Neutral Citation Number: [2019] EWHC 2855 (Ch)

Case No: CR-2018-001831

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS ENGLAND AND WALES
COMPANIES COURT

The Rolls Building
Fetter Lane, London, EC4A 1NL

Date: 30/10/2019

Before:

CHIEF INSOLVENCY AND COMPANIES COURT JUDGE BRIGGS

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Between:

(1) RICHARD TOONE **(2) ELIAS PAOUROU** **(In their capacity as Joint liquidators of Implement Consulting Limited)** **(3) IMPLEMENT CONSULTING LIMITED (IN LIQUIDATION)**	**Applicants**
- and -	
(1) WILLIAM JOHN GAILEY ROSS **(2) WILLIAM ARTHUR BELL**	**Respondents**

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- -

JOSEPH CURL (instructed by **ASHFORDS LLP**) for the **Applicants**
DAVID MOHYUDDIN QC (instructed by **FREETHS LLP**) for the **Respondents**

Hearing dates: 7, 8, 9, 10 and 30 October 2019

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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Chief ICC Judge Briggs:

Introduction

1. Implement Consulting Limited (the "Company") entered insolvent liquidation on 26 November 2016. Mr Toone and Mr Paourou were appointed liquidators (the "Joint Liquidators") at a creditors' meeting held on the same day.

2. Mr Ross was a director of the Company until it entered voluntary liquidation. Mr Bell was a director at the relevant time but resigned in April 2013.

3. The main creditor of the Company is Her Majesty's Revenue and Customs ("HMRC"). HMRC has lodged a proof of debt in the liquidation in the sum of £1,747,621.51.

4. The Joint Liquidators make claims against Mr Ross and Mr Bell in respect of transactions that took place between 2009 and 2013.

Summary

5. This judgment deals with the claims and the defence to the claims, made by the Company through the Joint Liquidators. It deals with a proper characterisation of payments made out of the Company in the period 2009 to 2011 when the Respondents, who owned 80% of the shareholding in the Company, and one other, Mr Flanagan, who owed 20% of the shares, received payments via profit extraction schemes. The aim of the schemes was to place money drawn from the Company into the hands of the shareholders.

6. In 2017 the Supreme Court (*RFC 2012 plc (in liquidation) (formerly Rangers Football Club Plc) v Advocate General for Scotland* [2017] 1 WLR 2767) found that money paid into an employment benefit trust was intended to operate to give each employee access to the use of the money paid into the principal trust. The money was to be treated as employee's remuneration for employment, and subject to tax. The employer company should have made the necessary deductions to pay the Revenue. In this case the Joint Liquidators ask the Court to look at the position from the point of view of the Company. The distributable reserves were stripped out and paid to employment benefit trusts (and later an interest in possession fund) for the purpose of making tax free payments to the shareholders who were also employees. The payments received by the Respondents and Mr Flanagan were calculated by dividing the capital paid out of the Company, to match the number of shares each of them held.

7. In my judgment although the payments of the Company's capital were made to the Respondents via a trust or interest in possession fund, they were in substance distributions. Due to a failure to comply with the statutory code they constitute unlawful distributions and are void. Later payments totalling £70,000 made to the shareholders in 2013 also constituted unlawful distributions. One shareholder and employee, Mr Flanagan, received £30,000 in expenses in March 2013. Such payments were made at a time when the Company was insolvent, and in breach of directors' duties.

The Claims

8. The claim mainly arises firstly, out of monies paid by the Company into an Employment Benefit Trust in October 2009 ("EBT 09") and March 2010 ("EBT 10"), and secondly (and separately) monies paid into an interest in possession fund ("IIP") in 2012. The Joint Liquidators assert that the EBTs and IIP were "aggressive tax avoidance" schemes; that the Respondents knew there was a risk that HMRC would challenge the schemes; failed to make any or any proper provision for the possibility that the aggressive schemes would be challenged successfully; personally benefited from the payments made into the schemes; and that the payments were in substance unlawful distributions of the Company's capital.

9. These simple facts are used to support various other causes of action against Mr Ross and Mr Bell. The Particulars of Claim summarise: "these proceedings arise from distributions of the Company's assets (almost entirely for the direct personal benefit of the Respondents) made in breach of trust and/or fiduciary duty and/or that were unlawful and void and/or within the meaning of s. 423 of the Insolvency Act 1986".

10. The Respondents put the Applicants to proof on various matters, argue that the Company was not insolvent at the time of the transactions under consideration and assert that the EBTs and IIP were entered into following professional advice which should shield them against the claims brought. The Joint Liquidators make their claim from a position of hindsight.

Advice provided to the Respondents

11. Mr Bell, in his written evidence, states that he and Mr Ross asked the Company's accountant how it could structure its payments to the three main employees and shareholders in a tax efficient manner. The Company's accountant then raised the prospect of tax planning in early 2009. The "scheme that was proposed was a scheme developed by Premier Strategies Limited which was a subsidiary of Tenon, one of the largest accountancy practices in the UK at the time." He explains:

> "the prospective tax planning was initially discussed on a Teleconference Board meeting on 26 March 2009 with William Ross, Kieran Flanagan, Frank Walker and I in attendance and I have retained my agenda and notes……… It was again discussed at a further meeting held on 19 June 2009 with William Ross, Frank Walker, Kieran Flanagan, and myself…… Subsequently, at a meeting on 28 August 2009 Ian Oliva of Peak Performance Tax gave a presentation on the Premier Strategies EBT to William Ross, Kieran Flanagan, Frank Walker and myself…..These were formal discussions we had regarding the tax planning, however we discussed it amongst ourselves many, many times in the intervening months. Our accountant Frank Walker spoke to other accountants at professional tax seminars who were also considering and or undertaking EBTs for clients and attended webinars and conferences to better understand this form of tax advisor planning. Ian Oliva informed us that Premier Strategies (part of Tenon Accountancy) had done over 800 EBTs confirming this as an accepted and established method of tax planning used by many companies and widely promoted by professional advisers and barristers….. Both myself and the First Respondent are cautious by nature but

> were interested in the tax planning as a way of maximising the Company's tax efficiency and rewarding the employees/providing a return to shareholders in the most tax efficient manner."

12. Although the link between Premier Strategies Limited ("PSL") and Tenon is a little laboured, PSL make clear in correspondence that they are not "an accountancy firm". PSL also made clear that it is "for the company's accountant and auditors to make a judgment as to what is the most appropriate accounting policy, based on the specific facts of their EBT."

13. Mr Ross states that he researched EBTs and IIPs personally and that "it was in the best interests of the company and its shareholders to engage in the planning, and that it would achieve the purpose of rewarding the key employees whilst maximising the company's tax efficiency." He says he spoke with a friend, Mr McKenzie who is also a lawyer based in Glasgow. He spoke on the phone prior to entering into the first EBT. His account of the conversation can be summarised shortly. Mr McKenzie said that he knew of EBTs and that as far as he was concerned "they worked". He did not advise the Respondents to enter into the EBTs. He did not see any detail of the particular EBT or have to hand any information regarding the Company.

14. In a letter dated 13 October 2009 PSL wrote to Mr Bell setting out "the key points" of a "Pre-funded Employee Benefit Trust". I quote at length as both the Applicants and Respondents rely on the correspondence. The Applicants argue it cannot be relied upon as independent advice. The Respondents argue that it made clear that there was only a remote risk by entering into the EBTs. The letter reads (where relevant):

> "An EBT is a form of discretionary trust established to benefit a defined class of employees. In order for an EBT to be effective it is vital that the trustees have a complete and unfettered discretion as to the way in which they deal with the trust funds. This fundamental point has to be understood by any company acquiring such an EBT. However it is perfectly acceptable for a company to make recommendations to the trustees as to how funds are to be distributed and we would normally suggest that in most cases you would want to make recommendations...."

> "On acquiring the EBT you can specify the classes of beneficiaries under the deed of appointment. In most cases it is likely that you will want to include all current employees and the draft deed of appointment that is provided will also include their dependents. You should ensure that this is acceptable. If it is not then you will need to speak to us as soon as possible in order to discuss your specific requirements. The fact that the class of beneficiaries is very widely drawn does not necessarily mean that every potential beneficiary or actually receive anything from the trust."

> "There is no material difference in the operation of an onshore or offshore trust, though obviously the logistics of having trustees offshore need to be considered. In our experience, however, offshore trustees will normally give as efficient a service as onshore trustees. The independence position is often clearer when the trustees are offshore."

> "The main difference between onshore and offshore trusts is taxation. This is not relevant to the taxation of the company or the beneficiaries but does have an impact on the taxation of the trust itself……. An offshore trust will not be taxable on its offshore income, or gains, where ever situated. However it will be taxable on its UK source income……… The EBT trustees can only act within the powers set out in the deed under which the trust is established. We would recommend therefore that the widest possible powers are given to the trustees and indeed the EBT deed that has been executed will contain these powers…… A trust can be used for many purposes, such as the provision of benefits or particular remuneration strategies……. One form of award which many companies and trustees find attractive is the use of a sub – fund under the trust. Broadly the sub-fund is a discretionary fund within the EBT, which is reserved for the benefit of a particular employee's family and which will be de facto controlled by the adult beneficiaries of the sub – fund. Assets in the EBT, including cash, may then be assigned to the sub-fund of the employee. The assignment of the EBT's assets to the sub-fund is not a taxable benefit on the employee and this view is supported by leading Tax Counsel and case law. Although the employee does not get full ownership of the cash in the fund he has the satisfaction of knowing that there is an element of the overall EBT which is reserved for the benefit of him and his family."

> "One of the great virtues of a sub – fund is its flexibility….. The monies in the sub – fund may also be loaned to the employee or his family. Where interest-free loans connected with an employment are provided in excess of £5000, currently a 4.75% benefit in kind would arise……… The employer company is also liable to account for Class 1A National Insurance Contributions ("NIC's") on the value of the benefit in kind at a rate of 12.8%. This payment of NICs will be deductible for Corporation Tax purposes, resulting in a cost to the company which equates to a charge of approximately 0.5% per annum."

15. The letter continued with a statement that a loan may carry the HMRC "prescribed rate" of interest, and inheritance tax liability arising from the creation of an EBT. General information was then proffered (with a warning that it was general, and specific advice should be taken from the Company's accountant), about the consequences of entering into an EBT in respect of taxation. The Company could swap one asset for another - cash in return for a trust asset. Looked at this way the assets in the EBT would have to be shown on the Company's balance sheet. Once the assets are irrevocably and unconditionally transferred leaving the Company with no control over the assets, they fall from the balance sheet. This occurs simultaneously.

> "Broadly speaking therefore, the company would, under…. new provisions receive Corporation Tax relief on direct contributions to fund a trust only as and when funds are used to provide benefits (other than loans) that are taxable on employees. This would also apply if the trust was indirectly funded…."

> "The assignment to a sub-fund is not a taxable benefit and therefore although the assets may then be expressed in the profit and loss account of the company, Corporation Tax relief could not be claimed at that time. Indeed if

> funds are never paid out in a form subject to Income Tax and National Insurance the company will never be able to claim Corporation Tax relief for the contributions."

16. I pause here to mention that I heard no argument as to whether the letters from PSL constituted advice, information or sales pitches. PSL are not joined as a third party for the purpose of showing that any purported advice was wrong, or the information contained in the letters was inaccurate in the sense explained by Lord Hoffmann in *South Australia Asset Management Corporation Ltd v York Montague Ltd* [1997] AC 191. It maybe that the letters were in part a sales pitch, in part information and in part advice. In his witness statement Mr Bell states that he and Mr Ross made a decision "based upon the information available". For this reason I shall seek to use the term "information" to describe the letters from PSL rather than "advice", but by so describing make no decision about its character .

17. The letter from PSL informed the Respondents of the risks involved in entering into an EBT, and in particular transferring assets to sub-funds. The EBT trust deed provides that no remuneration is to be awarded to employees through the trust fund, but loans may be made. This avoids tax on remuneration or considerations of corporation tax if remuneration is not paid within 9 months of the year end.

18. In terms of the risk, the letter of 13 October 2009 states that leading tax counsel have provided "favourable" opinions, and:

> "As you may be aware, in December 2004 the government opened the way for retrospective tax legislation…… In the 2006 budget, the Government's position on such schemes was demonstrated when it carried out its threat and introduced retrospective legislation in connection with options over "employment related securities". It is anticipated that the use of retrospective legislation this way will be challenged… If you do intend to undertake the strategy there are two important points to be made in connection with this: Firstly, the strategy does not involve "employment related securities". It is a scheme that indefinitely defers payment of PAYE/NI. However, from the government's perspective, this type of planning is perhaps less offensive than schemes which avoid PAYE altogether. Secondly, HM Revenue & Customs have been aware of the use of EBTs for some time and in particular they are aware of the fact that there are various ways in which the legislation introduced in November 2002 may be circumvented, not least because we were initially required to provide details of such schemes to them on 30 September 2004………HM Revenue & Customs could therefore have legislated against those schemes at that time and indeed have since done so but not retrospectively. It should be noted, however, that the proposed planning is a new variation and therefore was only recently been registered with HM Revenue & Customs. Clearly it is very difficult for us to predict exactly what the Government will do in the future but whilst we cannot guarantee it, we think it very unlikely that they will bring in retrospective legislation to attack this particular type of planning……. You need to be aware that any enquiry may take some years before there is a final decision from HM Revenue and Customs as to whether or not the planning will be successful, and that there may be significant periods when little or nothing

> appears to be happening. Again this is perfectly normal. Most enquiries are settled by agreement and HM Revenue & Customs have said publicly that if they believe that a scheme works Inspectors should not attempt to keep matters open unnecessarily. But it is possible that HM Revenue & Customs will want to take a case to the First-tier Tribunal or Upper Tribunal to test the legal arguments and to establish the facts. There is thus a possibility that you might be called upon as a witness of fact in any appeal…… As I say, this is highly remote - not one of Premier Strategies' cases has been before the Tribunals or Special Commissioners…..in the decade or more that we have been in existence, but you need to be aware of the possibility."

19. A more simplified position is put later "the legislation contains a motive test and consequently the rules apply only if the purpose, or one of the purposes for which the transfer (to the EBT) took place was for the avoiding of a liability to tax. Here, there is an argument that the transfer was for bona fide commercial reasons but counsel has opined that a Court may not be persuaded that the reason for choosing offshore rather than UK resident trustees, was not to avoid tax." The use of a double negative is unlikely to have assisted the understanding of a lay person. In the letter PSL elaborated that "any investments made should be non-income generating e.g. interest free loans or capital producing assets. If you do wish the trustees to consider investing in income generating assets it may be possible to avoid any future problems in structuring the investment in a specific way. Therefore, we would strongly recommend that you seek further advice before proceeding with any investment recommendations to the trustees."

20. I shall later conclude that no other advice was taken other than discussions with the Company's accountant, Mr Walker. The Respondents chose to take no legal advice. The conversation with Mr McKenzie cannot be deemed advice. The Respondents do not contend that the words spoken during the telephone conversation were intended to be relied upon. A similar letter was written by PSL to Mr Bell ahead of entering into the 2010 EBT ("EBT 10"). I need not repeat it here.

21. In 2012 the Company was seeking a way to distribute to shareholders its capital and avoid payment of "the higher and additional rates of income tax on those dividends". On 25 January 2012 PSL wrote to Mr Ross to explain the mechanism, effect and risks involved in their "Aikido" strategy. It explained that the aim was to achieve a "tax free" dividend "in the hands of the recipient". The strategy was said to achieve the aim by "relying upon detailed anti-avoidance legislation to the advantage of your shareholders". This involved creating a subsidiary which would have two classes of shareholders, but the subsidiary was to be wholly owned by the Company. The B class shares were to carry the right to a dividend. The "Company will then grant an "interest in possession" trust over the B shares to those shareholders to whom it wishes to pay a dividend. An interest in possession is where the beneficiary has an immediate and automatic right to the income of the trust….For tax purposes the IIP trust will be looked through and the beneficiary taxed upon the income". The dividend payment was to come from the Company transferring money to its subsidiary to capitalise it, followed by a reduction in the share capital of the subsidiary to create distributable reserves. The letter further explained "we believe that any dividends declared upon the B share will be taxed not as income of the recipient, but as though it

were income of the company. Implement Consulting Limited will not pay further tax upon the receipt of a dividend from another UK company."

22. The letter came with what appears to be a standard risk warning. It states "Aikido has, of course, been subject of a favourable opinion from leading Tax Counsel but planning of this nature cannot of course be guaranteed……Aikido has been disclosed under the Disclosure of Tax Avoidance Schemes regime and will by its nature be viewed as aggressive by HMRC. You should therefore expect HMRC to enquire into this planning…..You should expect any enquiry may take some years…it is therefore possible that HMRC will want to take a case to the First Tier Tax Tribunal to test the legal arguments and to establish the facts….We do not believe that this is at all likely but it is something that you do need to be aware of and it is for that reason that the separate fighting fund has been established. If HMRC are successful in challenging the planning, the most likely downside will be that they will recharacterize the whole planning as a normal dividend and assess the shareholders for the income tax due, plus any interest accruing on the late payment…".

23. Mr Bell and Mr Ross accept that they did not read or see the advice of leading Counsel. Although Mr Walker appears to have been heavily involved with the Company and attended a PSL presentation, he also accepted that he had not read or seen the opinion of leading counsel. In addition to the specific warning set out above, the letter warned about the use of retrospective legislation to attack the scheme. It assessed the chances of a risk of retrospective legislation as "minimal".

HMRC investigation and warnings

24. Very little, if anything, relevant to this matter took place between 30 September 2010 and 9 June 2011 when a letter was written by HMRC to the Company stating that they "are checking the company's corporate tax return for the period 1 April 2009 to 30 September 2009" and that the "check into the EBT will be carried out by Specialist Investigations…..". A few days later on 15 June HMRC wrote explaining that the enquiry related to the Company's use of a Marketed Avoidance product and stated "I must also inform you that I intend to raise formal assessments under Regulation 80 of the Income Tax (PAYE) Regulations 2003, and Section 8 Decisions under the Social Security Contributions Act 1999, to protect HMRC's position with regard to PAYE and NIC. These assessments will be issued in due course." Very shortly after HMRC wrote, on 20 June 2011, to FL Walker & Co (the Company's accountants) offering to discuss terms of settlement. The letter was marked "Without Prejudice" and began "HMRC has reviewed its approach to outstanding enquiries into the Employee Benefit Trust (EBT) and similar arrangements and I am writing to let you know that we will be contacting your client on 27 June 2011 to suggest terms on which we may be prepared to settle EBT enquiries and discuss related tax liabilities…". The letter went on to set out the position of HMRC:

> "With the introduction of the new Disguised Remuneration legislation (announced by the Government on 9 December 2010 and published in the Finance (No 3) Bill 2011 on 31 March 2011) we would like to offer your clients the chance to discuss their outstanding EBT enquiries and related matters so that they can obtain certainty in regard to their tax and NIC liabilities……the disguised remuneration legislation, once enacted, will have

> effect from 6 April 2011 and, in some cases, will apply to transactions that took place on and after 9 December 2010. Our intention is to make corresponding regulations to deal with NICs."

25. The Company then received the letter HMRC had warned the accountants it would send. It is dated 27 June 2011:

> "We are writing to you because our records show that you have an outstanding enquiry on your EBT for the following periods 01 October 2008 to 30 September 2010. This enquiry has been open since 09 June 2011, and it is our view that you have accrued approximately £860,800:00 in outstanding liabilities. This sum carries an interest charge. If you make, or have already made, a payment on account this will reduce, or has already reduced, the interest that is accruing….. EBT arrangements can have a wide range of potential liabilities that include Income Tax, National Insurance, Corporation Tax, Capital Gains Tax (on the beneficiaries), and Inheritance Tax charges."
>
> "Furthermore, some EBT have sub-trusts and loans to offshore structures and these can have liabilities under the non-resident trust rules…. Based on the information we hold on your EBT we propose to settle these enquiries on the basis of treating contributions as earnings."

26. Settlement was not made. Matters progressed and after a warning in September 2012, HMRC sent on 7 March 2013, Determinations under Regulation 80 Income Tax (Pay As You Earn) Regulations 2003 ("Determination") and a Decision under Section 8 of the Social Security Contributions (Transfer of Functions Act) 1999 ("Decision") in respect of PAYE and Class 1 National Insurance Contributions. On 2 April 2013 PSL lodged an appeal on behalf of the Company against the Determination and Decision.

27. On 5 July 2013 the Company received a letter from HMRC stating that an enquiry had been opened in respect of the IIP. A Determination and Decision was sent in relation to the EBTs under cover of a letter dated 6 January 2014. There followed demands for sums said to be due from the Company and accelerated payment charges totalling £1,122,364.57. Of that sum £258,537.25 related to the tax year 2008 to 2009.

The accounts

28. The abbreviated accounts for the Company, for the year ending 30 September 2009 showed £1,192,717 of shareholder funds (total assets, less current liabilities). This sum mostly comprised funds on the profit and loss account. There was £7,500 of called up share capital and a capital redemption reserve of £2,500. The accounts disclosed that the Company had entered into EBT 09 "Trusts have been established for the benefit of Company employees and certain of their dependants. Monies held in these trusts are held by independent trustees and managed at their discretion. Where the company retains a future economic benefit from, and has *de facto* control of the assets and liabilities of the trust, they are accounted for as assets and liabilities of the company until the earlier of the date that an allocation of the trust funds to employees in respect of past services is declared and the date that assets of the trust vest in identified individuals. Where monies held in trust are determined by the company on the basis of employees' past services to the business and the company can obtain no future economic benefit from those monies, such monies, whether in the trust or

accrued for by the company are charged to the profit and loss account in the period to which they relate.”.

29. The 2010 abbreviated accounts contained the same share capital and reserves, but the profit and loss account had reduced showing £841,815. The same declaration concerning EBT 10 is included in the notes to the accounts. The profit and loss on the 2011 accounts is £312,342. The accounts were approved by the board on 29 June 2012. Amended accounts were filed as approved by the board on 14 June 2013. The amended accounts show an increase in the profit and loss to £678,653. There is nothing on the face of the accounts that explain why the first filed 2011 accounts were so wrong.

30. Mr Walker was not asked about the corrected accounts in cross-examination. Mr Ross said that there had been a miscalculation which led to a correction. There had been some wrong postings. Mr Toone has queried the late amendment to the accounts but does not take issue with it for the purpose of these proceedings. The Company ceased trading in September 2011. Despite this event the accounts for the year ending 2012 show a positive profit and loss account of £74,349.

31. The accounts do not make a provision for HMRC. They do not take account of any tax accruing as a result of the EBTs or IIP. They do not provide for PAYE or NIC or other tax charges that were warned. The Company’s accountant did not see the need. He relied upon FRS 12 where a “contingent liability” is defined as “either (i) a possible obligation arising from past events whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the entity’s control; or (ii) a present obligation that arises from past events but is not recognised because it is not probable that a transfer of economic benefits will be required to settle the obligation or because the amount of the obligation cannot be measured with sufficient reliability.” As PSL had advised that it was possible that HMRC might take a case to court to prove a liability but “this is highly remote”, there was thought to be no obligation arising from past events, that could be described as “possible” or a present obligation arising from past events.

The evidence

32. I heard first from Mr Toone, one of the joint liquidators of the Company. His evidence is said to have been given with the consent of Elias Paourou. Mr Toone’s evidence was based mostly on the documents. In cross-examination he was shown to be unsure of the documentation upon which he relied. His written evidence is straight forward:

> “On 22 October 2009, the Respondents paid away £609,000 from the Company under the auspices of an Employee Benefit Trust… That payment was largely for their own benefit, in that each respondent benefited to the tune of £240,000;
>
> On 9 March 2010, the respondents paid away a further £1,015,000 for the Company under the auspices of another EBT. That payment was largely for their own benefit, in that each respondent benefited to the tune of £400,000;

> The Respondents have admitted that the payments referred to above were remuneration. There was no provision is made for the PAYE and/or NICs that is chargeable on remuneration, either at the time or subsequently;
>
> In June 2011, the Respondents received a letter from HMRC offering to settle the Company's liabilities that have arisen as a result of the EBT 09 and EBT 10 payments for the sum of £860,000. By this point the respondents knew that the EBTs did not work and that HMRC intended to raise substantial assessments in respect of PAYE and NICs. Furthermore, once the liability to HMRC was taken into account- as it should have been- the Company was on any view insolvent on a balance sheet basis;
>
> Instead of making provisions for the PAYE and NICs, the Respondents entered into another tax avoidance scheme called the Aikido in Possession ("IIP Fund") and paid away a further £601,701 on 8 March 2012;
>
> The Company ceased trading of 30 September 2012. HMRC raised PAYE and NIC assessments from March 2013 onwards. Regardless, between 5 March 2013 and 17 June 2013, the Respondents extracted a further £100,555.49 from the Company, leaving it with just £3,968.43 in its bank account. Instead of either paying the tax or pursuing an appeal of the assessments, the Respondents caused the Company to enter creditors' voluntary liquidation."

33. Mr Toone did not waiver from this summary. He was challenged about his statement that monies lent from the sub-funds did not have to be repaid. His lack of understanding or familiarity with the underlying EBT documents was exposed and he admitted that he did not know if the loans were repayable. He was challenged about his claim that it was not reasonable for the Respondents to enter into the EBTs or IIP. Mr Toone's evidence was that the directors should have taken account of information that could have been obtained from the internet.

34. He was asked by Mr Mohyuddin QC whether he meant that they should not have caused the Company to enter the EBTs as a result of the letters and information provided by PSL. He responded: "They knew the EBTs didn't work…they also knew because of the general discourse in the public domain". Later he said they "should have been aware of what was going on in the press". Mr Toone admitted that he had no evidence of what was being presented in the press on 22 September 2009 or on 26 January 2010 (the date of the deeds of settlement). He was forced to admit that he had no evidence as to what internet searches would produce by way of guidance in respect of EBT 09 and EBT 10. His evidence on these issues was weak and he gave the strong impression that he was grasping at straws. After further testing his evidence, he was forced to accept that he relied only on the correspondence from PSL to support his claim that the Respondents acted in breach of duty. He accepted that there was ongoing litigation in respect of the IIP scheme. He also accepted that the sums claimed by HMRC under the accelerated payment notice relating to the tax year 2008/2009 did not form part of his case.

35. Mr Toone is not to be regarded as an ordinary litigant. He was not present when any of the material events took place and has only the available documents, which are

incomplete, to guide him. As he has no direct experience of the events nor studied the documents in the same detail as solicitors or counsel preparing for trial, he may be forgiven for not knowing the material as well as one might expect of a witness. That does not excuse him from introducing opinion evidence. His case remains as set out in the pleadings supported by the documents he has obtained. Insofar as his evidence comprised opinion, I give it no weight.

36. Mr Bell was cross-examined by Mr Curl. He is an intelligent and ambitious man who provided credible evidence, on the whole. In my judgment he gave straight forward answers, was willing to be corrected, wanted to understand the question before answering, and was focused on the documentary evidence. Cross-examination was broadly divided into four parts. First, causing the Company to enter into EBT 09 and EBT 10; secondly, reasons for entering into the profit extraction schemes; thirdly, entering into the IIP; and lastly payments made to the director/shareholders at a time near to or when the Company ceased to trade. There was a good deal of overlap between the examination of Mr Bell and Mr Ross. There was some differences between them as to what they thought at the relevant time but none that were relevant to the outcome of the case. One such instance involved questions about acting in the best interests of the Company. Mr Bell was asked for example, whether it was necessary or if there was a commercial need to enter into EBT 10 so soon after entering EBT 09. He agreed that there was no pressing need to enter into EBT 10, but that the information they obtained was positive:

> "Q. there was no pressing need to do another so soon?
>
> A. No commercial need?
>
> Q. No, you were just trying to get money out of the Company?
>
> A. Yes that is right. The need was to reward employees and retain them. We had profits and wanted to look at ways of rewarding the shareholders. We wanted to reward the hard work of the employees."

37. His ability to switch between the interests of the shareholders and employees is explained because they were broadly the same people. I had the impression that Mr Bell did not make any meaningful distinction save that there were some employees who were not shareholders. Mr Ross thought that there was a commercial need, at least initially. He said that the commercial need was to reward employees and retain them. That was not convincing. There was no evidence that Mr Bell and Mr Ross were going to leave the Company. Mr Bell did say that Mr Flanagan (who held 20% of the shares in the Company but was not a director) had been offered a post working for a different Company. No documentary evidence supported this assertion. I am not convinced that extracting the profits of the Company in the manner under contemplation was the sole or even a reason for the retention of the shareholders. I agree with Mr Curl's submission. Given that the Respondents and Mr Flanagan were together absolutely entitled to the entirety of the surplus value in the Company there is some conceptual difficulty with the idea that a person who is already absolutely entitled to a certain fund can be motivated to enhance that fund by means of payments from that same fund to which they are already entitled. It is more likely that they simply wanted to avoid paying tax.

38. Mr Bell did not like the words "profit extraction" and shied away from its use. Mr Curl asked him why he found it difficult to use the phrase bearing in mind it had been used in the documentation provided by PSL, and Mr Walker advertised his services on his firm's web site using the term. He answered that he thought it sounded like he had been committing an illegal act whereas he was only seeking to "avoid rather than evade" taxes by legitimate means. Mr Ross was not so concerned about the language.

39. Mr Bell was asked about the formation of a new company, Implement Consultancy Limited ("Consultancy") at a time soon after the Company received correspondence from HMRC on 15 June 2011:

> "Q. NewCo was a phoenix company. It traded under an almost identical name?
>
> A. The purpose of NewCo was to protect OldCo because of the new commercial offering we were putting in place.
>
> Q. it's coincidental that NewCo was incorporated so soon to receiving the letter?
>
> A. NewCo had no clients of the OldCo.
>
> Q. What were you protecting?
>
> A. The framework agreement which permitted us to do work for the Government all over the country was a contract with OldCo and we didn't want to jeopardise it, and the Company's history. NewCo was at risk because we were giving a guarantee to new clients that they would receive a three for one return. So for every £1,000,000 they spend they would see a £3,000,000 on their bottom line."

40. Mr Bell later conceded that the history of the Company was not a real factor but that he did express a hope that the Company would receive more work from the framework agreement. He added that "there had been a 90- 95% drop in turnover [for OldCo] between 2009 and 2011". The creation of a new company may be important for the overall context, but I shall find that this last admission is relevant to their knowledge of insolvency.

41. Mr Ross gave robust and honest evidence. I have no hesitation in accepting his evidence although his view of what constituted proper advice and his assessment of risk, I do not accept. The most contentious part of his evidence concerned the advice he received prior to entering into EBT 09. He claimed that there were many e-mails sent and received from Frank Walker, but they had gone missing. Only one e-mail is in evidence. He could not explain where the other e-mails were save that the events took place 10 years ago and he regularly rationalised his inbox, deleting e-mails he no longer thought were needed. The lack of e-mails led Mr Curl to ask Mr Ross how he could show that he was acting in the best interests of the Company when contemplating and entering into EBT 09, and why he did not wait until HMRC had made a decision about EBT 09 before entering into another tax scheme:

> "Q. there is a minute but there is no discussion in it of how the payment can be in the interest of the Company as opposed to the shareholders;

A. it was because the Company was the 3 shareholders- I have never distinguished between what is right for the shareholders and what is right for the Company. In my mind it's the same thing.

Q. the Company did not benefit from the payment of £609,000 did it?

A. it did because it was in the interests of the shareholder/employees. It motivated the employees to be paid more.

Q. if you paid out the money as dividends and paid tax in the usual way, the Company would have had no uncertainty about tax issues?

A. tax issues were highly unlikely because of the EBT, that was the advice. We had offers of other employment and could have left the Company.

Q. there was no commercial pressure to pay the money out at that time and into [another] EBT [10]? It was open to you to wait to see how the EBT 09 played out with HMRC before making further payments from the Company, wasn't it?

A. Yes, it was open to us to wait, but as far as we were concerned there was no tax due at that time. The Company did not go into liquidation because of the EBTs.

Q. If you had not caused the Company to enter EBT 10, the Company would have had sufficient reserves to pay EBT 09 tax?

A. Yes."

42. His candid response that he viewed the Company and his interests as a shareholder as the same, and acceptance that the Company would have been better placed if it had not entered into EBT 10, was characteristic of his evidence. Mr Ross went on to explain that he and Mr Bell had regular meetings with Mr Walker (sometimes a meeting over a coffee) where profit extraction, to avoid tax "in a legal way", was often one of the subjects when they met. At no time did he think that the Company owed money as a result of the EBTs. He said that the Company was at "world class level" when it came to paying its debts, "we would pay our debts within 72 hours" of receipt of an invoice. He was challenged about (i) the timing of the notice from HMRC dated 15 June 2011 stating that assessments were to be raised and (ii) the incorporation of Consultancy on 17 June 2011. The name is undeniably similar to Implement Consulting Limited. Mr Ross was again candid saying: "it does not look good" but added "it is a coincidence". He explained that instructions were given to Frank Walker to incorporate Consultancy months before the receipt of the letter dated 15 June 2011 and that the Company would have received the letter of 15 June 2011 a good time after incorporation of Consultancy because it was sent to an address that would have ensured it would not have come direct to the Company.

43. Mr Ross made clear in evidence that he trusted Mr Walker's advice, that whenever he received a notice or letter from HMRC he would contact Mr Walker who would tell him: "there is no debt- relax". He was asked about the expenses paid to Mr Flanagan and £70,000 paid to the shareholders in proportion of their shareholding in March 2013. He responded that the monies were paid as expenses because they were owed to

Mr Flanagan and that an expense schedule had been provided. The schedule is in the trial bundle and although Mr Curl sought, quite properly, to test some of the items, he was unable to make any headway. I accept that the payments were for expenses properly due. That does not mean that they should have been paid at the point in time when they were paid.

44. Mr Ross properly accepted that the payments to the shareholders in the proportion of the shares held could be categorised as dividends. He also accepted that there was no board resolution recorded and no board minute compliant with the Companies Act 2006 (the "Act"). Finally, Mr Ross wanted the Court to know that as the Supreme Court had found that payments into a sub-trust in the form created by the EBTs were unreservedly at the disposal of the employee, they were earnings for PAYE and NIC purposes: *RFC 2012 Plc (in liquidation) (formerly The Rangers Football Club Plc) v Advocate General of Scotland* [2017] 1 WLR 2767. He said that he and Mr Bell intended to settle the HMRC debt and there were ongoing discussions. I have no information about the negotiations. I was informed that as at the date of this hearing the sums claimed by HMRC had not been paid, and HMRC were aware and had been put on notice of these proceedings by Mr Toone. HMRC would therefore know that the main claim made by Mr Toone is that the payments out of the Company to EBT 09, EBT 10 and the IPP were unlawful distributions.

45. Last to give evidence was Mr Walker who gave careful and considered evidence. He informed the Court that he had advised the Company of the threat of an assessment, but that an assessment did not constitute a liability; it was a remote possibility that HMRC would be able to claim the tax. As an accountant Mr Walker was not qualified to give legal advice. He did not profess to have done so.

46. Much of his written evidence was not disputed or if it was it was not undermined. In his witness statement he states that he raised the idea of tax planning with Mr Bell and Mr Ross. The reason he did so was that he had attended a seminar presented by PSL, was informed that EBTs had been widely used and were supported by opinions from two leading counsel. He said that it was his belief that "the scheme appeared to be more tax efficient than other options such as salary or dividend. I agreed with the general consensus following discussion that it would be in the best interests of the Company to enter into EBT 09, albeit ultimately that was a decision for the First and Second Respondents. The prospect of entering into EBT 10 was again discussed at various meetings, which I attended. I have no doubt that the First and Second Respondents believed that it was in the interests of the Company to enter into EBT 10".

47. In his statement he takes issue with the opinion given by Mr Toone that the Respondents always knew that the tax planning would not work: "The opposite was the case". He states: "At the time of the raising of the assessments, the law was firmly on the side of the tax planning working and it was not until the *Rangers* decision in the Court of Sessions in Scotland in November 2015 that the position changed.".

The relevant legal principles

48. At trial Mr Curl argued that the impugned payments to the EBTs and the IIP as well as the expenses payments and the £70,000 were (a) distributions that were *ultra vires*

the Company or (b) made at a time when the Respondents should have had regard to the interests of creditors not just the shareholders or (c) transactions defrauding creditors within the meaning of section 423 of the Insolvency Act 1986 (the "IA 1986").

49. Part 23 of the Act provides that a company may not make distributions to any of its members except out of profits which are available for that purpose. Section 830(2) of the Act defines profits available for distribution by a company as its "accumulated, realised, profits, so far as not previously utilised by distribution or a reduction or reorganisation of capital duly made". Regard is to be had to the net overall position of the company taking into account its accumulated surpluses and losses over the years up to date; and profits must be realised. Section 830 provides:

> "(1) A company may only make a distribution out of profits available for the purpose.
>
> (2) A company's profits available for distribution are its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made".

50. The Company was required to rely on proper accounting information to determine whether there were distributable profits and the relevant accounts are the company's last annual accounts, properly prepared: sections 836 and 837 of the Act. In my judgment the language of the section, properly construed, means that the time when distributions are to be tested for legality is the time they are made. Mr Curl refers to section 847 of the Act. This section applies:

> "(1) …. where a distribution, or part of one, made by a company to one of its members is made in contravention of this Part.
>
> (2) If at the time of the distribution the member knows or has reasonable grounds for believing that it is so made, he is liable–
>
> (a) to repay it (or that part of it, as the case may be) to the company, or
>
> (b) in the case of a distribution made otherwise than in cash, to pay the company a sum equal to the value of the distribution (or part) at that time.
>
> (3) This is without prejudice to any obligation imposed apart from this section on a member of a company to repay a distribution unlawfully made to him".

51. Mr Curl urges the Court to stand back and look at the reality of the transactions, submitting that the payments represented a return to shareholders albeit they were made indirectly via a trust device. Mr Mohyuddin QC argues that the Court must take the establishment of a trust by a settlement deed (EBT 09 and EBT 10) and the payment of dividends through a subsidiary (the IIP) at face value. It is impermissible to inquire further unless the deeds are impugned.

52. I turn to some case law. The facts in *Ridge Securities Ltd v Inland Revenue Commissioners* [1964] 1 WLR 479 are complicated. In essence, the company was a dealer in securities. It acquired shares and debentures of two companies, the debentures of a subsidiary of one of the two companies, and stripped them of their profits. It had previously acquired the shares and debentures of another company. It was stripped of profits by way of dividend. Four companies then created unsecured debentures in favour of Ridgeway. The applicable interest rates on the debentures varied from 90 per cent to 99 per cent of the gross dividends received during the year. The total debenture "interest" was greatly in excess of the amounts secured. The Commissioners of Inland Revenue found the transactions were "not genuinely commercial and were not trading transactions . . . . were a device for obtaining a tax repayment which was separate from and formed no part of its trade". The company appealed and the matter came before Pennycuick J in the Chancery Division. The Judge upheld the Commissioners decision. In the course of his judgment Pennycuick J cited the judgment of the Court of Appeal in *Petrotim Securities Ltd v Ayrcs (No 2)* [1964] 1 WLR 190 which had been handed down between the date of the decision made by the Commissioners and the hearing of the appeal in *Ridgeway*. Lord Denning M.R. said (p193):

> "It seems to me that when there is a sale at a gross undervalue by one associated company to another, the commissioners are entitled to find it is not the transaction made in the course of trade. Whoever would suppose that any trader in his right senses would enter into transactions of this kind? That he would sell at a gross undervalue-were it not that he had in mind some benefit out of making a loss? It is just on a par with a case where a company gives its money away. You might, indeed, say here that £630,000 was given away by Petrotim in the X [defined earlier in the judgment] transactions. It could have realised the securities for £835,000 but it chose to sell them for £205,000. Such a transaction is so outside the ordinary course of business of any trader but the commissioners were entitled to find that it was not done in the course of trade."

53. Pennycuick J recounted the arguments of *Ridgeway* and in reaching his decision explained (492):

> "No doubt, where one finds an arm's-length purchase and an arm's-length sale with a dividend strip interposed, these transactions are to be treated as in the course of the trade of a dealer; but where, as here, the transactions, as planned from their inception include a transaction which is not in accordance with the normal usage of the trade-i.e., a sale at much less than the market value-the commissioners are, I think, fully justified in treating the transactions as a whole not being in the course of trade. They cannot be obliged to treat the purchase and strip as in the course of trade and then adjust the sale so as to approach so as to quate the whole transaction to a transaction in the course of trade."

54. And a little later, he tackled the question of whether the payments were *ultra vires* the four companies with the result that they had "no legal operation". He said that as the commissioners had found that none of the companies had any reason to issue a debenture and "on the face of it" the "so-called" "interest" represented a gratuitous disposition, and in the absence of "any further material, it seems to him to follow that

it was not within the powers of the company …to make the payment". His legal reasoning followed (495):

> "A company can only lawfully deal with its assets in furtherance of its objects. The corporators may take assets out of the company by way of dividend or, with leave of the court, by way of reduction of capital, or in a winding up. They may, of course, acquire them for full consideration. They cannot take assets out of the company by way of voluntary disposition, however described, and, if they attempt to do so, the disposition is ultra vires the company".

55. In seeking to define a distribution Pennycuick J. relied on *re Lee, Behrens and Co Ltd* [1932] 2 Ch 46, 51, where Eve J. explained that "whether [payments] ….be made under an express or implied power, all such grants involve an expenditure of the company's money and that money can only be spent for purposes reasonably incidental to the carrying on of the company's business, and the validity of such grants is to be tested, as is shown in all the authorities by the answers to three pertinent questions: (i) is the transaction reasonably incidental to the carrying on of the company's business? (ii) Is it a bona fide transaction? (iii) Is it done for the benefit and to promote the prosperity of the company?"

56. In my judgment Pennycuick J, Eve J and Lord Denning M.R were carrying out an exercise that required them to stand-back and look at the reality; ignoring the labels or devices used to get to the substance of the transaction in question. The three pertinent questions provide useful guidance. Looking at the substance of a transaction and ignoring labels is not a new concept to the law. In *Street v Mountford* [1985] AC 809 Lord Templeman explained that the parties cannot turn a tenancy into a licence merely by calling it one. He graphically explained:

> "The manufacture of a five-pronged implement for manual digging results in a fork even if the manufacturer, unfamiliar with the English language, insists that he intended to make and has made a spade.".

57. The analysis given by Slade L.J in the Court of Appeal was based upon the express bargain struck by the parties. In his judgment it was incumbent upon the challenging party to demonstrate a sham:

> "it seems to me that, if the defendant is to displace the express statement of intention embodied in the declaration, she must show that the declaration was either a deliberate sham or at least an inaccurate statement of what was the true substance of the real transaction agreed between the parties; ..."

58. In identifying the hallmarks of a tenancy to reflect reality Lord Templeman eschewed Slade L.J's. analysis. Similarly in *Agnew v Commissioners of Inland Revenue* [2001] 2 AC 710, the Privy Council was concerned with whether a charge was fixed or floating, Lord Millett looked at the substance by identifying the "hallmark" of a floating charge (paragraph 13): "the classification of a security as a floating charge was a matter of substance and not merely a matter of drafting".

59. The same approach was taken in *Progress Property Co Ltd v Moore* [2010] UKSC 55 where the Supreme Court was asked to determine whether a sale was in fact a

disguised distribution of assets to the shareholders. Lord Walker explained (paragraph 27) that "in cases of this sort the court's real task is to inquire into the true purpose and substance of the impugned transaction. That calls for an investigation of all the relevant facts, which sometimes include the state of mind of the human beings who are orchestrating the corporate activity. Sometimes their states of mind are totally irrelevant." If a controlling shareholder treats a company as his own property his state of mind is irrelevant. All these cases concern the proper characterisation of the transaction under consideration: a lease or licence; a floating or fixed charge; a sale or distribution of capital. But looking at the reality of the situation is not confined to characterisation.

60. The House of Lords thought it was important to look at the reality of the situation in an undervalue case where there were linked transactions: *Phillips v Brewin Dolphin Bell Lawrie Ltd* [2001] UKHL 2. There was no need to claim there had been a sham to unravel the substance of the transaction. Lord Scott explained why and how the Court should apply common sense and not disregard reality:

> "Where the events, or some of them, on which the uncertainties depend have actually happened, it seems to me unsatisfactory and unnecessary for the court to wear blinkers and pretend that it does not know what has happened. Problems of a comparable sort may arise for judicial determination in many different areas of the law. The answers may not be uniform but may depend upon the particular context in which the problem arises."

61. These high authorities coupled with the contextual analysis provided in *In re Lee, Behrens*, *Ridgeway Securities,* and *Petrotim Securities Ltd* firmly point to an established approach. I reject the submission made by Mr Mohyuddin QC in closing that the only basis of attacking the payments made to the trusts is to allege that the trusts were a sham. It is not necessary to frame the trusts as shams in order to establish the true nature of the transaction under consideration. The Court does not have to wear blinkers and ignore (i) the purpose for which the trusts were set-up (ii) the events leading to the establishment of the trusts as evidenced by the letters from PSL and the board minutes and (iii) the carrying into effect of the intention to pay the shareholders a tax free sum of money from the Company's capital.

62. Mr Curl has argued, as an alternative to his main contention that there had been unlawful distributions, that by causing or allowing the return of capital, the directors breached their duties to the Company. Mr Curl recites in his skeleton argument the codified duties of a director as set out in the Act but in fact only relied upon two sections:

> "s 171 Duty to act within powers
>
> A director of a company must – ….
>
> (b) only exercise powers for the purposes for which they are conferred.
>
> s. 172 Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to –

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

(c) the need to foster the company's business relationships with suppliers, customers and others,

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company.

63. Mr Mohyuddin QC and Mr Curl cited in argument the recent case of *Burnden Holdings (UK) Limited (in liquidation) v Fielding* [2019] EWHC 1566. In this case Mr Justice Zacaroli found the majority directors of a company not liable in respect of a grant of security to themselves for a loan made by them to the company. He found that there was authority given by the board for the grant of the security. More relevant to this case Zacaroli J found that if the directors knew the facts constituting an unlawful dividend, they could not escape liability for breach of trust. On the other hand if the directors were found to be unaware of the facts rendering the dividend unlawful, they would not be personally liable if they could demonstrate they had taken reasonable care to secure the preparation of accounts which showed that a lawful dividend could be paid, even if it emerged that there were insufficient profits to do so. In doing so Zacaroli J determined that liability was fault-based (as opposed to strict liability).

64. The timing of a Company's insolvency is important. When a company becomes insolvent the interests of creditors intrude. As regards solvency or insolvency section 123 of the IA 1986 provides (where relevant):

"(1) A company is deemed unable to pay its debts –

…….

(e) if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.

(2) A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into accounts its contingent and prospective liabilities."

65. The leading case on the insolvency test is *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc* [2013] 1 WLR 1408 which followed the decision of

Briggs J (as he was) in *Re Cheyne Finance Plc* [2007] EWHC 2402. The cash-flow test (section 123(1)(e)) is concerned with debts falling due from time to time and account is to be had of debts that fall due within the reasonably near future. It is a fact sensitive enquiry. The cash-flow test is not appropriate if the analysis moves from the near future. The balance sheet test (section 123(2)) was explained by Toulson LJ in the Court of Appeal in the same case:

> "Essentially, section 123(2) requires the court to make a judgment whether it has been established that, looking at the company's assets and making proper allowances for its prospective and contingent liabilities, it cannot reasonably be expected to be able to meet those liabilities. If so, it will be deemed insolvent although it is currently able to pay its debts as they fall due. The more distant the liabilities, the harder this will be to establish."

66. More recently the Court of Appeal applied the tests enunciated in *Eurosail* in *Bucci v Carman; Re Casa Estates Ltd* [2014] EWCA Civ 383 where Lewison LJ explained:

> "It is in my judgment clear from *Eurosail* and its approval of *Cheyne Finance* that the balance-sheet test in s.123(2) is not excluded merely because a company is for the time being in fact paying its debts as they fall due. In the case of *Eurosail* that is clear from Lord Walker's approval at [42] of what Toulson L.J. had said in the Court of Appeal, and his description of the two tests as standing side by side. In the case of *Cheyne Finance* it is clear from Briggs J's description of the balance-sheet test as an alternative test. Thus, I agree with Warren J. at [34] that the two tests feature as part of a single exercise, namely to determine whether a company is unable to pay its debts."

67. Mr Curl emphasises that the Court should look to the future not only the present and also take account of liabilities that are not yet payable. He cites two authorities for propositions that support the Joint Liquidators' claim. First *Integral Memory plc v Haines Watts* [2012] EWHC 342 (Ch) for the proposition that a liability to tax is not contingent on the determination of a tax tribunal or court. The liability accrues on the occurrence of the transaction that gives rise to the taxable charge. Secondly, *Videocon Global Ltd v Goldman Sachs International* [2016] EWCA Civ 130 for the proposition that a liability may be due without being payable. I accept those submissions.

68. Mr Mohyuddin QC emphasises that the essence of the test for solvency is whether a company can pay its debts. I am not entirely sure that there is anything between them, but I shall apply the test first enunciated by Briggs J (as he was), approved in the Supreme Court by Lord Walker, and summarised by Lewison LJ in *Casa Estates*.

69. Mr Mohyuddin QC relies on *BTI 2014 LLC v Sequana SA* [2019] 2 All ER 784 to argue that the Mr Bell and Mr Ross did not know or should not be taken to have known that the Company was insolvent until at the earliest 27 June 2011. *Sequana SA* concerned a dividend that was paid by a company to its parent company. Importantly the dividend was found to have been paid at a time when the paying company had ceased to trade and had contingent indemnity liabilities in respect of foreign claims. The dividend payment was said to have been made by way of set-off against an inter-company debt. At first instance Rose J. (as she was) found that the dividend had been paid in compliance with the Companies Act 2006 Pt 23 and dismissed a breach of

duty claim. She also held although there was a risk of insolvency it was not of a scale sufficient to trigger the common law duty to have regard to the interests of creditors, but she found that the provisions of s.423 IA 1986 had been contravened and ordered sums to be paid that matched the amount of the dividend.

70. Giving the leading judgment in the Court of Appeal, David Richards L.J. explained that dividends were both commercially and legally a return on an investment. The payment of a dividend involved the payment of funds beneficially owned by a company to its shareholders, who received them pursuant to rights conferred by the terms of share issue or by the articles of association. Those rights were attached to the shares, for which consideration had been provided.

71. He explained that s.172(3) of the Act implicitly recognised that it was difficult to identify when the duty to creditors was triggered. Having reviewed the authorities he viewed the test as when the directors knew or should have known that the company was or was likely to become insolvent. In that context, "likely" meant probable.

72. As indicated the Joint Liquidators claims are also brought pursuant to section 423 of the IA 1986. For reasons I shall come to it is not necessary to set out the section.

Characterisation: the EBTs, IIP, and the March 2013 payments

73. The question, as Lord Walker explained in *Progress Property Co Ltd* (paragraph 24), is how the transfer of money from the Company into an employment benefit trust (whether it was EBT 09 or EBT 10) which in turn paid the shareholders (who also occupied the position of director and employee), is to be categorised.

74. The purpose of EBT 09 and EBT 10 was to withdraw an asset out of the Company and not pay tax. This has been described in various different ways such as profit extraction and avoidance of tax. An offshore trust was the chosen tool used through which the asset would pass but the end recipients were, and, in my judgment, were always intended to be the shareholders. As Mr Bell himself acknowledges he and Mr Ross "were interested in the tax planning as a way of maximising the Company's tax efficiency and rewarding the employees/*providing a return to shareholders* in the most tax efficient manner" (emphasis supplied). In cross-examination Mr Bell said that the schemes were to benefit employees. He also acknowledged that this meant the "key employees". The "key employees" were the shareholders. Mr Ross said that it was to "reward the senior employees and maximise our tax efficiency". The senior employees were Mr Bell, Mr Ross and Mr Flanagan who held shares in the proportion 40:40:20.

75. In his written evidence Mr Bell said that the "tax planning …was in the best interests of the Company and its shareholders." Mr Curl asked Mr Bell to agree with him that using the word employees was really "window dressing" for shareholders. Mr Bell was not able to provide a full answer but agreed that it was a scheme designed to move money "in a tax efficient way". Mr Ross said with due candour, in his witness statement, that entering into EBT 09 "was believed by us collectively to be clearly more tax efficient than paying salary or dividends…".

76. The EBTs were intended to and did act as a conduit through which the shareholders, who were also directors and/or employees of the Company, were given a tax free sum taken from the Company's capital.

77. Two simple facts support this. In the October 2009 letter PSL explained to Mr Bell and Mr Ross, that "on acquiring the EBT you can specify the classes of beneficiaries under the deed of appointment". First, the shareholders being the intended recipient comes from the specification of the class of beneficiaries. The minutes prepared by PSL record that there was "a discussion about which employees and directors it would be appropriate to include in the employee reward arrangements for the period….[and it] was drawn up of the following people: William Bell, William Ross, Kieran Flanagan". They are the shareholders. Secondly, the payments from the sub-trusts were paid in proportion of their shareholding: 40:40:20.

78. Pulling the evidence together the evidence is that the payments: (i) were taken from the reserves of the Company; (ii) always ended up in the hands of the shareholders; (iii) were not paid for the benefit of non-shareholder employees (iv) were not intended to benefit normal employees and in any event it was not contended that the intention was to make payments to any employee who was not a shareholder; (v) were made to a specific list of beneficiaries that matched the identity of the shareholders only. In addition: (i) Mr Ross said in cross-examination "I have never distinguished between what is right for the shareholders and what is right for the Company" (ii) the PSL letters of 13 October 2009 and 22 February 2010 warned that a "payment of an amount significantly in excess of the current year's profits…would be seen by HMRC as effectively a disguised dividend (i.e. sweeping out all of the reserves of the company to a director who happens to be the shareholder)…"; (iii) in my judgment the same can be said when the entire or near entire reserves are paid out; (iv) the entire or near entire reserves were paid out; (x) the PSL letter of 25 January 2012 expressly stated that the IPP "is suitable for any UK resident company with the desire, and sufficient distributable reserves, to pay a dividend"; and (v) the payments were made in the proportion of the shareholding I have identified above.

79. Standing back and applying the test enunciated by Eve J in *re Lee, Behrens* I conclude that the payments to the EBTs and IIP were not transactions reasonably incidental to the carrying on of the company's business. Despite protest from Mr Bell and Mr Ross that the transactions incentivised them to remain in the Company, they were not done for the benefit and to promote the prosperity of the Company. These conclusions are reached not simply from a retrospective evaluation but from a realistic assessment of all the relevant facts as they were at the time.

80. This analysis leads to a conclusion, looking through the eyes of the Company, that the payments made under EBT 09 and EBT 10, are to be characterised as returns of capital to shareholders. It is conceded that the formalities required under Part 23 of the Act were not performed. It follows that the returns of capital were unlawful.

81. Mr Mohyuddin QC rightly conceded that payments made to shareholders (in relative proportions) totalling £70,000 in June 2013 fall foul of the provisions of Part 23 of the Act and consequently are unlawful. It was not argued that as members they did not know or had no reasonable grounds for believing that the payments were not made in contravention of the Act: section 847 of the Act. Mr Mohyuddin was right not to

argue the point as the recipient members had actual knowledge of the payments as they were the directors and orchestrated, with the aid of PSL, the payments. They had actual knowledge of the relevant facts constituting the contravention. A shareholder cannot claim that he is not liable to return a distribution because he did not know of the restrictions in the Act on the making of distributions: *It's a Wrap (UK) Ltd (in liquidation) v Gula* [2006] EWCA Civ 544.

82. Section 847 of the Act provides the remedy for unlawful distributions. Save for the payments made to Mr Flanagan in respect of expenses on 5 March 2013 there is no need to consider other causes of action. I shall turn briefly to breach of directors' duties.

Directors' duties

83. I make some general findings before dealing with the detail of the statutory duties of the Respondents. I have mentioned that the Respondents knew of the relevant facts giving rise to a contravention of the Act.

84. The Respondents knew, in the case of the IIP, that the Company's capital was to be transferred to a newly formed subsidiary, for the very purpose of paying them a dividend. They knew from reading the PSL letters in October 2009 and February 2010 that if there was a "sweeping out" of the reserves, there may be a consequential risk that the "sweep" be viewed as a disguised dividend. They failed to take any or any proper legal advice. I do not think a phone call to a friend who is qualified as a lawyer in Glasgow is sufficient for the purpose of independent legal advice. This is because first, Mr McKenzie only gave (on Mr Ross's evidence) general advice, secondly, Mr McKenzie did not have sight of any papers such as Company information, accounts, or draft minutes of board meetings, and lastly the advice, according to Mr Ross, was not intended to be relied upon.

85. The directors chose to rely only on an accountant who suggested to them the idea of profit extraction for the Company, and the seller of the schemes (PSL). Whatever the character of the information provided by PSL, it was not suggested that PSL could provide the Company and the Respondents with an independent evaluation or advice. PSL had a very real interest in the Company entering into the EBTs and IIP, namely a payment measured by a percentage of the sums of capital paid out of the Company.

Insolvency and Section 172 of the Act

86. The issue in relation to insolvency or near insolvency is that it marks the point in time when the Respondents as directors should have taken account of the interests of creditors. Mr Curl argues that the Company's best interests included its creditors by 30 September 2010 as it was insolvent or near insolvent at that date. It is for the asserting party (the Joint Liquidators) to satisfy the Court that creditor interests intruded at this time.

87. The defence of the Respondents pleads "when the Respondent's caused the Company to make payments pursuant to EBT 09 and EBT 10 and the Aikido In Possession trust, it was neither insolvent nor ought the Respondents in their conduct of the Company's business to have anticipated its insolvency.". In his witness statement Mr Bell asserts that the Company was solvent when all "planning was undertaken". He says that he

has been advised "by my accountant and was advised by Mr Walker at the time of preparation and finalisation of the Company's filed accounts that there are no tax rules that require provision to be made." And "I am advised by my solicitors that a hindsight test cannot be applied in terms of insolvency for a misfeasance claim."

88. The statutory accounts are important as (i) they represent the only available financial information of the Company during 2009-September 2011; (ii) the Company has provided no management accounts or other material; and (iii) although filed accounts present only a historic view they provide some basis upon which the Court may determine whether it is likely that the Company was insolvent.

89. The other information before the Court is the HMRC proof of debt and a reconstructed schedule produced by the Joint Liquidators. For the period ending 30 September 2009 the Company's retained shareholder funds of £1,192,717. With this sum the Company could cover the accruing debt owed to HMRC. One year later shareholder funds dropped to £851,817 leaving the Company short of funds by in excess of £270,000. Each subsequent year end, the debt to HMRC increased until 30 September 2013 when, according to Mr Toone, £1,706,090.02 was due to HMRC. Mr Toone calculated this sum as a net figure taking the shareholders' funds as stated in the accounts for the year ending 2013 (£10,040) and subtracting the cumulative sum said by HMRC to be due to it (£1,716,130.02). By this time the Company had only £10,000 odd to meet the debt.

90. The debt due to HMRC for the year ending 30 September 2010 arose (in most part) because of the unpaid tax due on EBT 09 and EBT 10. Mr Curl argues that since the Supreme Court found in July 2017 that remuneration paid to a trustee was subject to a charge to tax in the same way as if it had been paid direct to the employee, the law is deemed always been that way: *RFC 2012 plc v Advocate General of Scotland* [2017] 1 WLR 2767. In other words, the debt was due (not necessarily payable) from the time the Company transferred monies into EBT 09. The debt increased when entering into EBT 10 and the IIP.

91. The declaratory theory of judicial decisions was explained by Lord Goff in *Kleinwort Benson Ltd v Lincoln* [1999] 2 AC 349, 377. At first, I thought this may be relevant but on reflection it is of limited use in this context. More apposite is *National Westminster Bank plc v Spectrum Plus Ltd* [2005] 2 AC 680, paragraph 38 where Lord Nicholls provided a definitive answer:

> "But leaving these aside, the interpretation the court gives an Act of Parliament is the meaning which, in legal concept, the statute has borne from the very day it went onto the statute book. So, it is said, when your Lordships' House rules that a previous decision on the interpretation of a statutory provision was wrong, there is no question of the House changing the law. The House is doing no more than correct an error of interpretation. Thus, there should be no question of the House overruling the previous decision with prospective effect only. If the House were to take that course it would be sanctioning the continuing misapplication of the statute so far as existing transactions or past events are concerned. The House, it is said, has no power to do this. Statutes express the intention of Parliament. The courts must give effect to that intention from the date the legislation came into force. The

> House, acting in its judicial capacity, must give effect to the statute and it must do so in accordance with what it considers is the proper interpretation of the statute. The House has no suspensive power in this regard."

92. As *RFC 2012 Plc* was decided as a matter of statutory interpretation, namely of section 131 of the Income and Corporation Taxes Act 1988 and section 62 of the Income Tax (Earnings and Pensions) Act 2003, the answer provided by the House had prospective and retrospective effect. In light of this, it could be said that the Company was, on the evidence before it (the Court has to do its best with the material before it) insolvent by 30 September 2010.

93. The question before the Court is, as David Richards L.J. said in *Sequana SA* when did Mr Bell and Mr Ross know or when should they have known of the insolvency? As a result of my findings in respect of the unlawful distributions I need only ask whether the Respondents knew or should have known of the likelihood of insolvency at the time the Company made the decision and paid out the expenses to Mr Flanagan on 5 March 2013. At trial the Joint Liquidators did not contend that these should be categorised as unlawful distributions. Accordingly, these are the only payments that are not caught by the unlawful distributions. In closing submissions Mr Mohyuddin QC argued that the earliest date at which the insolvency test could be satisfied was 27 June 2011 when HMRC wrote stating "it is our view that you have accrued approximately £860,800 in outstanding liabilities". Mr Curl argues that it is the latest date.

94. In my judgment the letter to the Company on 27 June 2011 was sufficient to put them on notice of a substantial debt owed to HMRC. It could be said that the precise sum was yet to be calculated. It could be said that HMRC reserved its position to raise further arguments and it was not sure of its own position. On the other hand, the PSL letters had warned that HMRC may make a challenge; that such a challenge may take years to work through the tribunal; accordingly a risk was always present; the risk was all the greater because a sum had been calculated by HMRC; HMRC had sent a written warning that "EBT arrangements can have a wide range of potential liabilities that include Income Tax, National Insurance, Corporation Tax, Capital Gains Tax (on beneficiaries) and Inheritance Tax charges"; and an offer of settlement was raised by HMRC. Further by this time the Company knew (according to Mr Bell) that it had lost "90-95% of its turnover since 2009". Pulling these strings together the following represent material factors: (i) the interpretation of statute by the Supreme Court in 2017 is deemed to be the true interpretation; (ii) the statutes under consideration express the intention of Parliament; (iii) the courts must give effect to that intention from the date the legislation came into force; (iv) the Courts have no suspensive power; (v) the Respondents had caused the capital reserves to be swept from the balance sheet since 2009 notwithstanding the presence of a risk that sums would become due to HMRC as a direct result of the "aggressive tax" planning undertaken by the Company; (vi) no provision had been made for a risk that was apparent even if they believed it to be remote or unlikely; (vii) the Company's turnover was not only falling at speed but significantly falling; (viii) the Respondents were warned that HMRC had opened an enquiry and a special investigator appointed; (ix) HMRC wrote on 15 June 2011 stating that it intended to raise assessments (which would give rise to a present obligation of a large sum); (x) HMRC wrote again five days later offering to settle before issuing assessments; and (xi) a debt figure was provided in the letter of

27 June 2011. These material factors lead me to conclude on the balance of probabilities, that as at that date, looking at the Company's assets and making proper allowances for its prospective and contingent liabilities, the Company could not reasonably be expected to be able to meet HMRC liabilities. It was insolvent even if it continued to pay the debts of other creditors at the time.

95. I comment that from this date, to enter into an arrangement which sought to achieve a distribution of assets, without regard to the requirements of statute, and without making proper provision for creditors was, itself a breach of duties which directors owe to a company*: MacPherson v European Stategic Bureau* [2000] 2 BCLC 683 paragraph 48. Having reached the conclusion above, the expenses paid to Mr Flanagan in March 2013 constituted a breach of duties. The Company was not bound, at the date of the expense payment, to make the payment. The Company owed a duty to its creditors to keep its property inviolate and available for the repayment of its debts.

Conclusion

96. In my judgment the payments made from the capital reserves of the Company into EBT 09, EBT10, the IIP, and the payments in June 2013 to shareholders had the character of distributions. None of the distributions are supported by board minutes identifying "relevant accounts" or recording a consideration of such accounts. There is an absence of any relevant resolutions.

97. This will appear to the Respondents to be a harsh conclusion. I have some empathy with their position. Mr Ross and Mr Bell described themselves as cautious by nature but attracted, as they were, by the spectre of tax-free distributions, they failed to take independent legal advice and failed to read opinions from leading counsel provided to the promotor of the schemes. They did not seek comfort directly from HMRC before causing the Company to enter the schemes. In my view when entering the schemes, they chose to take a risk which they did not entirely understand. The lack of understanding had the effect of handicapping the directors from making decisions in accordance with their statutory obligations owed to the Company.

98. I have found that Mr Ross and Mr Bell are honest and were honest in their dealings. Failing to take the simple steps I have mentioned however, cannot be described as reasonable conduct for a director faced with such a large financial decision on behalf of the Company. As liability is strict, the Company is entitled to its statutory remedy.

99. I mention briefly, an issue of limitation was raised early in the hearing, but not pursued.

100. In my judgment the Company was insolvent at the time the expenses were paid to Mr Flanagan in March 2013. The payment to Mr Flanagan was made in breach of directors' duties. The Respondents are to account for the loss.

101. I will hear counsel on the terms of the order when this judgment is handed down.