that governs the tax tribunal's jurisdiction. It also follows that the cases on which Mr Mullan relied (including *McCullough v Ahluwalia* [2004] EWCA Civ 889, [2004] STC 1295, *Hallamshire Industrial Finance Trust Ltd v IRC* [1979] 1 WLR 620, *Archer v HMRC* [2017] EWCA Civ 1962, [2018] 1 WLR 5210 and *MCX Dunlin (UK) Ltd v HMRC* (see above)) do not assist him. They were dealing with different provisions, in different contexts.

133. This ground of appeal accordingly fails.

IV. The Transfer of Assets Abroad ("TOAA") Issues

The relevant legislation

134. During the three tax years under appeal, the TOAA legislation was contained (as it still is today) in Chapter 2 of Part 13 of ITA 2007. Part 13 is headed "Tax Avoidance", and Chapter 2 is headed "Transfer of Assets Abroad". The chapter runs from sections 714 to 751. Although in some respects framed in simpler language than its predecessors, in

accordance with the principles of the Tax Law Rewrite Project, the legislation may be traced in its essentials back to its first enactment in section 18 of the Finance Act 1936. It was then restated, incorporating intermediate amendments, in the Income Tax Act 1952 (as Chapter IV of Part XVIII), the Income and Corporation Taxes Act 1970 ("ICTA 1970", as Chapter III of Part XVII) and the Income and Corporation Taxes Act 1988 ("ICTA 1988", again as Chapter III of Part XVII). In what follows, we will refer to the legislation as it stood between 6 April 2008 and 5 April 2011. It has not been suggested that there were any material differences between the provisions in force during that period.

135. The basic charging provision is section 720, which provides:

> "**720 Charge to tax on income treated as arising under section 721**
>
> (1) The charge under this section applies for the purpose of preventing the avoiding of liability to income tax by individuals who are ordinarily UK resident by means of relevant transfers.
>
> (2) Income tax is charged on income treated as arising to such an individual under section 721 (individuals with power to enjoy income as a result of relevant transactions).
>
> (3) Tax is charged under this section on the amount of income treated as arising in the tax year.
>
> …
>
> (5) The person liable for any tax charged under this section is the individual to whom the income is treated as arising. …
>
> (7) For exemptions from the charge under this section, see sections 736 to 742 (exemptions where no tax avoidance purpose or genuine commercial transaction)."

136. The concept of a "relevant transfer" is defined in section 716:

> "**716 Meaning of "*relevant transfer*" and "transfer"**
>
> (1) A transfer is a relevant transfer for the purposes of this Chapter if –
>
> (a) it is a transfer of assets, and
>
> (b) as a result of –
>
> (i) the transfer,
>
> (ii) one or more associated operations, or
>
> (iii) the transfer and one or more associated operations,

> income becomes payable to a person abroad.
>
> (2) In this Chapter "*transfer*", in relation to rights, includes the creation of the rights.
>
> (3) For the meaning of "*assets*", see section 717."

137. By virtue of section 717(a), "assets" is defined as including "property or rights of any kind". "Associated operation" is very broadly defined in section 719, and includes "an operation of any kind effected by any person in relation to … any of the assets transferred … whether the operation is effected before, after or at the same time as the transfer". By virtue of section 715, a "relevant transaction" is defined as "(a) a relevant transfer, or (b) an associated operation".

138. Pausing at this point, an individual (such as Mr Hoey) who is ordinarily resident in the UK is potentially within the scope of the charge to tax under section 720(2) if he has "power to enjoy income as a result of relevant transactions". The ingredients of this composite requirement are then elucidated in sections 721 to 723:

> "**721 Individuals with power to enjoy income as a result of relevant transactions**
>
> (1) Income is treated as arising to such an individual as is mentioned in section 720(1) in a tax year for income tax purposes if conditions A and B are met.
>
> (2) Condition A is that the individual has power in the tax year to enjoy income of a person abroad as a result of:
>
> (a) a relevant transfer,
>
> (b) one or more associated operations, or
>
> (c) a relevant transfer and one or more associated operations.
>
> (3) Condition B is that the income would be chargeable to income tax if it were the individual's and received by the individual in the United Kingdom.
>
> (4) For the purposes of sub section (2), it does not matter whether the income may be enjoyed immediately or only later.
>
> (5) It does not matter for the purposes of this section –
>
> (a) whether the income would be chargeable to income tax apart from section 720,
>
> (b) whether the individual is ordinarily UK resident at the time when the relevant transfer is made, or

(c) whether the avoiding of liability to income tax is a purpose for which the transfer is effected.

(6) For the circumstances in which an individual is treated as having the power to enjoy income for the purposes of this section, see section 722.

722 When an individual has power to enjoy income of person abroad

(1) For the purposes of section 721, an individual is treated as having power to enjoy income of a person abroad if any of the enjoyment conditions are met.

(2) In sub section (1) "*the enjoyment conditions*" means conditions A to E as specified in section 723.

(3) In determining whether an individual has the power to enjoy income for the purposes of section 721, regard must be had to the substantial result and effect of all the relevant transactions.

(4) In making that determination all benefits which may at any time accrue to the individual as a result of the transfer and any associated operations must be taken into account, irrespective of –

(a) the nature or form of the benefits, or

(b) whether the individual has legal or equitable rights in respect of the benefits.

723 The enjoyment conditions

(1) Condition A is that the income is in fact so dealt with by any person as to be calculated at some time to enure for the benefit of the individual, whether in the form of income or not.

…

(3) Condition C is that the individual receives or is entitled to receive at any time any benefit provided or to be provided out of the income or related money.

(4) In sub section (3) "*related money*" means money which is or will be available for the purpose of providing the benefit as a result of the effect or successive effects –

(a) on the income, and

(b) on any assets which directly or indirectly represent the income,

> of the associated operations referred to in section 721(2).
>
> (5) Condition D is that the individual may become entitled to the beneficial enjoyment of the income if one or more powers are exercised or successively exercised.
>
> (6) For the purposes of sub section (5) it does not matter –
>
> (a) who may exercise the powers, or
>
> (b) whether they are exercisable with or without the consent of another person.
>
> …"

139. The provisions which we have so far examined impose a charge to income tax under section 720 where an individual has power to enjoy "*income*" as a result of relevant transactions. Section 727 then imposes a separate charge to income tax in circumstances where an individual receives *capital* sums as a result of relevant transactions. Put shortly, this alternative head of charge applies if income has become the income of a person abroad as a result of relevant transactions, and "the capital receipt conditions" set out in section 729 are met in respect of the individual in a tax year. The capital receipt conditions will be so met if "the individual receives or is entitled to receive any capital sum, whether before or after the relevant transfer": see section 729(1)(a). For these purposes, by virtue of section 729(3), "capital sum" means "(a) any sum paid or payable by way of loan …"

140. We next need to refer to the statutory defence which is available to an individual who would otherwise be chargeable to income tax under the Chapter if he is able to establish, in broad terms, the absence of any tax-avoidance purpose. Where, as in the present case, all the relevant transactions took place after 4 December 2005, the conditions which have to be satisfied in order to make good the defence are set out in section 737:

> "(2) An individual is not liable to income tax under this Chapter for the tax year by reference to the relevant transactions if the individual satisfies an officer of Revenue and Customs –
>
> (a) that Condition A is met, or
>
> (b) in a case where Condition A is not met, that Condition B is met.
>
> (3) Condition A is that it would not be reasonable to draw the conclusion, from all the circumstances of the case, that the purpose of avoiding liability to taxation was the purpose, or one of the purposes, for which the relevant transactions or any of them were effected.
>
> (4) Condition B is that –
>
> (a) all the relevant transactions were genuine commercial transactions (see section 738), and

> (b) it would not be reasonable to draw the conclusion, from all the circumstances of the case, that any one or more of those transactions was more than incidentally designed for the purpose of avoiding liability to taxation.
>
> (5) In determining the purposes for which the relevant transactions or any of them were effected, the intentions and purposes of any person within sub section (6) are to be taken into account.
>
> (6) A person is within this sub section if, whether or not for consideration, the person –
>
> (a) designs or effects, or
>
> (b) provides advice in relation to,
>
> the relevant transactions or any of them.
>
> …"

Section 738 then defines what is meant by a "commercial transaction" in this context.

141. Finally, we should mention section 743, which is headed "No duplication of charges", and provides by sub section (1) that "No amount of income may be taken into account more than once in charging income tax under this Chapter", while sub section (4) states that:

> "If income treated as arising to an individual is charged to income tax under section 720 or 727 and the individual subsequently receives that income, it is treated as not being the individual's income again for income tax purposes."

142. It has long been established, by statements of high authority, that the TOAA legislation was intended by Parliament not merely to combat tax avoidance, but to be penal in its effect and to deter transfers abroad in circumstances where the statutory motive defence could not be established. The words of Lord Greene MR in *Lord Howard de Walden v Inland Revenue Commissioners* [1942] 1 KB 389 at 395-396 are well-known, but bear repetition:

> "The section is a penal one, and its consequences, whatever they may be, are intended to be an effective deterrent which will put a stop to practices which the legislature considers to be against the public interest. It would not shock us in the least to find that the legislature has determined to put an end to the struggle by imposing the severest of penalties. It scarcely lies in the mouth of the taxpayer who plays with fire to complain of burnt fingers."

143. Some 45 years later, in *Inland Revenue Commissioners v Brackett* [1986] STC 521, Hoffmann J (as he then was) said at 539:

> "It has been said more than once that s 478 [*of ICTA 1970*] is a broad spectrum anti-avoidance provision which should not be narrowly or technically construed."

144. In the most recent case on the TOAA provisions to reach this court, the two passages which we have quoted were referred to, without disapproval, by Newey LJ at the beginning of his review of the relevant case law: see *Fisher v Revenue & Customs Commissioners* [2021] EWCA Civ 1438, [2022] 1 WLR 651, at [39].

145. Furthermore, although the House of Lords, in the *Vestey* case in 1979, held that the legislation did not apply to non-transferors of the relevant assets, Lord Wilberforce, delivering the leading speech, explicitly upheld the approach adopted by Lord Greene MR in *Lord Howard de Walden* to the facts of that case, where the transferor had derived only "a comparatively small benefit from the transferred assets", but was nevertheless "taxed in respect of the whole income": see 1175 C-D. Having rejected some of the unreasonable and unconstitutional arguments upon which the Revenue had relied in support of the application of the legislation to non-transferors, Lord Wilberforce then said, at 1176 C:

> "The alternative which is supported by the language is to suppose that the section was intended by Parliament as a limited section, attacking, with penal consequences, those who removed assets abroad so as to gain tax advantages while residing in the United Kingdom …"

Was there a transfer of assets abroad by Mr Hoey?

146. If Mr Hoey was to be held liable under the TOAA legislation, it was necessary for him to have made a transfer of assets as a result of which, with or without associated operations, income become payable to a person abroad. At first blush, it is difficult to see how this requirement could have been satisfied, because Mr Hoey did not in any conventional sense transfer any assets in his ownership to a person resident or domiciled outside the UK (that being the definition of "person abroad" in section 718(1)). What he did do was to enter into a contract of employment with such a person (either Penfolds or Hamilton), but did he thereby transfer any asset to the employer? If it were not for the extended definitions of "transfer" and "assets" in sections 715 and 717, the answer to this question would clearly be no; but "transfer" is defined in section 716(2) to include, in relation to rights, "the creation of the rights", and by virtue of section 717(a) "assets" includes "rights of any kind".

147. In *IRC v Brackett*, see above, Hoffmann J relied on equivalent definitions in section 478 of ICTA 1970 to hold that the entry into a contract of employment between the tax payer, a chartered surveyor resident in the UK, and a Jersey company formed by the trustees of an off-shore settlement which he had made, fell within the scope of the section. As Hoffmann J explained, at 538-539:

> "The Revenue submit that by entering into the contract of employment the taxpayer created rights vested in Drishane which were valuable and capable of being turned to account, and that by virtue of those rights, together with the associated

> operation of carrying on a trade as business consultant, income became payable to Drishane.
>
> The Special Commissioners rejected this argument on three grounds. First, they said that the taxpayer's earning capacity was not an asset in respect of which rights could be transferred to or created in favour of Drishane. This suggests that the "rights of any kind" which can constitute assets under s 478(8) must be rights in rem subsisting over some other assets. I can see no basis for this restrictive interpretation. The Special Commissioners found, in my judgment rightly, that the contract of employment conferred on Drishane enforceable rights against the taxpayer
>
> Second, the Special Commissioners said that the rights acquired by Drishane were not created by the taxpayer because they came into existence under a contract to which he was only one party. This, too, is in my view an unduly restrictive construction. The contract of employment is no doubt a bilateral transaction by which each party undertakes obligations and thereby confers rights on the other. In the context of s 478, and in particular the extended meaning of "assets" contained in sub-s (8), it seems to me appropriate to describe the rights of one party under the contract as having been created by the other."

148. This reasoning was not challenged by Mr Hoey before either tribunal, nor was it questioned by Mr Mullan in his submissions to us. We confess that we have some misgivings about treating the entry into a contract of employment as involving the creation by the employee of rights vested in the employer, even on the broad approach to construction of the legislation which is no doubt appropriate. Those doubts are only increased when they apparently lead to the conclusion that the employee may be chargeable under the TOAA provisions in respect of income of the employer which he has power to enjoy, for example by receipt of a salary, even though the salary will also be chargeable to income tax in his hands as employment income. We were not referred to any provisions which would be effective to prevent economic double taxation of the employee in such circumstances, and indeed the possibility of such penal consequences is clearly contemplated by section 721(5)(a). However, we will not pursue these doubts any further, because there is no issue between the parties on the point, and we have not heard full argument on it. It may also be relevant to note, as Ms Nathan (who argued this part of the case for HMRC) informed us, that section 721(5)(a) was repealed by the Finance Act 2013. For present purposes, therefore, we proceed on the assumption that when Mr Hoey entered into a contract of employment with either Penfolds or Hamilton he thereby made a transfer of assets within the meaning of section 716(1)(a).

149. In order for the transfer of assets to be a "relevant transfer", however, it had to have the result that "income" became payable to the foreign employer: see section 716(1)(b). That is the next question, to which we now turn.

Did income become payable to Mr Hoey's Employers as a result of the transfer and/or associated operations?

150. The TOAA legislation contains no definition of the word "income". It is therefore critical to understand what is meant by the word in this context. The question was addressed by Lord Wilberforce (with whose speech Lord Salmon, Lord Fraser of Tullybelton and Lord Russell of Killowen agreed) in *Lord Chetwode v Inland Revenue Commissioners* [1977] 1 WLR 248. Referring to section 712 of the Income Tax Act 1952 he asked, at 251, "what is meant by "income"?", and continued:

> "It is first to be noticed that this section forms part of the United Kingdom tax code – it was part of the Income Tax Act 1952 which dealt comprehensively with all aspects of income tax in the UK. Moreover, it is concerned with individuals ordinarily resident in the UK and aims at taxing them: it would be a misconception to regard it as concerned with the taxation of companies resident abroad. This means that one should start with a disposition to interpret "income" as that word is used in our tax legislation. It is notorious that there is not and never has been any definition of income in the UK tax code. What, as income, is chargeable with income tax is left to be determined according to particular heads of charge under the Schedules."

151. Lord Wilberforce then quoted the words of Viscount Radcliffe in *Inland Revenue Commissioners v Frere* [1965] AC 402, 418:

> "One can start with some safe generalisations on this subject. Income that is assessed to tax is neither measured by expenditure nor is it the residual income that lies after expenditure of an income nature. It is not the savings of income. In principle it is gross income as reduced for the purposes of assessment by such deductions only as are actually specified in the tax code or are granted by way of reliefs, usually in the form of fixed sums or proportions. No doubt the assessment of profits under Schedule D has come to require a rather different approach, since in that case the basic figure for assessment is the balance between receipts and expenditure: but even there it is plain that the code is intended to keep a control over the forms of expenditure that can appear in the profit account. "

152. It is common ground that the only relevant activity of Penfolds or Hamilton was a trade, which in broad terms consisted of supplying the services of contractors such as Mr Hoey to end users. Accordingly, the only relevant income of each employer was the profits of its trade, computed on the principles set out in the UK tax code. Those principles are now contained in the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA 2005"), replacing the previous charge to income tax on trading profits under Schedule D. It is elementary that in the case of a trader, it is only the profits of the trade, thus computed for an appropriate period in accordance with generally recognised principles of commercial accounting, which constitute "income" chargeable to tax. Trading receipts which enter into the computation, and from which allowable expenditure is deducted, do not themselves constitute income. Moreover, if the result of the computation is that the trade was carried on at a loss, no taxable income arises at all to the trader for that period. So it was that Lord Wilberforce said in the *Lord Chetwode* case, at 253:

> "The fact that in the case of a trade it is necessary to strike a balance, in respect of a period, *before any taxable "income" arises*, is no argument for applying the same process to other heads of charge … "

153. We emphasise the words "before any taxable income arises", which reflect the fact that no income can properly be treated as arising to a trader from its trading activities unless and until a positive balance has been struck at the end of an appropriate period.

154. We consider that this point was also recognised by Hoffmann J in *IRC v Brackett*, where he said at 539 e that in the context of section 478 of ICTA 1970:

> "the words "income becomes payable to" are wide enough to include not only the case in which the payment to the non-resident has in itself the quality of income but also the case of payments to a non-resident trader from which, after deduction of expenses, the income will arise."

155. The distinction which Hoffmann J was here drawing, we think, was between payments which in themselves have the quality of income, such as interest or dividends, on the one hand, and payments which enter into a computation of trading income, which will only arise when the computation has been carried out, on the other hand. We do not think he was intending to suggest that the mere payment of a trading receipt, which would in due course enter into a computation of trading income, could in itself be treated as a payment of income for the purposes of the TOAA provisions at the moment of receipt. If that is what he meant to say, we would respectfully disagree. Even on a broad interpretation, we do not see how a mere trading receipt can be equated with the receipt of trading income.

The quantum of the Employers' profits

156. So far, our analysis has largely reflected matters which were not in dispute. We come now to a question which lies at the heart of this part of the case: did the Employers have any trading profits, and thus any income for the purposes of the TOAA code, which Mr Hoey could in principle have had power to enjoy? If the answer to that question is negative, HMRC's attempt to charge him to tax under the code must fail.

157. It was on this ground, as we shall explain, that the FTT would have rejected HMRC's case on the TOAA issues, had it been necessary for the FTT to do so. The FTT found as a fact, at [169], that "the income of Penfolds and Hamilton for these purposes was nil". That finding was in turn upheld by the UT, on the basis that it involved no error of law. As the UT said, at [228]:

> "The ultimate question was whether there was sufficient evidence for the FTT to reach the conclusion it did on the issue and whether that was a finding that was open for it to reach on the evidence. We consider there was sufficient evidence, and it was so open to the FTT to conclude as it did."

158. In order to understand the arguments now advanced by HMRC, which challenge the decisions of the two tribunals on this question as being erroneous in law, it is first necessary to fill in some more of the relevant procedural background. In particular, we need to examine how and when an issue arose whether the payments made by the

Employers into the EBTs in respect of Mr Hoey's remuneration were properly deducted in computing the Employers' trading profits. HMRC's central contention in this court has been that the payments were not deductible, as a matter of law, because they could not have been made wholly and exclusively for the purposes of the Employers' trades, and therefore fell foul of the rule stated in section 34 of ITOAA 2005. It is convenient to refer to that rule as "the wholly and exclusively rule". Section 34 provides:

> "**34 Expenses not wholly and exclusively for trade and unconnected losses**
>
> (1) In calculating the profits of a trade, no deduction is allowed for –
>
> (a) expenses not incurred wholly and exclusively for the purposes of the trade, or
>
> (b) losses not connected with or arising out of the trade.
>
> (2) If an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade."

Procedural background

159. To begin at the beginning, the discovery assessments made against Mr Hoey in February and March 2014, in respect of the 2008/09 and 2009/10 tax years, were primarily based on the contention that the loans received by Mr Hoey from the EBT constituted taxable employment income. The only reference to the TOAA code was an oblique and non-specific sentence in the covering letter of the 2009/10 notice of assessment, in which the writer said:

> "Although described as loans, I believe that these sums related to your professional work in the UK and are taxable income, either as such, or under long-standing anti-avoidance rules".

160. A little more detail was given in the closure notice issued to Mr Hoey on 22 December 2015 in respect of his 2010/11 self-assessment tax return. This referred to the relevant DOTAS disclosures for the Hamilton scheme and the subsequent loan-cleansing scheme and stated the writer's conclusion that there was an insufficiency of tax on the further or alternative basis that the TOAA provisions applied. It was said that Mr Hoey had transferred his "earning capacity and associated operations (an asset)", and as a result had "the power to enjoy income of a person abroad". Accordingly, a charge to income tax arose under sections 720 and 721 of ITA 2007, or in the further alternative the "loans" were a capital sum chargeable under sections 727 to 729. The "further amount to be assessed to tax" was said to be "the full value of the asset transferred for the purposes of the Transfer of Assets legislation and/or the full amount of your employment earnings." The writer then said:

> "I am unable to quantify fees or commissions that may have been deducted from untaxed monies as a result of your use of the schemes.

> Consequently, I am amending your return by reference to the "loans" made in the year ended 5 April 2011 which amounted to £101,254.19."

The important point to note for present purposes is that this cryptic explanation said nothing about the computation of the employer's trading profits and made no reference to the wholly and exclusively rule.

161. The hearing of Mr Hoey's appeals from the assessments and closure notice did not take place until July 2019. There was thus a period of well over three years for the parties to refine their contentions and prepare for the eventual hearing. Appropriate directions were given by the FTT for this purpose, including directions for the filing of statements of case by Mr Hoey and the appellants in the other five conjoined appeals, in reply to the initial consolidated statement of case served by HMRC on 4 July 2016. In that consolidated statement of case, which ran to 108 paragraphs, the TOAA provisions were dealt with in a single short paragraph, as follows:

> "107. As an alternative basis of charge to the employment income heads of charge, [*HMRC*] will say that the transfer of assets provisions apply to the Scheme and accordingly the Appellant is liable to income tax in respect of the income arising to the person abroad (whether the employer or the EBT). [*HMRC*] will say that it is for the Appellant to prove that he can benefit from the motive defence."

162. Pursuant to the FTT's directions, Mr Hoey filed a statement of case, settled by Mr Mullan, on 27 April 2017. This dealt with the TOAA provisions at paragraphs 54 to 59. It pointed out, correctly, that HMRC had not provided any explanation of how the TOAA code was said to apply, or how income could be said to arise to a person abroad as a result of a transfer of assets by Mr Hoey. After setting out some arguments in relation to the motive defence and its alleged incompatibility with EU law, Mr Hoey further contended in paragraph 59 that:

> "59.1 No income accrues to either the Penfolds EBT or the Hamilton EBT;
>
> 59.2 Such income as does accrue to the employers is subject to deduction for proper expenses of the employer's business. That requires payments to the EBTs which were wholly and exclusively for the employer's trade to be taken into account (see *Lord Chetwode v IRC* [1977] 1 WLR 248 at 253C-H)."

163. It can therefore be seen that the wholly and exclusively issue was explicitly raised by Mr Hoey, together with an appropriate reference to Lord Wilberforce's speech in *Lord Chedwode v IRC*.

164. HMRC then filed a reply to Mr Hoey's statement of case on 14 July 2017. This set out, for the first time, HMRC's detailed case on the TOAA legislation, explaining how it was said that a charge arose under both section 720 and section 727. Nothing was said, however, about the basis on which the income of the off-shore employer was to be computed, beyond the bare assertion that "income in the form of fees from end clients arose to Penfolds/Hamilton". Nor was there any reference to the wholly and exclusively rule, even though it had been explicitly raised on Mr Hoey's behalf. It was

therefore left to be covered by the general traverse contained in the introductory paragraph 3, putting Mr Hoey "to proof of each and every factual assertion contained" in his statement of case, save where expressly admitted.

165. In further directions issued by the FTT on 10 October 2017, directions were given on a number of matters, including the calling of witnesses and whether they would be required to attend the hearing for cross-examination. Following compliance with that procedure, the parties were then given 28 days within which to inform each other and the tribunal "whether they are pursuing any arguments other than those set out in their respective Statements of Case." If they were, particulars of the additional arguments were to be provided. In response to these directions, HMRC eventually confirmed in a letter dated 24 October 2018 that they were "only pursuing the arguments as set out in their respective statements of case." The letter also said:

> "HMRC note that there is no allegation contained within their statement of case which would shift the burden of proof to HMRC. In consequence, the burden remains with the Appellants to establish both the primary facts and inferences and conclusions of fact that should be drawn from the primary facts in order to establish their tax liability is different to either HMRC's assessments pursuant to s 29 TMA 1970 or HMRC's amendments as stated in a closure notice."

166. There matters rested, in terms of pleadings, until the FTT hearing. In his skeleton argument for the hearing, settled by Mr Mullan on 17 June 2019, Mr Hoey belatedly conceded that the reasoning of Lord Hodge in the *Rangers* case would apply to the facts of the appeal, with the consequence "that sums which were paid to the Trusts with a view to an onward loan to the Appellant were properly to be taxed as earnings of the Appellant as HMRC contend". A footnote indicated that the concession had been communicated to HMRC and the FTT a few days earlier, on 12 June 2019. The skeleton then dealt with the TOAA code, but it did so relatively briefly in the light of Mr Hoey's not unreasonable assumption that HMRC would not pursue "an alternative basis of charge" under the TOAA code in the light of his concession that the sums in question were properly to be taxed as his earnings. The only implicit reference to the wholly and exclusively rule was in paragraph 23, which said:

> "As regards the Employer, the charge would be on his profits (see *Lord Chetwode v Commissioners of Inland Revenue* [1977] 1 WLR 248 and *IRC v Brackett* [1986] STC 521) and therefore would not include sums paid to the Trust."

167. Read in the light of Mr Hoey's previous statement of case, this paragraph made it tolerably clear that Mr Hoey was contending that the payments made by the Employers into the EBTs in respect of Mr Hoey's employment were properly deductible in computing the Employers' profits, because they were wholly and exclusively made for the purposes of each of their trades.

168. On 24 June 2019, counsel for HMRC filed their skeleton argument. In their submissions on the TOAA provisions, counsel repeated the contention that "income in the form of fees from end clients arose to Penfolds/Hamilton" and that Mr Hoey had power to enjoy such income. In apparent response to paragraph 23 of Mr Hoey's skeleton argument, counsel said at paragraph 136:

> "The effect of the decision in *Brackett* … cannot be circumvented by asserting that the profits of the employers would not include sums paid to the EBTs. The question of what is meant by "income" for these purposes was considered in *Latilla v CIR* [1943] 25 TC 107 (referred to by Lord Hoffmann in *Brackett*) and *Chetwode v IRC*. The Appellant is put to proof as to why it is alleged that such a deduction would be due and/or has in fact been applied."

169. In the light of this material, we would accept that the wholly and exclusively issue was, albeit rather indirectly, included in the matters potentially in dispute before the FTT. Nevertheless, and with the benefit of hindsight, we think it is a pity that HMRC did not take the opportunity afforded by the FTT's directions to state explicitly that they would be arguing for the non-deductibility of the payments made by the EBTs in respect of Mr Hoey, when computing the trading profits of the Employers, on the ground that the payments were inevitably infected by a fatal duality of purpose. Had this been made clear, we think it is at least possible that Mr Hoey and his advisers might have been able to adduce much fuller evidence than they actually did about the financial model on which the Employers operated in the context of the schemes, and the basis upon which their trading profits were computed. We also think that a focus upon this issue might have thrown into higher relief the important distinction, which HMRC's submissions frequently seemed to elide, between trading receipts, which do not themselves constitute income, and trading profits, which do.

The wholly and exclusively rule: legal principles

170. We could discern no disagreement between the parties about the basic legal principles which must be applied in determining whether an expense incurred by a trader was incurred wholly and exclusively for the purposes of the trade. We can therefore deal with the matter briefly. A convenient and authoritative summary of the main principles was helpfully provided by Millett LJ, giving the leading judgment in this court with which Hirst LJ and Sir John Balcombe agreed, in *Vodafone Cellular Ltd v Shaw* [1997] STC 734 at 742-3:

> "Whether a payment is made exclusively for the purpose of the taxpayer company's trade or partly for that purpose and partly for another is a question of fact for the commissioners. The court can interfere only if the commissioners have made an error of law in reaching their conclusion. The principles on which the court acts are to be found in the speech of Lord Radcliffe in *Edwards (Inspector of Taxes) v Bairstow* [1956] AC 14, 36 TC 207 and are too well known to repeat. It is sufficient to say that the court will interfere where the true and only reasonable conclusion from the facts found by the commissioners contradicts the determination.
>
> In the case of an individual taxpayer, the other purpose is usually a private purpose of his own. In a case like the present, where the taxpayer company is a company forming part of a group, the other purpose is likely to be the purpose of the trade of one or more of the other companies in the group. But the same principles apply

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

171. It follows from the application of these principles that where a trader pays remuneration to an employee for services performed in furtherance of the employer's business, it is not invariably the case that the payment will satisfy the wholly and exclusively rule. For example, the wages may be deliberately inflated so as to confer a personal benefit on the employee, or with the object of artificially reducing the employer's taxable profit. A graphic example of such a case is provided by *Copeman v Flood (William) & Sons Ltd* [1941] 1 KB 202, where Lawrence J said at 204:

> "It does not necessarily follow that, because the sums were charged as remuneration, to the directors they were wholly and exclusively laid out for the purposes of the trade."

172. Nevertheless, where the remuneration paid to an employee is reasonable in amount, and the services in question were performed for the purposes of the employer's trade, it is usually difficult to envisage circumstances in which deduction of the expenditure will not be allowable.

173. In this context, Mr Hoey rightly relies on a passage in the speech of Lord Oliver (with which the other members of the court agreed) in *MacKinlay v Arthur Young & Co* at 254, where he drew a distinction between the position of partners in a trading partnership, such as the taxpayers in that case, and the position of an employee. Lord Oliver said, at 254E:

> "Superficially, the analogy is attractive, as indeed is the suggestion that "the reality" of the situation renders absurd any distinction between, for instance, a senior employee and a junior partner. But, with respect, the distinction is not only legal but real. An employee has no interest in the property or profits of the firm and anything paid to him by way of additional remuneration for acting as an employee and to secure his continued loyalty to the firm cannot easily fail to be deductible as an expenditure exclusively for the purpose of the firm's business. There are, of course, limits to this – for instance, the firm cannot pay the employee's PAYE tax for him and claim to deduct it as an expense: see *Bamford v ATA Advertising Co Ltd* [1972] 1 WLR 1261. But, in general, money laid out in order to secure the continued loyal service of the workforce is referable only to the business or profession in which that workforce is employed and is accordingly deductible. The purpose to which the employee chooses to devote what he receives does not enter into the picture as one is not concerned to inquire into the connection between that purpose and the business in which the employee is employed."

The decisions of the FTT and the Upper Tribunal

174. The FTT dealt with the TOAA issues at [140] to [183]. Leaving aside for the moment the section with which we are primarily concerned, dealing with measurement of the income of the person abroad, at [162] to [169], the decision of the FTT on the other TOAA issues may be summarised shortly. First, the FTT accepted HMRC's submissions that Mr Hoey's entry into the employment contracts constituted a transfer of assets by him to a person abroad, which generated what the FTT called "income" in the form of fees from the End Users to the Employers. Although nothing turns directly on the point, it would in our view have been more accurate to refer to the payments made by the End Users (through one or more intermediaries) to the Employers as constituting trading receipts of the Employers rather than income: see [155] and [169] above. Secondly, the FTT considered the motive defence, concluding that neither Condition A nor Condition B was satisfied. It followed that Mr Hoey could not take advantage of the defence. Thirdly, with regard to the application of EU law, the FTT considered that the transactions fell within the ambit of Article 63 TFEU prohibiting all restrictions on the movement of capital between Member States and third countries

(which included the Isle of Man and Guernsey). The FTT went on to hold that the TOAA legislation restricted Mr Hoey's freedom under Article 63 to transfer his capital, in the form of his contract of employment, but that the discrimination inherent in the restriction was justified because it was a proportionate response to the EU concept of tax avoidance. The FTT relied for this purpose on the decision of the Grand Chamber of the CJEU in Case 135/17, *X GmbH v Finanzamt Stuttgart-Körperschaften*, ECLI:EU:C:2019:136, at paragraph 84 of the judgment of the Court.

175. We now need to set out in full the reasoning of the FTT under the sub-heading "Measurement of the Income of the Person Abroad":

> "162. It was agreed between the parties that "income" for these purposes was the profits of the "person abroad", ie, Penfolds and Hamilton. I was however given no evidence as to the profits of either Penfolds or Hamilton, such as profit and loss accounts.
>
> 163. The evidence I was given suggests that the profit and loss account of Penfolds/Hamilton consisted of the receipt of fees from the intermediary in respect of Mr Hoey's services, which, according to the agreed statement of common facts, were received from DMS/Cascade net of the fees payable to the promotors and other facilitators, less the payments of salary to the Contractors and the funds contributed to the trusts.
>
> 164. Ms Nathan suggested that I should consider the fees payable to the promotors as being payments made by Penfolds/Hamilton, the deductibility of which might be in doubt because there was a duality of purpose. However, the agreed statement of common facts stated that these fees were deducted by DMS/Cascade before the Contractor fees were paid on to Penfolds/Hamilton. DMS/Cascade then presumably distributed the fees to the relevant parties. No arguments were advanced to me as to who actually paid these fees from the perspective of strict legal construction and my working assumption is that the fees were in fact paid, as a matter of legal construction, by Mr Hoey. The question of their deductibility from the point of view of Penfolds/Hamilton does not therefore arise.
>
> 165. From the information I have therefore the Profit and Loss account of Penfolds/Hamilton consists of the net fees received from DMS/Cascade less the salaries and the payments into the Trusts. There may have been a small amount of residual profit remaining in Penfolds/Hamilton but I have no evidence as to its existence or amount.
>
> 166. In arriving at the profits of Penfolds/Hamilton, I think it is not in dispute that the amounts paid by way of salary to the Contractors are valid deductions. The payments into the Trusts are however potentially more controversial. I must therefore look to the judgment of Lord Hodge, in [*Rangers]*, which might indicate their true nature.

> 167. In [*Rangers*], Lord Hodge (at [59]), said:
>
> > "Parliament in enacting legislation for the taxation of emoluments or earnings from employment has sought to tax remuneration paid in money or money's worth. No persuasive rationale has been advanced for excluding from the scope of this tax charge remuneration in the form of money which the employee agrees should be paid to a third party, or where he arranges or acquiesces in a transaction to that effect."
>
> 168. It is clear from these words that the payments made into the Trusts were nothing more or less than additional payments of salary. They therefore properly fall to be deducted in arriving at the "income" of Penfolds and Hamilton for the purposes of s 721 ITA.
>
> 169. I therefore find that the income of Penfolds and Hamilton for these purposes was nil."

176. We should explain that the "agreed statement of common facts", referred to by the FTT in [163] and [164], was not, strictly speaking, a statement of agreed facts for the purposes of the appeals to the FTT. It was, instead, a statement of common facts and issues which the FTT had directed the parties to agree for the purposes of specifying lead cases pursuant to rule 18 of the Tribunal Procedure (FTT) (Tax Chamber) Rules 2009. A direction specifying one or more lead cases may only be given under paragraph 18 if two or more cases have been started before the Tribunal, the proceedings remain undisposed of, and "the cases give rise to common or related issues of fact or law". It follows that the statement of common fact and issues agreed by the parties was no more than a statement that the common facts set out in the statement were in issue in the relevant cases. As paragraph 2 of the statement made clear, the parties' agreement to facts in this document was not a concession or admission of fact, nor was it in any way intended to discharge the burden of proof on the Claimants.

177. We think it improbable that the FTT had lost sight of this point when it referred to the statement. In our view, the FTT was probably doing no more than using it as a convenient summary of the arrangements which were reflected in the evidence which it had heard about the schemes from Mr Parr and Mr Hall. If, however, the FTT was mistaken about the nature of the document, the error was not in our judgment a material one. Nobody has suggested that the common facts set out in the document were in any material respect inaccurate.

178. With that clarification, it seems to us that the FTT's process of reasoning may be summarised as follows:

    i) The relevant income for the purposes of the TOAA provisions was the trading income of Penfolds and Hamilton; which was in principle to be ascertained by drawing up an appropriate profit and loss account.

    ii) In the absence of any accounting evidence, the evidence of fact given to the FTT indicated that a profit and loss account would relevantly consist of the Employer's receipt of net fees paid by the intermediary in respect of Mr Hoey's

services, less the payments of salary to Mr Hoey and the funds contributed on his behalf to the EBT.

iii) The fees paid to the promotors and other facilitators of the scheme were borne, in one way or another, by Mr Hoey, and were not separately treated as outgoings of the Employer's trade. They could therefore be ignored for the purpose of constructing a notional profit and loss account.

iv) After deduction of the salaries and payments into the EBTs for Mr Hoey and other users of the scheme, there may have been a small amount of residual profit accruing to the Employer, but no findings could be made as to the existence or amount of such profit.

v) It was common ground that the amounts paid by way of salary to Mr Hoey and the other employees were "valid deductions", by which we think the FTT must have meant that they satisfied the wholly and exclusively rule.

vi) The deductibility of the payments into the EBT was not agreed, but the reasoning in *Rangers* indicated that there was no basis for drawing a distinction between remuneration paid directly to the employee in the form of salary and payments made on his behalf, or with his acquiescence, to a third party.

vii) On that basis, it was clear that the payments made into the EBT "were nothing more or less than additional payments of salary", and were therefore deductible in arriving at the trading income of the employer.

179. The UT dealt with this part of the case at [207] to [230], under the heading "HMRC Cross-Appeal Ground 2". As we have already noted, its conclusion was that the FTT did not err in law in concluding that the quantum of the income of the employers was nil. In relation to the other TOAA issues raised on the appeal, the UT concluded (in short) that:

i) the FTT had been wrong to consider that it was not necessary to deal with the TOAA charge in order to dispose of Mr Hoey's appeal, because the legislation operates to give priority to a charge under the TOAA provisions;

ii) the FTT made various errors of law in dealing with the motive defence, but the only reasonable conclusion on the facts was that neither limb of the defence could be relied on by Mr Hoey; and

iii) the FTT also erred in law in concluding that the TOAA charge restricted free movement of capital within the scope of Article 63 TFEU, because on the facts of the case that freedom was not engaged.

180. In its consideration of the wholly and exclusively issue, the UT began by summarising the FTT's reasoning at [208] and [209]. HMRC's grounds of appeal were then summarised at [210]: first, the FTT had applied the wrong test; secondly, it wrongly found that Mr Hoey had met the burden of showing that the deductions were wholly and exclusively for the purposes of the employer's trade; and thirdly, it wrongly made findings in the absence of evidence. In particular, the FTT had been wrong to treat the

statement of common facts and issues for the purposes of rule 18 as if it were a statement of agreed facts.

181. On the question of whether the FTT had applied the wrong test, the UT referred to relevant case law and accepted as "uncontroversial" the proposition that sums paid as remuneration do not necessarily satisfy the wholly and exclusively test. The UT then said at [216]:

> "Returning to the FTT Decision, the crucial question to determine was whether the sums paid were wholly and exclusively for the purposes of the trade and thus to determine what Penfolds/Hamilton's object was for paying the sums. It is correct the FTT, having concluded the payment was remuneration, did not deal with the issue of whether the sums paid to the EBT were wholly and exclusively on Mr Hoey's behalf, as clearly as it should have done. However, reading the relevant section of its decision as a whole, it appears to us, that the FTT was apprised of the duality issue, that it considered it in relation to the EBT contributions, but that it concluded it presented no concern."

182. The UT then analysed the FTT's reasoning on this point, before adding at [217]:

> "HMRC highlight the lack of any evidence put forward by Mr Hoey as to the nature of trade, but as Mr Mullen points out, the "wholly and exclusively" question only arises if a trade is assumed. It did not appear to be an issue between the parties that for TOAA purposes, income was to be measured on the basis that Penfolds and Hamilton were carrying on a trade. HMRC, in any event, make the fair supposition that the trade was provision of services (through deployment of their employees) to end users in the UK. On that basis, it appears entirely consistent that the payments to the Trust were for remuneration from Penfolds/Hamilton for work performed for the end users. It is not irrational either given the other remuneration paid to the employee was deductible for the purposes of such trade. As Mr Mullen says, this was not a situation similar to that in *Copeland* where the money paid was over the odds and for personal use or something else."

183. The UT then addressed the criticism that Mr Hoey had not discharged the burden of proof which it was accepted lay on him to displace the assessments and closure notice. On the assumption that the Employers were carrying on a trade, the UT said at [219]:

> "We consider, there was at least some evidence before the FTT, on that assumption, capable of supporting the FTT's conclusion the EBT sums were properly deductible and to meet the burden which the appellant accepts lay on him. The FTT heard oral evidence from trustee, Andy Parr, which covered the operation of Hamilton Trust's activities including that it was set up to employ contractors and provide their services to third parties, and that its purposes included remunerating and rewarding those contractors during their employment. It also heard evidence from Matt Hall, who was employed by the firm who devised the Penfolds arrangements. In addition, there was documentary evidence: this included contracts between the employer and

> intermediaries, or between the intermediaries, employee information and trust information guides, statements in trust documents and documentation relating to the set-up of the trust referring to the purpose of incentivising and motivating employees. While not direct evidence they would, when considered cumulatively, and with the oral evidence, at least enable the FTT to infer that the nature of Penfolds' and Hamilton's trade was supplying contractors such as Mr Hoey to end users and that the payments into the trust were wholly and exclusively for the purpose of remunerating Mr Hoey for his employment. That is sufficient to answer the ground insofar the challenge raised is that the impugned finding was one that was made without any evidence."

184. The UT then dealt with HMRC's argument that there was ample evidence of a tax avoidance or non-trade purpose with regard to the payments into the EBT. The evidence relied on by HMRC for this purpose included excerpts from the oral and written evidence on both sides, as well as statements in the documentary evidence including marketing materials. The UT then said:

> "221. Having considered these, we can see how they may arguably have sustained an inference that at least one of Penfolds' and Hamilton's motives in making the payments was to avoid tax. However, in order to identify that the FTT erred in law, HMRC must go further and show the FTT was unreasonable in making the finding it did in the light of that evidence, in other words that the FTT's conclusion was one that was not reasonably open to it. We are not satisfied that the evidence HMRC points to crosses that threshold.
>
> 222. Many of the points go to the tax-driven nature of the arrangements as a whole: for instance, Mr Hall's evidence, the FTT's finding that the company was inserted into the arrangements for tax avoidance reasons (at [153]) or the awareness of tax issues or tax-related motives of others, in particular Mr Hoey."

185. The UT then pointed out that the relevance of much of this evidence to the purpose of the *Employer* in making payments to the EBT was questionable, and to the extent that it was relevant "it is consistent with the payments to the trust being viewed, from Penfolds'/Hamilton's perspective, as part of the remuneration intended for the employee": see [223] to [225].

186. The UT then summarised its conclusions:

> "226. The particular question for determination is what was Penfolds'/ Hamilton's object in making the payments – why did it make the payment? Ultimately, the points HMRC raise, regarding Penfolds/Hamilton being an instrument of tax avoidance, do not require a finding that [*their*] object in making the EBT [*payments*] was tax avoidance. They may be relevant to the question of why Penfolds/Hamilton was set up, or what their role was in the arrangements. But those are not the questions in issue.

> 227. HMRC must show, that on the evidence before the FTT, the FTT could not have reasonably reached any finding other than that there was a duality of purpose. We are not persuaded the evidence they have pointed to does that.
>
> 228. While both parties made submissions regarding the extent to which Mr Hoey needed to meet the burden of proof on the question of whether the payments were wholly and exclusively for the purposes of the trade, we do not consider the issue of burden of proof takes the matter any further and do not deal with those. The ultimate question was whether there was sufficient evidence for the FTT to reach the conclusion it did on the issue and whether that was a finding that was open for it to reach on the evidence. We consider there was sufficient evidence, and it was so open to the FTT to conclude as it did."

187. Finally, the UT dealt with two subsidiary points. The first of these dealt with an inconsistency between the evidence given by Mr Parr in cross-examination, which suggested that the payments received by the employers from the intermediaries in respect of Mr Hoey's services were received gross rather than net of intermediary fees, and the common statement of agreed facts, which indicated that the payments were received net of intermediary fees which were deducted by the intermediary. The UT considered that, although the FTT "might, usefully, in the circumstances, have elaborated on its reasoning for preferring what was said in the document rather than on the basis of Mr Parr's evidence", there was no ground of appeal in relation to sufficiency of reasons, so there was no need to say more about it. The second point, which we have already considered, related to the late stage at which the wholly and exclusively issue had been raised. The UT did not regard that as a live point, because the time to make such an objection had been during the FTT hearing, but there was no suggestion that this had been done: see [230].

Discussion and conclusions

188. HMRC's grounds of appeal to this court on the wholly and exclusively issue essentially repeated the submissions which they unsuccessfully advanced to the UT and alleged that the UT itself erred in law in failing to correct the errors made by the FTT. It is important for us to remember that an appeal from the UT to the Court of Appeal, like an appeal from the FTT to the UT, is confined to points of law: see sections 11(1) and 13(1) of the Tribunals, Courts and Enforcement Act 2007. These grounds of appeal were amplified at considerable length in HMRC's written submissions, and in Ms Nathan's forcefully presented oral argument. At heart, however, the question for us is a simple one. Was the FTT entitled, on the evidence before it, to conclude that the trading income of Mr Hoey's employer, to the extent that it was referable to the services provided by Mr Hoey to end users, was nil? That was an issue of fact and evaluation, which the FTT had to do its best to answer on the basis of the scanty and imperfect evidence presented to it. If the answer to the question is that the FTT was in law entitled to reach that conclusion, as the UT held, after careful consideration, that it was, then it must follow that HMRC's further appeal to this court cannot get off the ground, because no error of law in the approach and conclusion of the UT can be demonstrated.

189. It seems to have been common ground before both tribunals, as it was before us, that the answer to the question turned on whether or not the payments made by the

Employers into the EBTs, again to the extent that they were referable to the services provided by Mr Hoey to end users, satisfied the wholly and exclusively rule. There has never been an issue about the deductibility, in computing the Employers' profits, of the salary element of the remuneration paid to Mr Hoey (and to other participants in the scheme) under voluntary deduction of PAYE income tax. Ms Nathan explained to us that the reason why the deduction of this element of the remuneration has never been challenged by HMRC is that UK tax was duly paid and accounted for in respect of it. That may well be so, but since the deductibility of the salary element was never challenged, it was in our view entirely reasonable for the FTT to proceed on the footing that the wholly and exclusively test must have been satisfied in relation to it. Otherwise, it could not have been allowable as a proper deduction.

190. Ms Nathan accepted, in answer to questions from the court, that the logic of HMRC's case on duality of purpose was that the payments of salary were "tainted" in the same way as the payments into the EBTs. But if HMRC had wished to run that case before the FTT, they should have articulated the point in their statement of case, and explained, if they could, why the payments of salary could legitimately be treated differently from the payments into the EBTs in computing the employer's trading profits. In the absence of such an explanation, it was in our view clearly open to the FTT to infer, as it did, that both elements of Mr Hoey's remuneration should be treated in the same way for the purposes of the wholly and exclusively rule.

191. The main burden of Ms Nathan's submissions to us on the payments into the EBT was that they inevitably served a dual purpose. As well as remunerating Mr Hoey for the supply of his services to the end users, they also formed a crucial part of an artificial tax avoidance scheme which was designed both to confer a personal financial benefit on him (in the form of tax saved) and to confer further benefits (in the form of fees) which were creamed off and paid to the third parties who designed and implemented the scheme. Ms Nathan submitted that the FTT wrongly shut its eyes to this obvious duality of purpose, because it took an impermissible short cut from the admitted deductibility of the salary element of the remuneration to assuming that the EBT element had to be treated in the same way. This short cut also meant, she said, that the FTT did not properly investigate, as it should have done, the subjective intentions of the Employers when making the payments.

192. A further strand in the argument was that, on the FTT's analysis, the trade could not have been intended to make a profit at all, because it did no more than break even. In our view, however, there are several answers to this contention. In the first place, it is not a requirement of the concept of a trade for tax purposes, unless the legislation in question expressly says so, that the relevant activities should be carried on with a view to profit. For example, a trade may be carried on as a hobby, or on a not-for-profit basis. Secondly, it is of course possible for any trade, however commercial its operation, to return a loss in an accounting period, and thus to generate no taxable trading income during that period. Thirdly, the limited evidence before the FTT made it impossible to form a reliable view about the profitability of the Employers' trade viewed as a whole. The most that the FTT could do was to focus upon the segment of the trade which consisted of the activities relating to Mr Hoey, who was but one of the numerous participants in the tax avoidance scheme. We repeat that the FTT was not supplied with any profit and loss accounts, or any evidence about the Employers' business model or overall financial position. Finally, the FTT was prepared to accept,

at [165], that there may have been "a small amount of residual profit", although the existence and amount of any such profit could not be verified.

193. With regard to the tax avoidance context in which the trade was carried on, we agree with the UT that it is, at best, of doubtful relevance to the ascertainment of the employer's trading profits, because there is no evidence that the Employers were themselves engaged in any tax avoidance activity of their own. Rather, each was fulfilling a pre-arranged role in a scheme designed to obtain tax advantages for the UK taxpayers who participated in the scheme. Furthermore, there has never been any suggestion by HMRC that the transactions entered into by the Employers were "so affected or inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction", to quote from the speech of Lord Morris in *FA & AB Ltd v Lupton (Inspector of Taxes)* [1972] AC 634 at 647; see too the judgment of this court in *Ingenious Games LLP v Revenue & Customs Commissioners* [2021] EWCA Civ 1180, [2021] STC 1791, at [98]. Indeed, the premise upon which the wholly and exclusively issue arises is that there was a genuine trade for tax purposes being carried on by the Employers.

194. Furthermore, once the existence of a trade is recognised, the mere fact that a transaction is entered into with a fiscal motive does not, in the normal way, denature it or mean that it is infected by a duality of purpose which makes expenditure on it non-deductible. At times, HMRC's arguments seemed to come close to suggesting that the courts should recognise a general principle that the existence of a tax avoidance motive which is more than purely incidental must give rise to a duality of purpose which means that the wholly and exclusively rule cannot be satisfied. Any such principle, if it existed, would have very far-reaching implications, and would be contrary to many statements in the case law that the existence of a fiscal motive is generally irrelevant in answering the objective question whether there is a trade: see, for example, *Ingenious Games* at [64], where the court referred to "the general irrelevance of fiscal motive in answering the objective question whether the transaction viewed as a whole constitutes a trade".

195. This is not to deny, of course, that in some cases the correct analysis of the facts may be that expenditure incurred by a trader is not deductible because one of its purposes is to confer a benefit on a third party. One example cited to us was the decision of this court in *Interfish Ltd v Revenue & Customs Commissioners* [2014] EWCA Civ 876, [2015] STC 55, where the leading judgment was delivered by Moses LJ (with whom Patten LJ and Lord Dyson MR agreed). In that case, the First-tier Tribunal found that a payment of £1.2 million made by the taxpayer company, whose primary business was in the fishing industry, to Plymouth Albion Rugby Club, was not deductible in the computation of its profits for corporation tax purposes because it served two purposes, neither of which was subordinate to the other. One purpose was to promote the taxpayer's business, but the other was to benefit the rugby club's financial position. This court held that there were no grounds for interfering with the First-tier Tribunal's findings.

196. In reaching this conclusion, Moses LJ referred to the *MacKinlay* case in the House of Lords, where it was held there were two purposes in meeting the removal expenses of the partners in the firm when it relocated the relevant part of its business from London to Southampton. Reversing the special commissioners, who had found that the expenditure was deductible, Vinelott J held on HMRC's appeal to the High Court that the expenditure inevitably had a dual purpose, because it was not incurred solely for

the purposes of their practice as chartered accountants. The Court of Appeal disagreed, but the House of Lords restored the decision of Vinelott J. As Lord Oliver put it at 255-256, after rejecting the superficially attractive analogy with the position of an employee, in a passage which we have already set out, and after referring to *Mallalieu v Drummond*:

> "So here the payment of estate agent's fees, conveyancing costs and so on, and the provision of carpets and curtains cannot but have been intended to serve the purpose of establishing a comfortable private home for the partner concerned even though his motive in establishing a home in that particular place was to assist him in furthering the partnership interests"

197. Ms Nathan placed considerable reliance on the *MacKinlay* case, but properly understood, we consider that it helps Mr Hoey. The critical distinction is that, unlike the partners in *MacKinlay*, Mr Hoey was an employee, not a partner. We have not seen his contract of employment, which was one of the key documents which apparently could not be made available to the FTT, but everybody agrees that it must in substance have entitled him to receive the full amount of remuneration, at the daily rate for which he had agreed to provide his services to the end users, after deduction of fees payable to the promoters and facilitators of the scheme. It was essential to the operation of the scheme that Mr Hoey, in his capacity as employee, should receive the full net amount for which he had agreed to make his services available, consisting of the small salary element (from which tax was deducted) and the payments into the EBTs (which it was hoped would give rise to no UK tax liability as employment income). This objective could only be achieved if the Employers passed on to Mr Hoey the whole of the net amount which they had received from the intermediaries in respect of the provision of his services to the End Users.

198. In our judgment, this was inescapably both the object and the purpose of the expenditure by the Employers in making the payments to the EBTs, just as it was of the payments made by way of salary to Mr Hoey directly. The fact that the Employers may also have had the ulterior motive of helping Mr Hoey to engage in a tax avoidance scheme cannot, in our view, amount to a separate object of the Employers in making the payments. It was, at most, "a consequential and incidental effect of the payment", and thus fell within the third proposition stated by Millett LJ in the *Vodafone* case at 742g-h. In the case of an employee, as Lord Oliver said in *MacKinlay* at 254, anything paid to him by way of remuneration for acting as an employee "cannot easily fail to be deductible as an expenditure exclusively for the purpose of the firm's business". Given the existence of that principle, it seems to us that there was an evidential burden on HMRC to explain why the payments into the EBTs were not deductible in computing the Employers' profits, once it was established that the payments formed part of Mr Hoey's remuneration. That evidential burden was neither recognised nor discharged by HMRC, and we can see nothing to displace the strong prima facie inference that the whole amount of the payments into the EBTs in respect of Mr Hoey's services was properly deductible as expenditure wholly and exclusively incurred for the purposes of the Employers' trade.

199. Further and in any event, it is not strictly necessary for us to conclude, as we have, that this was the only sustainable interpretation of the facts found by the FTT. It is enough for us to say that the FTT was entitled to reach the conclusion which it did, and that we

can discern no material error of law in either its approach or its reasoning. It is true that the FTT dealt with the question relatively briefly, but brevity is in general a virtue, and we must bear in mind that the FTT had received full submissions on the relevant law from expert counsel on both sides. In such circumstances, the assessment of the evidence by a specialist tribunal is normally entitled to great respect, quite apart from the general reluctance of an appellate court to interfere with findings of fact made by the tribunal which heard and considered all the evidence.

200. For these reasons, and in respectful agreement with the UT, we consider that HMRC's appeal on the wholly and exclusively issue must be dismissed, with the consequence that there was no "income" of the Employers' trade which could be treated as arising to Mr Hoey if he had power to enjoy it. In those circumstances, there is no need for us to consider the question whether Mr Hoey would have had power to enjoy the income, and we prefer to say nothing about it. Not only would anything we said be both obiter and hypothetical, but the question was not addressed by either tribunal below. It is also unnecessary for us to say anything about the motive defence, because Mr Hoey did not pursue his appeal on that part of the case, and we heard no argument on it.

201. There is one further matter, however, which we should mention. As we have explained, it was part of HMRC's case before the UT that any charge to tax on Mr Hoey under the TOAA legislation would take priority over any liability to tax under the employment income provisions of ITEPA. The UT accepted this submission, and held that the FTT had erred in holding that it was not obliged to go on to consider the alternative assessments to tax under the TOAA provisions once it had held that Mr Hoey was liable under the income tax provisions. It was not at all clear to us on what basis HMRC contended that the TOAA charge to tax would take priority, and it would in our view be an extraordinary position to reach if it were indeed the case that the highly complex and potentially penal provisions of the TOAA code had logically to be considered first in any case involving employment income where they might potentially be engaged. Furthermore, such an approach would in all probability raise the unwelcome spectre of economic double taxation, potentially giving rise to concurrent liabilities arising out of the same transactions.

202. While HMRC must of course form their own view on the matter, and it is not for the courts to be prescriptive on questions of policy, we respectfully suggest that it would generally be in accordance with the intentions of Parliament that the TOAA provisions should be kept in reserve for deployment in cases of tax avoidance which cannot effectively be countered in any other way. If, as in the present case, the transactions in question give rise to a straightforward liability to tax on employment income, that should normally be the end of the matter. It is fortunately unnecessary for us to say any more on the subject, however, because HMRC wisely conceded, at the beginning of the fourth day of the hearing, that the TOAA provisions do not have priority over the charge to tax on employment income under ITEPA, although they do have a role to play as a fallback head of charge. Ms Nathan also explicitly undertook on behalf of HMRC that they would seek not to impose a double charge to tax, in the event that both sets of provisions applied. She informed us that the precise mechanism to avoid the possibility of a double charge in such circumstances was a question of some complexity, which required the input of numerous stakeholders, but as we understood it the undertaking which she offered on behalf of her clients was in substance unqualified. The only question was precisely how it should be given effect.

203. Beyond saying that we welcome this clarification and commend the willingness of HMRC to take appropriate steps to avoid the possibility of economic double taxation in cases of the present type, we are content to say no more on this aspect of the appeal.

The EU law issues

204. In view of the conclusions which we have reached, it is also unnecessary for us to say anything about the EU law issues. In our view, it would be undesirable for us to do so. It is clear from the argument we heard that the question is one of some complexity and difficulty, which we should not address unless it is necessary to our decision. Furthermore, since the UK is no longer a member of the EU, that is a further reason for us not to deal with the issues unless we have to. We would only add that, by declining to entertain the issues, we should not be taken to be expressing any view on the merits of the rival arguments and the conclusions reached by both tribunals.

V. Conclusion

205. It follows from our conclusions on each of the main issues that:

i) the 7A power in primary legislation is a wide power. It can operate both prospectively and retrospectively, and overlaps with the redirection regulations. It was available to be used in Mr Hoey's case and had the effect that his income tax liability must be paid by him without setting off notional PAYE deductions that would otherwise have been treated as made by the End Users.

ii) The power was lawfully exercised. There was no breach of any procedural legitimate expectation. The claim for judicial review accordingly fails and is dismissed.

iii) Neither the First-tier Tribunal nor the Upper Tribunal has jurisdiction to review or address the exercise by HMRC of the 7A power. The only avenue for challenging its exercise is on judicial review in the Administrative Court.

iv) There is no separate liability to income tax under the TOAA charge. The provisions in ITEPA take priority. In any event, the FTT did not err in law in holding that the quantum of the Employers' profits was nil because the contributions to the EBTs were deductible as expenses incurred wholly and exclusively for the purposes of their trade.

v) It is unnecessary and inappropriate in the circumstances to address the remaining questions raised in relation to the TOAA charge.

vi) For all these reasons, the appeal and cross-appeal both fail and are dismissed.

Sir Launcelot Henderson

206. I agree.

Lord Justice Phillips

207. I also agree.