TC02837

Appeal number: TC/2011/07487

INCOME TAX; provision of consultancy services; unformed company; fee for services subsequently paid to newly formed company after services performed; substance and commercial effect of arrangements; accounting treatment of fee; generally accepted accounting practice; corporation tax on fee paid by newly formed company; whether Appellant contractually or by reason of principles of unjust enrichment entitled to the same consultancy fee as individual and also liable to pay income tax thereon – No. Whether Appellant acting as promoter of unincorporated company under obligation to account for fee - No. Whether consultancy fee should be treated as miscellaneous income of Appellant - No. Statutory Penalty - Appellant relying on accounts accepted as accurate by HMRC; whether Appellant's conduct negligent conduct - No. Income Tax (Trading and Other Income) Act 2005 ss 5, 8, 25, 34, 687, 689; Companies Act 1985 s36C; Appeal ALLOWED

FIRST-TIER TRIBUNAL
TAX CHAMBER

MAUREEN HEPBURN **Appellant**

- and -

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

TRIBUNAL: JUDGE J GORDON REID QC, FCIArb
Dr HEIDI POON, CA, CTA, PhD

Sitting in public at George House, Edinburgh on 14, & 15 May, and 19 June 2013

Julian Ghosh QC, and Jonathan Bremner and Edward Waldegrave, barristers, for the Appellant instructed by Morton Fraser LLP, Solicitors

Sean Smith QC, instructed by the Office of the Advocate General on behalf of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The essentials of this appeal are that the Appellant proposed to provide consultancy services to a company (Envireneer Limited) through the medium of a limited company (to be named Torglenn Limited). She performed the bulk of these services before Torglenn had been formed. An invoice for the services was rendered to Envireneer by the Appellant in the name of Torglenn, still unincorporated. Envireneer paid the consultancy fee to solicitors to be held for Torglenn. Torglenn was eventually incorporated and the fee paid by the solicitors into Torglenn's bank account.

2. This appeal concerns the question whether the fee, which has already been recognised as profits in Torglenn's accounts with corporation tax paid thereon, and correspondingly allowed as a deduction in the assessment of Envireneer's corporation tax liabilities, falls to be taxed again as income of the Appellant. These basic facts raise questions about entitlement to profits, contracts involving companies yet to be formed, unjust enrichment, activities of company promoters and related fiduciary obligations and the nature of trading receipts and expenditure.

3. There is a subsidiary issue in relation to statutory penalties if the Appellant is liable to pay income tax on the consultancy fee.

4. It should be stated at the outset that the arrangements summarised above and discussed in more detail below were not, nor were they intended to be, an elaborate or even a simple tax-avoidance scheme. They were genuine commercial arrangements which had a rational purpose.

5. A Hearing took place at Edinburgh on 14 and 15 May, and 19 June 2013. The Appellant (Miss Hepburn[1]) was represented by Julian Ghosh QC and Jonathan Bremner and Edward Waldegrave, barristers, on the instructions of Morton Fraser LLP, Solicitors, Edinburgh. Mr Ghosh led the evidence of Miss Hepburn, and Steven Brice, an expert accountant. The Respondents (HMRC) were represented by Sean Smith QC on the instructions from the Office of the Advocate General. Mr Smith led the evidence of Teresa Hostad, an expert accountant. Joint Bundles of documents and authorities were produced. Both parties produced a Statement of Case, and a Skeleton Argument. A Statement of Agreed Facts setting out much of the background that was not in dispute is reproduced below. The expert accountants also produced a Joint Statement setting out some areas of agreement and noting the main competing expert views. While the experts' Joint Statement is a useful document, it is unnecessary to reproduce it in our Decision.

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[1] In some documents the Appellant is referred to as "Ms Hepburn". We were informed at the Hearing that the preferred designation is "Miss Hepburn"

Statutory Background

6. We set out or summarise below the following statutory provisions, included as part of the bundle of authorities, which are relevant to our determination.

Income Tax

7. Section 5 of the Income Tax (Trading and other Income) Act 2005 provides that income tax is charged on the profits of a trade, profession or vocation. Section 8 provides that the person liable for any such tax *is the person receiving or entitled to the profits.* Section 25 provides *inter alia* as follows:-

> (1) The profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for income tax purposes.

8. Section 34 provides *inter alia* that, in calculating profits of a trade, expenses incurred wholly and exclusively for the purposes of the trade are deductible.

9. Section 687 provides that

> Income tax is charged under this Chapter on income from any source that is not charged to income tax under or as a result of any other provision of this Act or any other Act.

10. Section 689 provides that

> The person liable for any tax charged under this Chapter is the person receiving or entitled to the income.

Companies Acts

11. Section 36C of the Companies Act 1985 (the current provision is section 51 of the Companies Act 2006) provides as follows:-

> A contract which purports to be made by or on behalf of a company at a time when the company has not been formed has effect, subject to any agreement to the contrary, as one made with the person purporting to act for the company or as agent for it, and he is personally liable on the contract accordingly.

12. It may be noted in passing that (although this is not now in dispute and not of any significance), this provision applies to Torglenn even although it was formed in Guernsey. Regulation 2 of the Foreign Companies (Execution of Documents) Regulations 1994, SI 1994/950, as amended, provides that section 36C applies to companies incorporated outside Great Britain, subject to certain modifications in Regulation 3, which in turn provides that references to a company in section 36C are to be construed as including a company incorporated outside Great Britain. No evidence of Guernsey law was led. Accordingly, insofar as relevant, it is assumed to be the same as Scots law.

Facts

13. Most of the facts are not in dispute. The conclusions to be drawn from those facts and their fiscal effect are in dispute. We set out below the Statement of Agreed Facts adding to it some further background material (*in italics*) which was generally uncontroversial.

1. In early 2004 an opportunity arose for Ms Maureen Hepburn to acquire a business (Transfer Systems International (UK) Limited (in receivership)). A new company (York Place (No 312) Limited, subsequently renamed Envireneer Limited ("Envireneer")) was formed for the purpose of acquiring the relevant trade and assets of Transfer Systems International (UK) Limited (in receivership) and did acquire that trade and those assets in April 2004.

1(a) Transfer Systems International (UK) Limited had operated in a niche market in the oil industry. It had developed and patented a bulk transfer system for dealing with drill "cuttings" (material removed from the borehole in the course of oil drilling). As part of her consulting business, Miss Hepburn had done some work in late 2001 for Transfer Systems. By 2003 however Transfer Systems was struggling. It was placed in receivership on 13 April 2004. Following its acquisition, Miss Hepburn and Ms Dow continued its business through Envireneer.

2. Ms Hepburn was managing director of Envireneer and held 80 per cent of the shares therein. Ms Hepburn acted as managing director of Envireneer pursuant to a service agreement dated 1 April 2004.

3. The remaining 20 per cent of the shares in Envireneer were held by Ms Linda Dow, who acted as finance director.

4. Pursuant to a Shareholders Agreement between Ms Hepburn and Ms Dow dated 22 June 2005, unanimity was required in relation to decisions on significant matters of business.

5. At a board meeting on 10 December 2004, the directors of Envireneer decided that Envireneer could benefit from business development advice. Envireneer therefore decided to appoint a consultant to develop the business and provide strategic advice. Envireneer decided that it wished Ms Hepburn to carry out this role. Ms Hepburn agreed to take on the consultancy assignment.

6. At a board meeting of 10 December 2004, the Board of Directors of Envireneer gave Ms Hepburn permission to carry out this role on the basis that she would do so through a company. Permission of the Board of Directors was required in this regard because Ms Hepburn's service agreement with Envireneer required her to devote her available time to her duties as a director and prevented her from working for another company (see clauses 3.1.7 and 3.2 thereof).

6(a) *Paragraph 4 of the Board Minutes of 10 December 2004 provided inter alia as follows:-*

> *It was noted that, in terms of her Service Contract, Maureen Hepburn was prohibited from having other interests in other companies which prevented her fulfilling her obligations to the Company. IT WAS RESOLVED THAT, notwithstanding the terms of clause 3.2 of her Service Contract, Ms Hepburn be permitted to own and control any other company or companies AND THAT subject to (i) the approval of the directors; and (ii) to the relevant arrangement being evidenced in a separate consultancy agreement between the Company and any company owned or controlled by Ms Hepburn, Ms Hepburn be permitted to provide her services in relation to matters such as business development and strategic direction of the Company through another company owned and/or controlled by her.*

6(b) *Clauses 3.1.2, 3.1.7 and 3.2 of Miss Hepburn's Service Agreement with Envireneer provides inter alia as follows:-*

> *3.1 During the continuance of her service hereunder the Executive* (sc Ms Hepburn) *shall:-*
>
> ……
>
> *3.1.2 perform such duties and exercise such powers in relation to the business of the Company or any Group Company as may from time to time be assigned to or vested in her by the Board;*
>
> *3.1.7 devote the whole of the Executive's time, attention and abilities to the duties of the Executive's employment;*
>
> *3.2 The Executive shall not during the term of the Agreement (except as a representative of the Company or with the consent in writing of the Company) be directly or indirectly engaged or concerned in the conduct of any other business nor shall she be directly or indirectly interested in any such business save through her holding or being interested in investments (but only in a public company or companies) not representing more than one per centum of the issued investments of any class of any one such company.*

7. A contract for the consultancy services was drawn up on 10 October 2005. At this time, Ms Hepburn's new company had not yet been incorporated. As a result, the contract was between "Envireneer and Newco Limited (a company which will be incorporated once it has been determined if there are fees chargeable under clause 4)".

7(a) The Agreement was signed on behalf of Envireneer by Linda Dow, and by Miss Hepburn on behalf of Newco (referred to in the Agreement as the "Consultant Company"). Clause 1.1 provided that the Commencement Date was 1 January 2005; and the termination date was 31 December 2005.

7(b) Further clauses provided inter alia as follows:-

2 TERMS OF ENGAGEMENT

2.1 The Company shall engage the Consultant Company and the Consultant Company shall provide the Services on the terms of this Agreement.

2.2 The Engagement shall be deemed to have commenced on the Commencement Date and shall continue unless and until terminated:

(a) as provided by the terms of this agreement; or

(b) by either party giving to the other not less than two months' prior notice.

3 DUTIES

3.1 During the Engagement the Consultant Company shall:

(a) provide the Services with all due care, skill and ability and use its reasonable endeavours to promote the interests of the Company or any Group Company;

……..

4 FEES

4.1 In consideration of the provision of the Services, the Company shall after receipt of an invoice submitted in accordance with clause 4.2, pay to the Consultant Company a consultancy fee amounting to 30% of the Company's External Revenue exclusive of Value Added Tax (if applicable). This can be restricted if agreed by both the Company and the Consultant Company.

4.2 The Consultant Company shall submit to the Company an annual invoice which gives details of the Services which have been provided by the Consultant Company and the amount of the fee payable (plus VAT, if applicable) for such Services during that year. It should be noted that fees are only chargeable at the end of the contract and not beforehand.

8. At a meeting of the Board of Directors of Envireneer on 23 December 2005 an invoice from Torglenn to Envireneer in respect of the services was tabled in the amount of £2.385m (the "Consultancy Fee") for the year to 31 December 2005 and approved.

8(a) Paragraph 5 of the Minutes provided as follows:-

5 *Consultancy Payments*

There was tabled an invoice from Torglenn Limited in respect of contract negotiations and advice in relation to procedures and controls in relation to the Company's operations in the UK and Norway for the year ended 31 December 2005. It was noted that the board had previously agreed that Ms Hepburn could arrange for her services to be provided through a company or companies owned and/or controlled by her. It was noted that the invoice amounted to £2,385,000 (calculated as 30% of all external revenues of £8,031,472 but restricted to £2,385,000) and was in line with the Company's agreement with Torglenn in this regard. The payment was accordingly approved and it was resolved that it be made forthwith.

8(b) The invoice from Torglenn was dated 31/12/2005. It bore the name of Torglenn Limited, with a Guernsey address. The narrative of the invoice stated "Consultancy services provided during the period between 1 January 2005 to 31 December 2005 £2,385,000.00".

8(c) As at 23 December 2005, Miss Hepburn thought that Torglenn had been or was on the point of being incorporated.

9. The Directors of Envireneer made a payment in respect of the Consultancy Fee to Morton Fraser LLP on 30 December 2005 for Morton Fraser to hold for Torglenn. Morton Fraser paid the Consultancy Fee into its client account and showed it on an Envireneer ledger as a sum appropriated to Torglenn. Once the incorporation of Torglenn was completed, Morton Fraser held the Consultancy Fee on its client account for the benefit of Torglenn and subsequently (on 8 January 2007) transferred the sum of £2.385m to Torglenn's bank account with HSBC.

9(a) Morton Fraser were Envireneer's solicitors. They were not Ms Hepburn's solicitors. Nor were they Torglenn's solicitors at that point.

10. A company, Torglenn Limited ("Torglenn"), was subsequently incorporated on 4 January 2006 in Guernsey.

10(a) Ms Hepburn had been in discussion with various advisers from about June or July 2005 in relation to the most suitable form of corporate vehicle. Guernsey was chosen for reasons of confidentiality and privacy and not to limit liability to UK tax. Ms Hepburn insisted that the company should have UK residence status so as to be liable for UK corporation tax. In this regard, the incorporation of Torglenn abroad was not with a view of obtaining any tax advantages for Torglenn. This requirement (offshore company registration but with UK tax residence) appeared to be somewhat unusual to those used to setting up companies in Guernsey and the administrative arrangements took longer than anticipated to carry out and complete.

10(b) Ms Hepburn and Ms Dow agreed that the shareholding in Torglenn should be split 81.5% to Ms Hepburn and 18.5% to Ms Dow.

11. A contract was concluded between Envireneer and Torglenn on 10 January 2006. This contract made provision for Envireneer to engage Torglenn and for Torglenn to provide services to Envireneer (clause 2.1) from the commencement date of 4 January 2006 (clause 1.1).

12. On 22 September 2006 a further contract was concluded between Envireneer and Torglenn.

13. The services provided to Envireneer included:

(1) Increasing the charge out rates for equipment and personnel on current contracts.

(2) Identifying and concluding contracts with new customers.

(3) Improving the consistency of service through the introduction of new procedures and working methods.

14. Torglenn reported the Consultancy Fee as income in its accounts and UK corporation tax return for the period ended 31 December 2006 and paid corporation tax thereon.

14(a) Before completing her personal tax return for the year in question, Miss Hepburn had been involved in the preparation of the accounts and statutory return for Envireneer for the year ended 31 December 2005. In its accounts for the year to 31 December 2005 (dated 31 May 2006) Evireneer had debited its payment to Torglenn in its profit and loss account and claimed a deduction for corporation tax purposes. These accounts have not been challenged by HMRC.

14(b) Miss Hepburn completed her Self-Assessment Tax Return for the year ended 5 April 2006 online in December 2006. In doing so, she relied on the accounting treatment in the accounts of Envireneer of the payment of the Consultancy Fee.

Expert Evidence

14. The purpose of the expert accounting evidence was to demonstrate whether the non-declaration of the Consultancy Fee in Ms Hepburn's Tax Return was or was not in accordance with generally accepted accounting practice. Both experts produced reports and diametrically opposed opinions. They relied on their views of the commercial nature and substance of the arrangements under consideration with reference to various accounting standards. In essence, they were in agreement that Envireneer, for the year ended 31 December 2005, and Torglenn, for the year ended 31 December 2006, produced financial statements or accounts which were in accordance with the Financial Reporting Standards Applicable to Smaller Entities,

effective from January 2005 (FRSSE (2005)). There are no material differences between the FRSSE 2005 standards and the full UK standards - referred to as Generally Accepted Accounting Practice in the United Kingdom (UK GAAP). Both considered in detail what they regarded as relevant standards produced by or under the auspices of the Accounting Standard Board (ASB). We refer to some of these below.

15. Neither, however, referred to any specific accounting practice setting out how to account for revenue *earned* or costs *incurred by* a limited company prior to its incorporation. Stating the matter thus, of itself engenders some controversy and possible ambiguity. There may not be any such accounting practice. In those circumstances, the experts both attempted to follow generally accepted accounting practice in accounting for the various transactions under consideration. They agreed that it was necessary to consider the substance of a transaction and not simply its legal form. They agreed that involved a consideration of the commercial effect in practice (meaning what is likely to happen or what actually happened).

16. FRS 5 (Reporting the Substance of a Transaction) provides at paragraph 14, as follows:-

> **The substance of a transaction**
>
> A reporting entity's financial statements should report the substance of the transactions into which it has entered. In determining the substance of a transaction, all its aspects and implications should be identified and greater weight given to those more likely to have a commercial effect in practice. A group or series of transactions that achieves or is designed to achieve an overall commercial effect should be viewed as a whole.

17. Paragraph 46 of FRS 5 provides as follows:-

> Paragraph 14 of the FRS sets out general principles for reporting the substance of a transaction. Particularly for more complex transactions, it will not be sufficient merely to record the transaction's legal form, as to do so may not adequately express the commercial effect of the arrangements. Notwithstanding this caveat, the FRS is not intended to affect the legal characterisation of a transaction, or to change the situation at law achieved by the parties to it.

18. FRS 12 (Provisions, Contingent Liabilities and Contingent Assets) provides at paragraph 14 *inter alia* as follows:-

> A provision should be recognised when
>
> (a) an entity has a present obligation (legal or constructive) as a result of a past event
>
> …….

19. A *constructive obligation* is defined in FRS 12, paragraph 2 as:-

> An obligation that derives from an entity's actions where:-
>
> (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

20. Mr Brice concluded that, having regard to the Minutes of 23 December 2005 and the October 2005 Agreement, Miss Hepburn had no right to the income arising from the services provided to Envireneer. She was not acting in her *own capacity.* The substance and commercial effect of the transaction was, he said, that Torglenn gained the principal economic benefits of the transaction. That gain needed to be and was reflected in Torglenn's accounts, which gave, in the opinion of its auditors, a true and fair view. The principal risk in the transaction was the possibility of Torglenn not being paid. In his Report he expressed his principal conclusions thus:-

> 3.2.5 … the substance of the Transaction was that the party that gained the principal benefits of the Transaction was Torglenn and not (Ms Hepburn). As such the "*commercial effect of the arrangement*" was a gain that needed to be reflected by Torglenn. …. (I)t is not probable that the economic benefits associated with the October Agreement will flow to … (Ms Hepburn). (Ms Hepburn) should not therefore account for the revenue.
>
> 3.2.6 This view is consistent with the audited financial statements of Torglenn for the financial period 4 January 2006 to 31 December 2006 which included the Consultancy Fee as income. These accounts were, in the opinion of the auditors, Cassie & Co, Chartered Accountants and Registered Auditors, considered to give a true and fair view in accordance with UK GAAP.

21. According to Mr Brice, if, contrary to that analysis under FRS 5, Miss Hepburn should have recognised the Consultancy Fee as income, then she had a *constructive obligation* to Torglenn under FRS 12. This meant that she also ought to have recognised an amount of expenditure equal to the Consultancy Fee. This was accordingly an item of expenditure rather than a capital contribution to Torglenn's assets (Ms Hostad's contention), as Miss Hepburn was acting as supplier of services. On that basis, a corresponding entry as an expense equal to the amount of the Consultancy Fee would be required and the two entries (the entitlement of the income of the fee and the extent of the obligation to pay Torglenn) would simply cancel each other out.

22. Mr Brice drew the conclusion therefore that, in accordance with FRS 5, the Consultancy Fee paid by Envireneer should not have been recognised as income of Miss Hepburn, there would, on that basis, be no profit to recognise. Alternatively, if the Consultancy Fee were to be recognised as income of Miss Hepburn, there would still be no profit to recognise as this would be counter-balanced by recognition of an equal amount of expenditure being the economic benefits which according to Mr Brice, Miss Hepburn was obliged to transfer to Torglenn under FRS 12.

23. Ms Hostad accepted that it was necessary to consider the substance of the transaction and acknowledged the importance of a transaction's commercial effect in practice. She relied, in paragraph 4.11 of her Report, in particular on the following features, namely (i) the services in question were for the period 1 January 2005 to 31 December 2005; (ii) the October Agreement was not signed until 10 October 2005; (iii) the October Agreement was between Envireneer and a company not yet formed; (iv) the October 2005 Agreement stated that "it was agreed that the Board had

previously agreed that Miss Hepburn **could** (her emphasis) arrange for her services to be provided through a company or companies owned/and or controlled by her"; (v) by that stage Miss Hepburn had provided services since January 2005; (vi) the consultancy fee was tabled at a meeting of the directors of Envireneer on 23 December 2005, when Torglenn was still not incorporated; (vii) by the end of 2005, Torglenn had still not been incorporated; and (viii) the consultancy fee was paid to Morton Fraser LLP who held it on Envireneer's client account as a sum appropriated to Torglenn until 8 January 2007 (over a year later) when it was transferred to Torglenn's bank account.

24. These features led Ms Hostad to conclude that the commercial effect in practice was that Miss Hepburn was performing the services on her own behalf. Relying in particular on the fact that when the services were performed and the October 2005 Agreement entered into, Torglenn was not in existence, she concluded that the risks and rewards of the October Agreement were with Miss Hepburn. In her Report she expressed her principal conclusions thus:-

> 4.12 In my opinion *the commercial effect in practice* is that (Ms Hepburn) is performing services on her own behalf rather than as employee/agent of Torglenn. The company is not in existence at the time the services were being performed (although an invoice was tabled and agreed on 23 December 2005), even though the services commenced prior to the October 2005 agreement. Indeed, by the time the agreement was signed, the services had been provided for over ten months.
>
> 4.13 The consultancy fee was ultimately received by Torglenn. … Although this may be indicative that the *economic benefits* do not flow to (Ms Hepburn), I believe that other factors should be taken into consideration as noted in paragraph 4.12 (sic; sc 4.11) (points 1-7 above); specifically the fact that the services had commenced prior to the October agreement, and that by the time the agreement had been signed, the services had been provided for over ten months.

25. Ms Hostad disagreed with the alternative argument advanced by Mr Brice. Her view was that Miss Hepburn was entitled to the fee and there was therefore no obligation to pay it to an entity which did not yet exist.

26. Ms Hostad also argued that the payment of the fee to Torglenn by Morton Fraser LLP amounted to the transfer of the benefits of an asset, ie a capital contribution. This proceeds on the basis that Miss Hepburn was entitled to the fee *qua* individual as she was providing the services *in her own right* and that she, in effect, made a gift of the Consultancy Fee to Torglenn. On the same basis, she disagreed with Mr Brice's view that a profit did not require to be recognised in respect of the consultancy fee.

27. Ms Hostad said that she was unable to express the view that the Torglenn accounts for the year ended 31 December 2006 were wrong. She was not prepared to say that attributing the Consultancy Fee to turnover in Torglenn's accounts was unreasonable or incompetent.

Procedural History

28. This is summarised in paragraphs 15 to 18 of the Statement of Agreed Facts as follows:-

> 15. HMRC opened an enquiry into the corporation tax return of Envireneer for the period ended 31 December 2005, in particular in relation to the Consultancy Fee paid to Torglenn, on 12 March 2007[2]. Ultimately, HMRC issued a closure notice on 4 February 2010 with no amendment to the corporation tax deduction which had been claimed by Envireneer in respect of this payment.
>
> 16. HMRC have contended that the Consultancy Fee falls to be taxed as self-employed trading income of Ms Hepburn and raised a protective discovery assessment for 2005/06 on 15 March 2010 in the amount of £979,751.60 (representing the income tax and class 4 national insurance contributions which according to HMRC arise on the consultancy fee of £2.385m in respect of tax year 2005/06) and a further protective discovery assessment for 2004/05 on 22 March 2011 in the amount of £253,670.59 (representing the income tax and class 4 national insurance contributions which according to HMRC arise on £614,219 of the consultancy fee of £2.385m in respect of the tax year 2004/05).
>
> 17. Ms Hepburn appealed against the 2005/06 discovery assessment on 31 March 2010 and full postponement of the tax was applied for. The appeal and postponement application was acknowledged by HMRC in a letter of 30 April 2010 and the postponement application agreed. Ms Hepburn appealed against the 2004/05 discovery assessment on 8 April 2011 and full postponement was applied for. The appeal and postponement application was acknowledged by HMRC in a letter of 18 April 2011 and the postponement application agreed.
>
> 18. Subsequently, a penalty determination was raised by HMRC on 20 October 2011. Ms Hepburn appealed against the penalty determination on 17 November 2011.

29. Neither party drew any distinction between the two discovery assessments or the consequential appeals. The parties have treated the proceedings as one appeal.

Issues

30. The parties have raised a variety of issues, some of which intertwine with other issues; some fall away if other issues are decided in a particular way; most are dependent on the facts as the Tribunal finds them to be. Some of these issues are connected and some raise essentially the same points. We shall deal with them separately, giving appropriate cross-references in an attempt to avoid unnecessary duplication.

[2] The enquiry was opened on 12 March 2007

31. The overarching issue, as ultimately presented on behalf of Miss Hepburn (which we shall call *Issue 1*) was whether by the application of generally accepted accounting practice, the Consultancy Fee constituted "profits from a trade profession or vocation" which Miss Hepburn was entitled to receive. In other words, would a notional trading and profit and loss account in her name as an individual, for the tax year (or years) in question, have included a credit entry in the profit and loss account for the amount of the Consultancy Fee? Parties approached that issue broadly by inviting us to accept their expert's views and reject the views of the competing expert. Mr Ghosh put this issue at the forefront of his submissions at the Hearing, although his Skeleton Argument was set out somewhat differently.

32. There were, however, a number of other issues, some of which are similar to or overlap with *Issue 1*. These other issues included whether Miss Hepburn was entitled, as a matter of law (under section 8), to the Consultancy Fee (*Issue 2*). Within this issue is the question of the application of section 36C of the 1985 Act (we shall call this *Issue 2(a)*); a possible entitlement on the basis of unjust enrichment (we shall call this *Issue 2(b)*); and the question whether Miss Hepburn would have been bound to account to Torglenn (once incorporated) for the Consultancy Fee had she received it, whether on the basis of an action of repetition or on the basis of acting as a promoter of an unformed company with a fiduciary obligation to account for profits while acting in that capacity (we shall call this *Issue 2(c)*).

33. The next of these other issues is whether Miss Hepburn realised any profit (within the meaning of ITTOIA section 8), as a result of the payment of the Consultancy Fee (*Issue 3*)

34. Then there is the question whether there is any trading source for the Consultancy Fee on the assumption that Miss Hepburn was entitled to it (*Issue 4*).

35. The next issue is whether the Consultancy Fee is chargeable to income tax as miscellaneous income not otherwise charged (ITTOIA s687) (*Issue 5*).

36. The final issue relates to the question of penalties (Issue 6).

Discussion

Issue 1 (Generally Accepted Accounting Practice)

37. At the Hearing Mr Ghosh put at the forefront of his submissions the argument that as Mr Brice's views were not said to be untenable or non-compliant with UK GAAP.

38. Both parties appeared to accept that what was important was the identification of the substance of the arrangements and their commercial effect.

39. We cannot accept the HMRC view that the Consultancy Fee should be treated as the trading income of Miss Hepburn. Nor can we accept the view that she made a gift of it to Torglenn. That seems to us to ignore the reality of the arrangements. Whatever their precise juridical nature, the substance and commercial effect of the

arrangements were that Miss Hepburn would never be entitled to payment of the Consultancy Fee. She was to incorporate a company. It was within her power to do so and she eventually did so. She was a director of Envireneer, and subsequently a director of Torglenn. Torglenn requested payment of the Consultancy Fee and Envireneer paid Torglenn. Torglenn accepted payment. All this accorded with the reasonable commercial expectations of Miss Hepburn, Ms Dow and Envireneer, and when incorporated, Torglenn. The expectation and reality match.

40. This seems to be the essence of the arrangements under consideration in this appeal. While the timing of the various arrangements is not synchronised and is to some extent out of sequence, parties to a commercial arrangement frequently let the paperwork lag behind. Parties are free to confirm or agree (retrospectively) the effect of the substance and commercial effect of what has happened. The doctrine of *relation back* applies in several areas of commercial law, notably in leases where the date of actual entry and occupation often long precedes the date of execution of a detailed lease; the rights and obligations of the landlord and tenant between the date of entry and execution of the lease are deemed to be as set forth in the subsequently executed lease.

41. No doubt practical and juridical difficulties might have arisen if Torglenn had never been incorporated. However, it was incorporated and the various arrangements contemplated eventually fell into place. The Consultancy Fee was paid to a company incorporated by Miss Hepburn in which both she and Ms Dow had a substantial interest. Their respective interests in Torglenn reflected what had previously been arranged.

42. Most of the points raised by Ms Hostad are largely points about timing, which plainly did not go according to plan. However, if one asks what was likely to happen in practice and what actually happened, it is apparent that the substance of the intended arrangements were carried out and had the commercial effect they were intended to have. The intention was that Miss Hepburn would provide additional services for the benefit of Envireneer. It was the intention that she should be paid for those services through the medium of a new company in which she was to have an 81.5% share thereby and Linda Dow 18.5%. The services were provided. A fee was agreed. The fee was paid by Envireneer and was eventually transferred to the bank account of the new company (Torglenn). The commercial effect reflected the commercial intention. The substance of the arrangements established in December 2004 was implemented. There was never any intention that Miss Hepburn would have any entitlement *qua* individual to the fee. No right to the Consultancy Fee was ever created in her favour. She did not receive the fee; she did not demand it be paid to her; it was not offered to her and it was not paid to her. At no stage did she have any control as an individual over the money which the Consultancy Fee represented. Had all the entities involved been at arm's length and she asserted entitlement to the fee *qua* individual, she would have been met with numerous arguments based on what was actually agreed coupled with arguments based on personal bar and possibly misrepresentation.

43. The perceived difficulties about the late incorporation of Torglenn are not, at the end of the day, difficulties at all because Torglenn was ultimately incorporated and the whole commercial arrangements carried into effect as planned.

44. Moreover, it is quite clear on the evidence, particularly Miss Hepburn's oral testimony, which we accept, that throughout she disclaimed whatever entitlement she may have had to receive the Consultancy Fee *qua* individual. The oral testimony is supported by the terms of the December 2004 Minutes, the October 2005 Agreement, the December 2005 Minutes, and the invoice rendered to Envireneer in the name of Torglenn. These documents are all consistent with the view that the substance and commercial effect of the arrangements was that Miss Hepburn had and would make no claim to be paid *qua* individual for the services she provided consequent upon the December 2004 meeting of the directors of Envireneer (ie Miss Hepburn and Ms Dow). That view is consistent with the accounts of Envireneer and Torglenn mentioned above.

45. At the end of the day, the overall issue may be focussed by asking whether Miss Hepburn should have booked a P&L credit equal to the amount of the Consultancy Fee in her notional personal trading and profit and loss account. That was how Mr Ghosh approached his cross examination of Ms Hostad and we consider that question takes us to the heart of the issue.

46. As an individual, any commercial risk for Miss Hepburn was minimal. One of the risks canvassed at the Hearing was the possibility of Miss Hepburn being sued by Envireneer for performing negligently some of the services to which the Consultancy Fee related. Given the close relationship among Envireneer, Torglenn and Miss Hepburn, such a risk, even if it existed as a matter of law, was theoretical rather than real. The reality of the matter was that it would be inconceivable that Miss Hepburn would have been pursued by Envireneer.

47. Much time was spent by the expert accountants in their reports and in their evidence to the Tribunal in assessing the substance and commercial effect of the various arrangements under discussion. The substance and commercial effect in practice of the various arrangements is largely, if not exclusively, a question of fact. It is for the Tribunal to make such findings of fact. It is at least questionable whether it is for expert accountants to determine what the substance and commercial effect of these arrangements might be, however helpful their views. Accordingly, we do not consider ourselves bound to accept the views of either of the experts on the question of the substance of the arrangements and their commercial effect. Rather, we prefer to form our own view. Once that view is known, then generally accepted accounting practice can be applied insofar as required by fiscal legislation to determine whether Miss Hepburn is liable, *qua* individual, to pay income tax on the Consultancy Fee.

48. In *Greene King plc v HMRC* [2012] UKFTT 385 (TC), [2012] SFTD 1085, to which we were referred by Mr Ghosh, the appeal related to inter-company loan transactions. The dispute centred on the correct accounting treatment of the transactions and the application to them of the loan relationship provisions in Chapter II, Part IV of the Finance Act 1996, and the consequential declaration or

under-declaration of profits in the taxpayer's accounts. The arrangements entered into were a scheme designed to take advantage of a perceived loophole in these statutory provisions. One of the critical issues was the accounting treatment of a loan and whether it should be discounted for reasons upon which we need not dwell (paragraph 20 page 1094c). The Tribunal heard conflicting expert evidence of accounting practice (paragraph 51 *et seq*, and 63) and expressed their own view of the reality of the transaction, which was properly reflected in the accounting treatment proposed by HMRC (paragraph 74). The Tribunal also acknowledged, in effect, that HMRC cannot substitute their own preferred method of accounting because it produces a higher tax yield, if the taxpayer's accounting method is GAAP-compliant.

49. We make the following additional findings of fact about the substance and commercial effect of the arrangements:-

> 19 Miss Hepburn at all times intended to form a company.
>
> 20 So far as Envireneer as payer, Ms Dow as 20% shareholder of Envireneer, and prospective shareholder of 18.5% Torglenn, and Miss Hepburn, were concerned, they all had the common intention that the Consultancy Fee would be paid to Torglenn once formed and not to Miss Hepburn on her own account.

50. These findings were specifically proposed by Mr Ghosh in his closing submissions. We consider that the evidence of Miss Hepburn, which we found generally to be credible and reliable, and the principal documents, namely, the December 2004 Minutes, the October 2005 Agreement, the December 2005 Minutes and the Torglenn Invoice dated 23 December 2005, justify the making of these findings of fact.

51. We also find, for the avoidance of any doubt about the matter, that the substance of the arrangements made by Envireneer, Ms Dow and Miss Hepburn, and their commercial effect, were as follows:-

a. Miss Hepburn was to supply services to Envireneer over and above her normal duties as a director of Envireneer. She was to supply such services and be remunerated for their supply through the medium of a limited liability company to be incorporated by her. The arrangements and her remuneration were to be processed through such a newly formed company.

b. Miss Hepburn duly performed such services in the course of 2005. There was no intention on the part of Envireneer, Ms Dow, or Miss Hepburn that she (Miss Hepburn) should be entitled to or should receive payment for those services as an individual.

c. The substance of these arrangements was carried into effect. The services were provided to Envireneer and payment of the Consultancy Fee for the supply of those services was made by Envireneer to Torglenn. Torglenn accounted for the Consultancy Fee as turnover in its accounts and duly

paid corporation tax thereon. All this reflected the common intention of Ms Dow, Miss Hepburn, Envireneer and Torglenn, once incorporated.

52. These findings are consistent with the principal views of Mr Brice as expressed in his Report at paragraphs 3.2.5, and 3.2.6 quoted above. While Ms Hostad's conclusion is tenable on the basis of her analysis of the facts, which she presented clearly and concisely in her evidence, it is not tenable on the basis of our factual findings.

53. If the substance and commercial effect of the arrangements are as we have found them to be, then generally accepted accounting practice would not require Miss Hepburn to recognise the Consultancy Fee as her income.

Issue 2 (Entitlement)

54. On one view, our conclusions on *Issue 1* make *Issue 2* and *Issues 2(a)-(c), 3, 4 and 6* redundant. Nevertheless we shall consider them. Our overall conclusion on *Issue 2* is that, having regard to all the evidence, and viewing it as objectively as we can, it is clear that neither Miss Hepburn, Ms Dow, Envireneer, or Torglenn (when it was formed) agreed (expressly or by implication) that Miss Hepburn should have any entitlement *qua* individual to the Consultancy Fee. None of the actings of any of these participants and none of the documents produced, indicates expressly or by implication, that there was an agreement between any combination of these participants that Miss Hepburn should be, or be treated as having become, entitled to the Consultancy Fee. This is not a case where we are construing a complex written commercial contract where the oral evidence by one of the parties of intention would be plainly inadmissible. We are dealing with much looser commercial arrangements expressed partly in writings, some informal, and partly in discussion. If the oral evidence of intention all points one way as we think it does, fairly assessed, it would be surprising for a court or tribunal to hold that contrary to the evidence before it, the result of these various loose arrangements was that, contrary to the understanding of the participants in these arrangements, contrary to the reasonable expectations of the participants, and contrary to what actually happened, Miss Hepburn was entitled to the Consultancy Fee and that it should have been paid to her.

55. The Board Minutes of 10 December 2004 are not a precisely written commercial contract. Minutes are a summary of proceedings at a meeting. The best evidence of what transpired at the meeting will usually come from those who attended the meeting. Miss Hepburn and Ms Dow attended the meeting. We have Miss Hepburn's evidence. Her oral evidence and the text of the Minutes do not support the argument that she was entitled or would ever become entitled to the Consultancy Fee. Miss Hepburn gave her evidence in a clear and straightforward manner. We found her to be reliable and credible. She was plainly a highly experienced and successful professional (a chartered accountant) in the principal branches of the oil industry (oil services and oil operations where she had numerous business contacts).

56. Notwithstanding his careful and measured presentation, we do not agree with Mr Smith's submission that Miss Hepburn was less persuasive when being cross-examined on the contents of the December 2004 Minutes and on the question of intention. Her response to numerous questions seeking to draw fine distinctions in the wording of the Minutes seemed to us to be both coherent and consistent. Her position in evidence was in substance that throughout she did not consider that she had any entitlement to a fee for her services; her intention and Envireneer's intention was that these services should be processed through the medium of a limited company in which both she and Ms Dow were to have and ultimately did have a significant interest.

57. The October 2005 Agreement which purports to be a contract between Envireneer and a company yet to be formed, does not, on any analysis (subject to the section 36C argument which we discuss below) create in favour of Miss Hepburn any entitlement to the Consultancy Fee. It is plain that the fee is to be paid to the new company when incorporated. That new company was subsequently incorporated, as Torglenn. The Consultancy Fee was subsequently paid to Torglenn in accordance with the commercial expectations of all those with an interest in the arrangements.

58. What transpired at the meeting of the directors of Envireneer (Miss Hepburn and Ms Dow) on 23 December 2005 was entirely consistent with what had already been arranged. The quantum of the Consultancy Fee was agreed. An invoice was tendered to Envireneer in the name of Torglenn for the agreed sum. Thereafter, the sum was eventually paid by Envireneer to Torglenn through the solicitors. The transaction was recorded in the books and accounts of Torglenn as income and in the books and accounts of Envireneer as business expenditure. These accounts have been accepted by HMRC for tax purposes. Mr Ghosh informed us that that acceptance cannot be changed whatever the outcome of this appeal. HMRC did not demur.

59. The subsequent consultancy agreements entered into in 2006 do not create any such entitlement. Nor do they lend support for inferring such an entitlement. They relate to later periods and were actually entered into by Torglenn.

60. Our findings and conclusions exclude HMRC's argument based on implied contract. That was based on the fact that the services or the bulk of them were provided before Torglenn was incorporated; and because the 10 December 2004 Minutes merely permitted Miss Hepburn to supply the consultancy services through the medium of a company but did not require her to do so.

61. We consider this to be a narrow reading of the Minutes and the surrounding circumstances. The Minutes are not a commercial contract. While it is true that Miss Hepburn supplied the bulk of the services before October 2005 and indeed all of the services before Torglenn was formed, we do not consider that this changes the overall arrangements made in December 2004 and subsequently given effect to. It was the intention of all concerned that Miss Hepburn would personally supply the additional services. It was the intention that the supply of those services would be processed through the medium of a limited company. The fact that the paperwork lagged behind, as it often does in commercial ventures, is of no consequence as the

paperwork eventually caught up with what happened and gave effect to the arrangements as all those interested in them had all along contemplated.

62. It should also be noted that the consequence of HMRC's implied contract argument is that Miss Hepburn became entitled to *reasonable remuneration* for her services. Whether that would have been the same as the fee agreed at the December 2005 meeting of the directors of Envireneer (Miss Hepburn and Ms Dow) was not explored in evidence. We discuss this further under Issue 2(c) (*Unjust Enrichment*) below.

63. In the light of these conclusions, it is unnecessary to consider in any detail any technical meaning which might be given to *entitled* in ITTOIA s8. Mr Ghosh referred to *UBS AG v HMRC* [2013] STC 68 (UT) at paragraph 61-62, and submitted that a *present right to a present payment* was a useful working definition. Reference was also made to *Pardoe v Entergy Power Development Corporation* [2000] STC 286 (Ch) 294 and to *Toshuku Finance UK plc v Kahn* [2002] STC 368. We did not understand this proposition to be disputed by HMRC. Mr Ghosh's working definition is sufficiently vouched by the authorities cited. *Pardoe* concerned a statutory direction by the Revenue relating to certain transactions in land. The phrase *any person entitled* was held to mean *any person presently entitled* as opposed to a prospect of a future entitlement. In the light of our findings and conclusions (subject to *Issues 2(a)(b) and (c)*) Miss Hepburn did not have, at any stage, any present right to payment of the Consultancy Fee.

Issue 2(a) (Companies Act 1985 s36C)

64. HMRC argue under reference to *Kelner v Baxter* [1866-67] LR 2 CP 174 at 1865 and *Braymist Ltd v The Wise Finance Co Lt* [2002] Ch 273 at paragraphs 59-64, 74-76, 80 and 83, 84 that the October 2005 Agreement was intended to have legal effect with the result that Miss Hepburn contracted personally and was both liable under and entitled to sue upon it. S36C achieved the same result as the common law by operating as a statutory novation of rights and liabilities, with Miss Hepburn being substituted for the new company. It was further submitted that the October 2005 Agreement provides that the unformed company is to have the fee but on the basis that it performs the services.

65. Assuming, without deciding that HMRC's argument as to the effect of s36C is sound, that effect is expressly *subject to any agreement to the contrary*. Mr Ghosh relies on that phrase and submits that the October 2005 Agreement, and in particular clause 4.1 (which provides for payment to the new company) is an example of an *agreement to the contrary* contained within it. He relied on *Halifax Life Ltd v DLA Piper* [2009] CSOH 74 paragraphs 5, 9, 10 and 15. He also referred to *Kelner* and *Braymist.* Although s36C made express provision for liabilities, it was necessary to consider the common law when identifying benefits, ie rights and entitlements.

66. The principal question is whether there was an agreement to the contrary and if so what was its effect. The October 2005 Agreement was a contract which purports to be made by or on behalf of a company at a time when the company had not been

formed. Torglenn had not been formed by October 2005. Miss Hepburn was purporting to act for Torglenn or as agent for it. On the face of it, she was personally liable on the contract in accordance with the words of s36C.

67. There was, however, as we have found, never any intention on the part of Miss Hepburn, Ms Dow or Envireneer, that Miss Hepburn should be personally liable on the contract constituted by the October 2005 Agreement, or that she should become personally entitled to any part of the Consultancy Fee as an individual. The thrust of the commercial arrangements was the very opposite. The common intention was that it should be paid to Torglenn in which Miss Hepburn was to hold and subsequently held an 81.5% interest and Ms Dow an 18.5% interest. That negates the effect of a construction of s36C which would otherwise entitle Miss Hepburn to enforce the 2005 Agreement and obtain payment in her favour as an individual.

68. *Halifax Life Ltd* concerned an offer by solicitors on behalf of a non-existent client (described as a syndicate) to purchase heritable property from the pursuers. The pursuers sought *inter alia* declaratory that the solicitors were personally liable to implement the contract. The court examined the surrounding circumstances. The pursuers did not contend that they knew that the solicitors' clients did not exist. There was nothing to suggest that the solicitors were acting otherwise than in the ordinary course of their business as agents of an identified client. The court held that the solicitors did not incur personal liability under the contract (paragraph 19) as there was nothing in the missives which suggested that the pursuers intended to contract with any party other than the syndicate which was never formed. The court appears to have given effect to the submission that there was no contract.

69. Here, both parties knew in October 2005 that Torglenn was not yet in existence. Torglenn could not have been a party to the October 2005 Agreement. Paragraph 7 of the Statement of Agreed Facts cannot be taken literally. If there had been any agreement at all then it must have been an Agreement between Miss Hepburn and Envireneer. Given the surrounding circumstances, particularly the arrangements made in December 2004, we do not consider it correct simply to substitute *Hepburn* for *Newco* wherever *Newco* is mentioned in the October 2005 Agreement. That would not be giving effect to the intention of Envireneer or Miss Hepburn. Neither Miss Hepburn nor HMRC contends that there was no valid agreement. It seems to us plain that the commercial intention and therefore the proper construction of the October 2005 Agreement was to ensure that payment for the services (most if not all of which had already been supplied) should be made to Torglenn when formed. That is what happened. That is how the relevant part of the October 2005 Agreement should be construed. That seems to us to reflect what a reasonable person, with all the relevant background information, would understand Miss Hepburn and Envireneer to mean by the language used in the October 2005 Agreement.

70. It seems to us perfectly possible for X irrevocably to agree with Y to perform services on the basis that the remuneration for the supply of those services is not paid to X but to X's nominee, for example a charity. The nominee may be an existing legal entity such as an individual, partnership, trust or limited liability company. It does not seem to matter whether the nominee is in existence, either at the time the

agreement is made, or when the services are supplied. If X subsequently specifies the nominee P (the nominee having come into existence) after the services have been supplied (but within the prescriptive period) Y, would be bound to make payment to the nominee at the insistence of X, who is thus enforcing the Agreement, but never has any entitlement to payment, or possibly at the insistence of the nominee who may have rights of enforcement as a third party (a *jus quaesitum tertio*). It is of no concern to Y to whom he makes payment for the services rendered by X, provided he obtains a valid discharge on payment and is not exposed to double liability.

71. Even if the proper interpretation of Clause 4.1 of the October 2005 Agreement, having regard to s36C, is that Miss Hepburn was somehow entitled to the whole of the Consultancy Fee or even just 81.5% of it, that is superseded, varied and negated by the actings of Miss Hepburn, Ms Dow and Envireneer at the meeting of the directors of Envireneer on 23 December 2005. There, it was agreed by all that the Consultancy Fee should be paid to Torglenn, which was about to be incorporated. Accordingly, even if the effect of the October 2005 Agreement was to give Miss Hepburn an entitlement to payment of the Consultancy Fee in whole or in part, that entitlement was superseded, varied and negated by what transpired on 23 December 2005. The arrangements made on 23 December 2005 constituted an agreement to the contrary within the meaning of s36C. The statute places no limitation on when the agreement *to the contrary* may be made.

72. It is unnecessary to consider what the position would have been if no company had ever been formed. Different considerations might apply but we need not explore them. These considerations might include what terms, if any, would be implied to make the contract work if no *Newco* was ever formed, or whether the contract might be said to have been frustrated by *Newco* not being formed at all.

Issue 2(b) (Unjust Enrichment)

73. HMRC's argument is that if Miss Hepburn had no contractual right to payment from Envireneer for her services, then, as she supplied services to Envireneer without any intention of donation, Envireneer would be unjustly enriched at the expense of Miss Hepburn. Miss Hepburn was therefore entitled to the whole Consultancy Fee.

74. Given our findings and conclusions on the arrangements made and carried into effect, it seems to us impossible to reach the view that Envireneer was, would, or could ever be unjustly enriched at the expense of Miss Hepburn. Envireneer paid an agreed sum for the services provided. That sum was paid to Envireneer's solicitors to be held for Torglenn with the agreement of Miss Hepburn, Ms Dow and Envireneer, and was subsequently transferred to Torglenn who accepted payment. Envireneer obtained value for the services for which they paid an agreed sum. Miss Hepburn throughout never expected to receive payment *qua* individual for the services she provided. The transaction was to be, and ultimately, was processed through the medium of a limited company in accordance with her wishes. Unjust enrichment is an equitable remedy. There is no basis, having regard to the facts and circumstances as we have found them to be, for concluding there was something inequitable in the payment of the Consultancy Fee being made to Torglenn.

75. No right in Miss Hepburn's favour was created, or asserted by her. No one has been enriched at her expense. Normally, when unjust enrichment arises, a mistake of one kind or another has occurred or an unintended benefit arises through the efforts of the person seeking to reverse such benefit or enrichment, because there is no justification for it. Here, what occurred was more or less what was planned. Miss Hepburn supplied services on the basis that the fee therefor would be paid to a limited company in which she and Ms Dow were to have an interest. That is what happened. There is no unfairness, and no unjustified enrichment which falls to be reversed.

76. There is a further fundamental difficulty with HMRC's argument. The assessment against which a statutory appeal has been taken to this Tribunal relates to a precise Consultancy Fee paid to Torglenn. Entitlement to reasonable remuneration based on unjust enrichment is something quite different. It is not a contractual entitlement at all. The amount of unjust enrichment and consequent entitlement to reasonable remuneration may be significantly different from a contractually stipulated amount. They might be the same but we heard no evidence on this aspect of the case and cannot reach any firm conclusion as to whether reasonable remuneration would be more or less or the same as the sum agreed to be paid as a consultancy fee.

77. It would also seem odd, given the respective interests of Miss Hepburn (81.5%) and Ms Dow (18.5%) in Torglenn that it is equitable and just that Miss Hepburn should be entitled to the whole of the Consultancy Fee under principles of unjust enrichment, when the substance and reality of the arrangements in effect intended that she received 81.5% and not 100%.

78. It is unnecessary to consider in any detail the principles of unjustified enrichment summarised in *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1998 SC 90 and 1999 SC (HL) 90 to which we were referred.

Issue 2(c) (obligation to account)

79. This issue only arises if we had concluded that Miss Hepburn was entitled, *qua* individual, to payment of the Consultancy Fee. We have already concluded that she had no such entitlement.

80. In the Appellant's Skeleton Argument it is submitted that, had Miss Hepburn received the Consultancy Fee but not accounted to Torglenn for it, Torglenn could have compelled her to do so by action of repetition (*Morgan Guaranty Trust Co of New York v Lothian Regional Council* 1995 SC 1; *Dollar Land (Cumbernauld) Ltd* 1998 SC 90). This line of argument is supported by Mr Brice who concluded that if Miss Hepburn ought to have treated the Consultancy Fee as income, then she had a *constructive obligation* to Torglenn which would have created a balancing item of expenditure against such income to be recognised in her accounts.

81. It was also argued on behalf of Miss Hepburn, that if she had been entitled to the Consultancy Fee *qua* individual, then she would have earned it in the capacity of promoter of an unincorporated company and would have been bound by her fiduciary

obligation to account to Torglenn once incorporated. She therefore held the Consultancy Fee on a constructive trust, the beneficiary being Torglenn. Reference was made to *Palmer's Company Law paragraphs 5.799.5 and 5.799.6, Gower and Davies, Principles of Modern Company Law paragraph 5-7, Regal Hastings Ltd v Gulliver* 1967 2 AC 134 at 150 and 154, *Lydney and Wigpool Iron Ore Co v Bird* 1886 33 Ch D 85, and *HKN Invest Oy v Incotrade Pvt Ltd* [1993] 3 IR 152.

82. For HMRC, Mr Smith referred to *Gluckstein v Barnes* [1900] AC 240, *Twycross v Grant* [1877] 2 CPD 469 at 541, *Lydney* and *Goff & Jones The Law of Unjust Enrichment* 8th edition, (paragraphs 24-28, to 24-30 and 6-52 to 6-62). He submitted that the provision of consultancy services was not in itself a necessary step in the promotion of a new company. Moreover, the very notion of a constructive trust was inconsistent with Miss Hepburn's personal right to receive the income.

83. While the cases are not entirely consistent, one definition of a promoter is someone *who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose.* (*Twycross* at page 541 per Cockburn LJ). Cockburn LJ illustrated that definition by reference to the *work of formation* such as framing the scheme to which the prospectus related, framing the prospectus, paying for printing and advertising and incurring all the incidental expenses necessary to bring the undertaking before the world; all with a view to the formation of the company.

84. The consequence in law is that a *promoter* stands in a fiduciary position, or deemed fiduciary position, towards the company he is creating both before incorporation, provided the company is subsequently created, and after incorporation (*Gluckstein* at 256, and 257; *Lydney* at page 94), where the facts involved secrecy and dishonesty; thus the promoter must not make any profit out of the promotion without the approval of the company; this is sometimes expressed by stating that a promoter is not entitled to make a secret profit (*Gower* paragraph 5-12). An alternative approach is to describe the promoter as a constructive trustee (*HKN* at pages 62-3 - we agree with Mr Ghosh that this case is best understood as being concerned with restitution for breach of fiduciary duty [a civil wrong] rather than simply circumstances which have created unjustified enrichment at another's expense). The effect appears to be the same (see also *Chitty on Contracts 31st ed* paragraph 9.054*; Palmer's Company Law* 5.799 footnote 2*; Erlanger v New Sombrero Phosphate Company* (1878) 3 App Cas 1218 at 1236 and 1268-9*; Lagunas Nitrate Company v Lagunas Syndicate* [1899] 2 Ch 392 at 422). The secret or unauthorised profits or gains have to be disgorged or accounted for to the company in the same way as a trustee must account to the trust beneficiaries, or an agent to his principal. The circumstances in which fiduciary duties can be breached are diverse (see for example *FHR European Ventures LLP v Mankarious* 2013 3 AER 29 at paragraphs 37 and 85).

85. It must be a question of fact whether Miss Hepburn was acting as a *promoter* (see *Lydney* at page 93). The facts from which it may or may not be inferred that Miss Hepburn was acting as a promoter are the agreed facts and the additional factual findings we have made which are set out above. Miss Hepburn procured the

incorporation of Torglenn and we assume that she provided the necessary capital to enable the formation of Torglenn to be completed.

86. While no doubt the arrangements made by Miss Hepburn in relation to the formation of Torglenn fall within the above *dicta*, her supply of services to Envireneer would not seem to do so. If she was entitled to payment of the Consultancy Fee, that would not be because she was acting as promoter of a company in the sense described in *Twycross*. Her provision of consultancy services was not with a view to the formation of the company. The intention was to process these services through the medium of a company. Moreover, there was nothing secretive, unauthorised or dishonest in her actings, which is the context in which most issues about whether a person acts as promoter arises or breach of fiduciary duty occurs.

87. Miss Hepburn provided the consultancy services. If she were personally entitled to receive payment for these services, it is difficult to see how, although personally entitled to payment, she nevertheless would hold any payment she might have received for behoof of Torglenn.

88. We consider that Mr Smith's argument, that the very notion of a constructive trust is inconsistent with Miss Hepburn's personal right to receive the income, is well founded. It seems to us to be a difficult argument for Miss Hepburn to present in the alternative because once entitlement *qua* individual is regarded as the consequence of the various arrangements entered into in 2004 and 2005, it is difficult to find any scope for any restitutionary obligation or resulting fiduciary obligation owed to Torglenn. Our conclusion is that these alternative arguments, submitted on behalf of Miss Hepburn, are not well founded and are, in any event, unnecessary. We do not therefore need to comment on the arguments advanced about *interceptive subtraction* (see *Goff & Jones* at 6-52 to 6-62).

Issue 3 (profit within the meaning of ITTIOA s8)

89. The Skeleton Argument submitted on behalf of Miss Hepburn presented this issue as one separate from *Issue 2 (entitlement)* but adopted the submissions on entitlement. The Skeleton Argument also relies on generally accepted accounting practice in relation to this issue. As discussed above, at the Hearing Mr Ghosh presented his argument on generally accepted accounting practice as an overarching one and we have treated it in that way.

90. Our conclusion on *Issue 3* and the reasons for it are essentially the same as our conclusion and reasons in relation to *Issue 2*, namely that the arrangements do not disclose any entitlement on the part of Miss Hepburn to the Consultancy Fee. Miss Hepburn did not therefore realise any profit as a result of the payment of the Consultancy Fee. We have already considered the expert evidence on generally accepted accounting practice.

Issue 4 (Trading Source)

91. This argument, as presented in the Skeleton Argument submitted on behalf of Miss Hepburn, proceeds on the basis that she became entitled to receive the

Consultancy Fee as profit and that it would have been appropriate for her to have recognised a profit in respect of it. Given our earlier conclusions, this argument does not arise. The argument, however, is that there is no trading source for that receipt; in other words, there is no trade as a promoter of companies. It is an essential requirement for liability to income tax to arise pursuant to ITTOIA s5 that the relevant receipt should have a trading source.

92. We cannot say on the evidence that there is no trade as a promoter of companies. Moreover, we consider that, on the assumption that Miss Hepburn provided oil industry-related consultancy services for a substantial fee over the course of about a year under arrangements which entitled her to payment *qua* individual (contrary to our findings), this would have been sufficient to justify liability to income tax in accordance with the assessment levied by HMRC. Such services could reasonably be described as being in the nature of a trade. As we heard little about this line of argument we shall say no more about it.

Miscellaneous Income (Issue 5)

93. The argument here for HMRC is that if Miss Hepburn was entitled to the Consultancy Fee, and if that is not a trading receipt, then the fee is nevertheless chargeable as miscellaneous income under ITTOIA s687-9. Reference was made to *CIR v Whitworth Park Coal Co (In Liq)* 1957 38 TC 531 at 572-3 and *Alloway v Phillips* [1980] 1 WLR 888. Entitlement was sufficient and receipt was not necessary.

94. By contrast Mr Ghosh submitted that, like its statutory predecessor (Schedule D, Case VI), miscellaneous income was taxed on a receipts basis (*Grey v Tiley* 16 TC 414). Moreover, the *euisdem generis* rule applied, and there were no profits similar in nature to profits which are otherwise charged to income tax (*A-G v Black* (1870-71) 6 LR Ex 308 (Ct of Exchequer) at 309, *Jones v Leeming* [1930] AC 415 at 422). In *Alloway*, relied on by HMRC, Mr Ghosh submitted that money was paid to the solicitors and therefore there was a receipt. *Tiley,* it was submitted, is binding on this Tribunal but it was not cited in *Alloway*.

95. Given our conclusions on the question of entitlement, this issue does not arise. In *Alloway* (a Schedule D, Case VI case), the Court of Appeal applied the general principle that receipts are to be taken as accruing in the period in which the money is earned even though not paid or received until a later period (at page 981). The sum in question (money paid by a newspaper to the wife of one of the Great Train Robbers), was paid to her solicitors in one tax year, and by her solicitors to her in a later tax year. The assessment related to the earlier tax year and was upheld. It can be said that in that case, payment had been received albeit by the taxpayer's solicitors.

96. *Grey* holds that in relation to casual profits under Case VI, it is the date of receipt that is important. That view is supported by *Whitworth* where the rationale was explained and *Grey* approved (at page 572-3).

97. If Miss Hepburn had been entitled to the Consultancy Fee, that entitlement would have arisen as a result of the supply of services in the nature of a trade. Accordingly, it would be unnecessary to classify the income as miscellaneous income. If it is classified as miscellaneous income, then, as there was apparently no intention to change the law by the enactment of ss687-9, the general principles in *Grey* and *Whitworth* still apply and, accordingly, actual receipt would be required before Miss Hepburn could be taxed on the Consultancy Fee as miscellaneous income.

Section 34 Argument

98. Finally, it was also argued briefly on behalf of HMRC that if Miss Hepburn was entitled to payment of the Consultancy Fee, she would not be entitled to set off any equal and balancing amount due to Torglenn by virtue of s34 ITTOIA. This general argument does not now arise. The argument was that such an obligation to Torglenn does not fall within s34. The general principle is that no deduction is available for any expense which is not wholly and exclusively incurred for the purposes of the trade in question. We are doubtful whether the assumed balancing payment has a proper business motive and therefore see the force of HMRC's argument. It is difficult to see how the balancing payment could have been made for the purpose of carrying on a trade and earning profits therefrom, or how it could benefit or further the assumed trade. A substantial body of case law has developed over the years on this topic. Had it been necessary to decide this point, however, we would have called for more detailed submissions on this question.

Issue 6 (Penalties)

99. This issue does not arise in light of our decision on the merits of the appeal. As the appeal is being allowed, the penalties fall to be discharged.

100. Had it arisen, we would have, in any event, discharged the liability to penalties. Miss Hepburn's conduct was not negligent. We were referred to the observations of the Special Commissioners in *AB (a firm) v HMRC* [2007] STC (SCD) 99 at 105 where it was pointed out that (i) whether there has been negligent conduct is a question of fact, (ii) negligent conduct amounts to more than just being wrong or taking a different view from HMRC, and (iii) a taxpayer who takes proper professional advice and acts in accordance with it, if not obviously wrong, would not have engaged in negligent conduct. We agree with these observations, the first and second of which are relevant here.

101. While Miss Hepburn did not seek professional advice in submitting her online return, she reasonably relied at the time on Envireneer's professionally prepared accounts for the year ended 31 December 2005. In her oral evidence, she expressed the view that, in resisting the liability to penalties, she was also entitled to rely on Torglenn's accounts for the year ended 31 December 2006, in order to justify the absence of the Consultancy Fee as an item of income in her own tax return.

102. Envireneer's accounts disclosed the payment to Torglenn of the Consultancy Fee as an item of revenue expenditure. HMRC have accepted the accuracy of those

accounts. Miss Hepburn may (although we do not take it into account because the evidence was not sufficiently clear) also have been influenced by the anticipated treatment of the same fee as income in Torglenn's accounts for the year to 31 December 2006 although she did not have the final audited version before her when submitting her return online for the Tax year to 5 April 2006 in December of that year.

103. Moreover, if she had taken Mr Brice's view (and the views he expressed were not said to be views which no reasonably competent accountant would express), she would probably not have proceeded any differently.

Summary

1 The substance and commercial effect of the arrangements were that Miss Hepburn would never be entitled to payment of the Consultancy Fee. [paragraph 39]

2 There was never any intention that Miss Hepburn would have any entitlement *qua* individual to the fee. No right to the Consultancy Fee was ever created in her favour. She did not receive the fee; she did not demand it be paid to her; it was not offered to her and it was not paid to her. [paragraph 42]

3 If the substance and commercial effect of the arrangements are as we have found them to be, then generally accepted accounting practice would not require Miss Hepburn to recognise the Consultancy Fee as her income. [paragraph 53]

4 None of the actings of any of these participants and none of the documents produced, indicates expressly or by implication, that there was an agreement between any combination of these participants that Miss Hepburn should be, or be treated as having become, entitled to the Consultancy Fee. [paragraph 54]

5 Miss Hepburn did not have, at any stage, any present right to payment of the Consultancy Fee. [paragraph 63]

6 Given the surrounding circumstances, particularly the arrangements made in December 2004, we do not consider it correct simply to substitute Hepburn for Newco wherever Newco is mentioned in the October 2005 Agreement. That would not be giving effect to the intention of Envireneer or Miss Hepburn. The commercial intention of the October 2005 Agreement was to ensure that payment for the services (most if not all of which had already been supplied) should be made to Torglenn when formed. That is what happened. That is how the relevant part of the October 2005 Agreement should be construed. [paragraph 69]

7 Given our findings and conclusions on the arrangements made and carried into effect, it seems to us impossible to reach the view that Envireneer was, would, or could ever be unjustly enriched at the expense of Miss Hepburn. [paragraph 74]

8 If Miss Hepburn was entitled to payment of the Consultancy Fee, that would not be because she was acting as promoter of a company in the sense described in *Twycross*. Her provision of consultancy services was not with a view to the formation of the company. [paragraph 86]

9 Miss Hepburn did not realise any profit as a result of the payment of the Consultancy Fee. [paragraph 90]

10 It cannot be said, on the evidence, that there is no trade as a promoter of companies. Moreover, on the assumption that Miss Hepburn provided oil industry-related consultancy services under arrangements which entitled her to payment *qua* individual (contrary to our findings), this would have been sufficient to justify liability to income tax in accordance with the assessment levied by HMRC. Such services could reasonably be described as being in the nature of a trade. [paragraph 92]

11 If the Consultancy Fee is classified as miscellaneous income, then, as there was apparently no intention to change the law by the enactment of ss687-9, the general principles in *Grey* and *Whitworth* still apply and accordingly actual receipt would be required before Miss Hepburn could be taxed on the Consultancy Fee as miscellaneous income. [paragraph 97]

12 Had the question of penalties arisen, we would, in any event, have discharged the liability to penalties. Miss Hepburn's conduct was not negligent. [paragraph 100]

Disposal

104. The appeals are allowed.

105. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to

"Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

J GORDON REID QC
TRIBUNAL JUDGE

RELEASE DATE: 20 August 2013