Spc00698

CORPORATION TAX – computation of profits – deductions - payments by Appellant before 2001 to employee benefit trust and after 2002 to family benefit trust - whether wholly and exclusively expended for the purposes of the Appellant's trade – yes – whether Appellant's profits computed in accordance with generally accepted accountancy practice – yes – whether payments to employee benefit trust were potential emoluments and so precluded from deduction for corporation tax purposes when paid – yes – whether payments to family benefit trust were made to an employee benefit scheme and so precluded from deduction for corporation tax purposes when paid - yes - ICTA 1988 ss 42 and 74; FA 1989 s 43(11); FA 2003 s143 and Sch 24

EMPLOYMENT INCOME – whether payments by Appellant to trusts were payments of emoluments or earnings giving rise to an obligation to deduct income tax and pay it to the Revenue – no – before 2003 ICTA 1988 ss 19(1), 131 and 203(1) and Income Tax (Employments) Regulations 1993 SI 1993 No. 744; after 2003 ITEPA 2003 ss 1, 6, and 684 and Income Tax (PAYE) Regulations 2003 SI 2003 No. 2682 Reg 80

NATIONAL INSURANCE CONTRIBUTIONS – whether payments by Appellant to trusts were earnings paid for the benefit of earners – no – Social Security Contributions and Benefits Act 1992 s6(1); Social Security Contributions (Transfer of Functions, etc) Act 1999 s8(1)(c)

THE SPECIAL COMMISSIONERS

SEMPRA METALS LIMITED

Appellant

- and -

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Special Commissioners: DR A N BRICE
EDWARD SADLER

Sitting in London on 14 – 18 April 2008

Andrew Thornhill QC with Jonathan Bremner, Counsel, for the Appellant

Timothy Brennan QC with Diya Sen Gupta, Counsel instructed by the Solicitor of HM Revenue and Customs for the Respondents

DECISION

The appeal

1. Sempra Metals Limited (the Appellant) appeals against:

(1) a number of estimated assessments to corporation tax for years before 30 September 1998 and amendments to corporation tax self-assessments for periods after that date;

(2) a number of notices of determination dated 30 March 2007 and 2 November 2007 determining tax payable by the Appellant under regulation 80 of the Income Tax (Pay as You Earn) Regulations 2003 SI 2003 No. 2682 (the PAYE regulations); and

(3) a number of decisions dated 30 March 2007 and 2 November 2007 made under section 8 of the Social Security Contributions (Transfer of Functions, etc) Act 1999 that the Appellant was liable to pay primary and secondary Class I national insurance contributions.

2. The appeal related to accounting periods ending from 30 September 1995 to 31 December 2000 and from 31 December 2002 to 31 December 2005.

The issues

3. The assessments and the amendments to self-assessment were made because the Commissioners for Her Majesty's Revenue and Customs (the Revenue) were of the view that certain payments made by the Appellant to an employee benefit trust, and later to a family benefit trust, were not deductible from the profits of the Appellant for corporation tax purposes. The notices of determination and decisions were made because the Revenue were of the view that the payments made by the Appellant to the trusts were emoluments or earnings of its employees. The Appellant appealed because it was of the view that the payments were deductible from its profits for corporation tax purposes and were not emoluments or earnings of its employees.

4. The issues arising out of the arguments of the parties were:

(1) whether the payments made by the Appellant were wholly and exclusively expended for the purposes of the Appellant's trade within the meaning of section 74(1)(a) of the Income and Corporation Taxes Act 1988 (the 1988 Act);

(2) whether the profits of the trade of the Appellant were computed in accordance with generally accepted accountancy practice within the meaning of section 42(1) of the Finance Act 1998 (the 1998 Act);

(3) whether the payments made by the Appellant to the employee benefit trust were deductible for the purposes of corporation tax when they were paid having regard to the provisions of section 43 of the Finance Act 1989 (the 1989 Act);

(4) whether the payments made by the Appellant to the family benefit trust were deductible for the purposes of corporation tax when they were paid having regard to section 143 and Schedule 24 of the Finance Act 2003 (the 2003 Act);

(5) whether the payments made by the Appellant to both trusts constituted the payment of emoluments or earnings to its employees giving rise to an obligation to deduct income tax and pay it to the Revenue; and

(6) whether the payments made by the Appellant to both trusts constituted earnings paid for the benefit of earners giving rise to a liability on the Appellant to pay national insurance contribution.

5. At the request of the parties we agreed, under Regulation 18(5)(b), to give a written decision in principle on these issues and to adjourn the making of the final determination until after the decision in principle had been issued.

The evidence

6. Six bundles of documents were produced (Files 1 to 6); very few of these documents were referred to at the hearing. Five other bundles (A to E) were produced some of which were referred to at the hearing. In addition a core bundle was produced to which constant reference was made at the hearing. We were grateful for the production of the core bundle.

7. Oral evidence was given on behalf of the Appellant by

Mr George Edward Daniel; Mr Daniel is a senior employee of the Appellant;

Mrs Karon Ann Daniel; Mrs Daniel is the wife of Mr Daniel and is also a nominated beneficiary of the Appellant's family benefit trust;

Mr Edward Watkin Gittins FCA of the Isle of Man; Mr Gittins was a director and the sole shareholder of Mt Management Limited (the trustee of the Appellant's employee benefit trust) and is a director and shareholder of MTM (Isle of Man) Limited (the successor of Mt Management Limited and the trustee of the Appellant's family benefit trust); MTM (Isle of Man) Limited is now known as Montpelier (Trust and Corporate) Services Limited;

Mr Michael John Hutchinson; Mr Hutchinson was the Managing Director, and later the Chief Executive Officer, of the Appellant until 2005 when he became the non-executive Chairman;

Mr Timothy Robert Jones, Mr Jones is a director and senior employee of the Appellant;

Mr Andrew David Leyton; Mr Leyton is a senior employee of the Appellant;

Mr Gavin Rankine; Mr Rankine is a senior employee of the Appellant;

Mrs Victoria Rankine; Mrs Rankine is the wife of Mr Rankine and a nominated beneficiary under the Appellant's family benefit trust;

Ms Phyllis Rock; Ms Rock is the wife of Mr Sellars and a nominated beneficiary under the Appellant's family benefit trust;

Mr Geoffrey Stephen Sambrook; Mr Sambrook was an associate director of the Appellant until he left in 1997;

Mr Peter Glenn Sellars; since 2006 Mr Sellars has been the Chief Executive Officer of the Appellant; and

Mr David Paul Tregar, Mr Tregar is the Finance Director, and later the Chief Financial Officer, of the Appellant.

8. Oral expert evidence on behalf of the Appellant was given by Mr Peter Alan Holgate the senior UK accounting technical partner with PricewaterhouseCoopers LLP. Mr Holgate had been the Secretary of the UK Accounting Standards Committee. He was also a member of the ASB's Urgent Issues Task Force, the ICAEW Financial Reporting Committee and Research Board and the CCAB International Accounting Committee. Written expert evidence on behalf of the Revenue was given by Mr Charles Roger Bath FCA, an Associate of the Chartered Institute of Taxation. Mr Bath is employed by the Revenue.

9. The first report of each expert witness considered payments to the employee benefit trust. Mr Holgate's first report was dated 7 July 2003 and Mr Bath's first report was dated 7 August 2003. Both expert witnesses met on 16 September 2003 and produced an agreed note of their meeting. Each expert witness submitted a further report about payments to the family benefit trust. Mr Holgate's supplementary report was dated 6 March 2008 and Mr Bath's updated report was dated 6 March 2008.

10. We consider the expert evidence within the context of the second issue in the appeal which concerns generally accepted accountancy practice.

The facts

11. From the evidence before us we find the following facts.

The Appellant and its business

12. The Appellant has at all material times carried on business in the City of London dealing in non-ferrous and precious metals either as principal or on behalf of clients. The Appellant was originally known as Mettallgesellshaft Limited. In 1999 the parent of Metallgesellschaft Limited floated on the London Stock Exchange. In 2000 the parent of Metallgesellschaft Limited was taken over by Enron. Enron became insolvent in November 2001 and in February 2002 the Appellant was acquired by Sempra Energy of San Diego in the United States of America.

13. Until 30 September 1999 the Appellant's accounting period ended on 30 September in each year. Thereafter it ended on 31 December in each year.

The Appellant's bonus arrangements

14. The Appellant employs about one hundred employees and is a competitive and profitable company. Its profitability depends upon the success of its employees, some of whom deal on the relevant exchanges and others of whom look after the clients who give instructions for transactions. Maintaining employees of high quality is critical to the success of the Appellant's business. In the market in which the Appellant operates it is normal to remunerate senior employees partly by way of bonus. An individual employee's bonus could, in a good year, significantly exceed his salary. We formed the view that the Appellant was a benevolent and generous employer who was well trusted by its employees. It had a reputation in the market for retaining the services and loyalty of its employees.

15. Before 1995 the employees of the Appellant were paid a fixed salary and, in addition, the Appellant had a discretion whether to award any employee a bonus. After 1993 the total bonus pool was calculated as a percentage of the Appellant's pre-tax profits. The Appellant's directors decided which employees should benefit and the amount of the bonus to be paid to each. Before 1995 bonuses were paid to the employees with their salary and were treated as PAYE income. In some years up to 1994 the Appellant paid the bonuses in ways that saved liability to national insurance contributions, such as by way of gold bullion or platinum sponge.

1995 – The discussions about the employee benefit trust

16. In the summer of 1995 Mr Hutchinson and Mr Tregar of the Appellant met Mr Gittins of the Isle of Man. Mr Gittins outlined the ways in which an employee benefit trust could provide tax efficient benefits to employees. Mr Gittins explained that each year the Appellant could make payments to an employee benefit trust which payments would be allocated to the employees who had materially contributed to the Appellant's profits and used to benefit those employees thus assisting in the retention, recruitment and motivation of the employees. Mr Gittins said that the benefits could take many forms but Mr Tregar was attracted by the idea that loans could be made to the employees. Mr Tregar understood that there would be no charge to income tax, and no liability for national insurance contributions, if a market rate of interest were paid on the loans. As normally the Appellant had to pay £10 in national insurance contributions for every £100 of bonus paid to an employee, Mr Tregar formed the view that the scheme would enable the Appellant to provide employees with benefits equal to £110 for every bonus payment of £100.

17. After the meeting with Mr Gittins the Appellant took independent advice and held a meeting at which it consulted with its employees. No minutes were made of that meeting but Mr Tregar told us that it was made clear that an employee who participated in the employee benefit trust would receive loans when he needed to draw on the payments which the Appellant had made to the trust and which had been "ring-fenced" for him. The loans would take the place of bonuses and there would be no tax or national insurance contributions. Alternatively, the trustee could invest an employee's allocation in a tax efficient manner (in property, shares or deposits in the Isle of Man) until it was taken as a loan. It was stated that the loans would be repayable but new loans could be taken out and loans could be written off at the discretion of the trustee. It was made clear that, if an employee left the Appellant, there would be no arbitrary calling-in of the loans. It was also stated that loans had advantages for inheritance tax

purposes because the amount of the loan would reduce the value of a deceased employee's estate and the repayment of the loan would go back into the trust for the benefit of the employee's family. Finally it was stated that the loans would be interest bearing.

18. After the consultation meeting each employee was given the choice of either taking a bonus in cash (as before) or having the amount of his bonus paid to the employee benefit trust. All employees chose to use the new scheme. Mr Sambrook was told that he would not have to repay his loans if he left the employment of the Appellant.

1995 - The establishment of the employee benefit trust

19. On 26 September 1995 there was a meeting of the board of directors of the Appellant. Mr Hutchinson was in the chair and also present were Mr Tregar and Mr Jones. The meeting resolved "that the company should establish an employee trust for the purpose of providing benefits and the payment of bonuses to employees".

20. On the same date (26 September 1995) the Appellant as settlor executed a deed of settlement which established an employee trust. The trustee was Mt Management Limited of the Isle of Man, of which company Mr Gittins was the director and sole shareholder. The initial trust fund was £1,000. The trust period was eighty years or any earlier date specified by the trustee. The beneficiaries were the present, future and retired directors, officers or employees of the settlor and their spouses, children and remoter issue and any charitable body.

21. The deed of settlement gave the trustee power to hold the initial trust fund, and any added property, upon trust for sale with very wide powers of investment. In addition, the trustee was given power to lend all or any part of the trust fund to any beneficiary (whether or not including provision for the payment of interest) as the trustee thought fit. The trustee was also given power to appoint, by deed, capital and income for the benefit of all or one or more of the beneficiaries and, failing such appointment, to apply the income for the benefit of any beneficiary in its absolute discretion. We were informed that the power to appoint had never been exercised. Any capital or income not wholly disposed of by the trustee was to be held for the Red Cross Society of Geneva**.**

The payments by the Appellant to the employee benefit trust

22. On 14 November 1995 there was another meeting of the board of directors of the Appellant. Mr Hutchinson was in the chair and Mr Tregar was also present. The purpose of the meeting was stated to be "to consider a payment to the Employee Trust". The accounts for the year ending on 30 September 1995 were tabled and it was resolved that a payment of £3,650,000 be made to the trustee forthwith. The total amount to be paid was calculated in the same way as the total bonus pool had been calculated prior to 1995.

23. The meeting of 14 November 1995 then considered the performance of the individual employees for the year ending on 30 September 1995 and resolved to advise the trustee in writing "of their view as to recommendations on any payment which the trustees might consider making to employees". It was also recorded that any

recommendations could not be binding on the trustee who would exercise its discretion. The minutes of the meeting then recorded the names of thirteen employees, including Mr Hutchinson, Mr Jones, Mr Tregar, Mr Sambrook and Mr Hussey and, against each name was recorded an amount.

24. In addition, the meeting of 14 November 1995 resolved that the board recommended that within twelve months the trustee might consider further benefits for the same thirteen employees and separate smaller further amounts were stated for each. The smaller amounts were in the nature of retention bonuses and each was dependent upon the employee remaining employed for the following twelve months. We were told that the amount of all the recommendations, including the further benefits, totalled £3,650,000.

25. The amounts recommended for Mr Hutchinson, Mr Tregar and Mr Jones were reviewed and approved by the Appellant's parent company before any final allocation was made.

26. Thereafter in each year until 2000 similar meetings were held and resolutions passed that amounts be paid to the trustee. Each time the minutes recorded the recommendations of the board and the amounts which the board recommended should be paid to identified employees. Exceptionally on 1 September 1997 the directors resolved to make a payment to the trustee of £2,250.000 and recommended that named employees be considered for benefit in stated amounts but on or after 30 September 1998. Each year each employee was given the choice of taking a bonus with his salary or having a payment made to the trust.

27. Details of the annual payments to the trustee were:

Accounting period	*Amount of payments*
30 September 1995	£3.651 M
30 September 1996	£2.200 M
30 September 1997	£5.664 M *
30 September 1998	£0.375 M
30 September 1999	£2.943 M
31 December 2000	£0.305 M

Total	£15.138M

* the amount of £5.664M includes the payment of £2.25M made in September 1997.

28. For each year that the Appellant made payments to the employee benefit trust the total amount paid was calculated as 110% of the bonus pool to reflect the fact that the Appellant did not have to pay national insurance contributions on the amounts of the payments.

29. The Appellant also paid to the trustee an annual fee equal to 3% of the amount of the payments made to the trust.

The administration of the employee benefit trust

30. Once the board of directors had resolved on the amounts applicable to each named employee, the trustee was sent a copy of the minutes of the board meeting. Members of the board verbally informed the employees of their recommendations.

31. All the recommendations of the board of directors of the Appellant were followed by the trustee. Mr Gittins gave oral evidence, which we accept, that allocations were made in the records of the trustee and that, in effect, each employee had his own fund; the funds remained trust property but were allocated or ”earmarked” to the individual employees, but were not formally constituted as a sub-trust for the individual employees. Each employee knew the amount which the directors had recommended should be allocated to him and regarded the amount of his allocation as “his” fund. In evidence Mr Hutchinson referred to the cumulative amount of all the sums allocated to him as “my pot”.

32. All the amounts recommended by the board of directors were made available by the trustee to the named employees. Although the class of beneficiaries stated in the deed of settlement included the present, future and retired directors, officers or employees of the Appellant and their spouses, children and remoter issue and any charitable body, no application for a loan was received from any beneficiary other than the employees named in the minutes of the meetings of the directors of the Appellant. Mr Gittins told us that if an application had been received from a beneficiary who was not a named employee then it would have been considered but only in relation to unallocated funds because all the allocated funds were regarded as “earmarked” for the named employees.

33. In November 1995 representatives of the trustee met individually some (but not all) of the employees named in the minutes of the meeting on 14 November 1995. We saw a transcript of the meeting with Mr Sambrook. The purpose of the meeting was stated to be “to try and get to know a little bit about” the employee in order to help the trustee to exercise its discretion under the deed of settlement. Mr Sambrook was asked about his wife and children, his home, its value and its mortgage, and his other investments. He was told about the recommendations of the Appellant concerning the amounts which were allocated to him and were available to him from the trust. He was told that he could take these amounts in the form of a loan or, alternatively, his allocated amounts could remain invested in the trust. Bearing in mind the size of some of the loans which were made, and the nature of the interviews, it could not be said that the interviews enabled the trustee to establish fully the financial circumstances of each employee, but Mr Gittins stated that the principal factor which the trustees took into account in considering the ability of the employee to service and repay the loan was his actual and potential earning capacity.

34. Only two employees decided they did not want a loan and their allocated funds were invested at interest; the interest was accumulated and added to that employee’s allocated fund. Mr Hutchinson took some loans but also suggested other investments to the trustee and he told us that “the trustee invested my pot in the things I suggested”. However, not all the investment suggestions he made were accepted by the trustee, as the trustee was not prepared to make a loan to a third party to the extent of the amounts

requested by Mr Hutchinson.

35. The Appellant asked the trustee to retain 40% of the funds for future income tax but this was not done on the basis that all the loans made to the employees were repayable.

The loans to employees

36. No application by a named employee for a loan to be made to him was refused by the trustee although some loans were made in stages. If an employee chose to take his allocated amounts by way of loan he signed a loan agreement. We saw a copy of a loan agreement signed by Mr Sambrook on 1 December 1995. The loans were unsecured. Mr Sambrook's agreement stated that interest was payable annually in arrears at the rate of 8% per annum but later agreements stated that the rate of interest was 2% over LIBOR. The arrangements for the payment of interest on the loans was described by a representative of the trustee to a named employee at an interview held on 30 November 1995 in the following way:

> "The reason for a rate of interest at 8% is that the loan has to be seen to be commercial and 8% is the Inland Revenue's official rate at present. If there was no rate of interest the Revenue would deem it as a benefit in kind and you would be taxed accordingly. However, the interest you will pay annually in arrears in essence is paid to yourself, back to the trust and you can take a new loan for the full amount and the capital continues to grow."

37. In fact until 2004 no demands for interest were made by the trustee and no interest was paid by the employees.

38. Initially no term was stated for repayment of loans but in later years loans were granted for a period of one year. Mr Tregar told us that the loans were intended to be repayable and that if an employee behaved, say, fraudulently, he could be "deprived of his allocation". On the other hand it was never intended that an employee who left the Appellant in the normal way would have to repay the loan. At the date of the hearing no employee had been made to repay a loan. In general, loans were not repaid and the employees did not expect to repay them. At the date of the hearing Mr Sambrook, who left the Appellant in 1997, had not repaid his loans and did not expect to repay them during his lifetime; it was his belief that on his death the loans would be renewed in favour of his widow and children. We also accept the evidence of Mr Leyton that he still had his loans and did not expect to be asked to repay them during his lifetime and it was his belief that the loans would then be renewed in favour of his wife and children. Mr Hutchinson did not expect to repay his loans but said he could do so; he thought that on his death his loans would be transferred to his legatee. We were told that one employee had died and his loans had been written off.

39. As the years went by the total indebtedness of the employees to the trustee mounted. In one case the amount of an employee's outstanding loans exceeded by twenty times the amount of his basic annual salary. A very few loans were repaid voluntarily. Where an employee did repay a loan the amount of the repayment was held by the trustee for the benefit of that employee and so the benefit of the funds originally allocated to the employee was not lost to him. We accept the evidence of Mr Jones who

told us that he had made some repayments to reduce his loans; at the time he had money and wanted to repay his loans "into my pot" because he wanted to buy a property in the United Kingdom through the employee benefit trust. He repaid his loans and a company purchased the property through the trust. He regarded the property as "in my pot". If he had kept his money in the United Kingdom he would have had to pay tax on it. He had been led to believe that if he repaid a loan, or paid interest, the money would be held for him in "my pot in the trust". In total he had purchased three properties through the trust; he had moved into one of them; his parents lived in another and paid a peppercorn rent.

40. Much of the paperwork completed by the employees in connection with the loans was handled through Mr Tregar. Mr Tregar provided the employees with the loan application forms and witnessed their signatures. He also kept a record of the amounts which the Appellant had recommended should be held by the trustee for each employee and the amounts which had been lent to each employee by the trustee.

Mr Hussey

41. Mr Hussey was an employee of the Appellant. He was named in the minutes of the meeting of 14 November 1995 and an amount was specified against his name. Mr Hussey was interviewed by representatives of the trustee and was told the amount available to him as a loan. Mr Hussey stated that he wanted to take his money out as soon as possible and not as a loan but was told that if he did that then PAYE tax would be payable. Mr Hussey then applied for and received a loan. Later, in 1997, Mr Hussey decided that he wished to take in cash all the amounts paid by the Appellant to the trustee and allocated to him. A calculation was made of the amounts allocated to Mr Hussey (that is the amounts recommended by the Appellant) and to the total was added interest on any amount not taken as a loan. From the resulting figure was deducted the amount of the loan and interest on it and also tax on the payment to Mr Hussey. The trustee wrote to the Appellant and sent a letter and cheque for Mr Hussey and a cheque made out to the Appellant in respect of the PAYE element of the payment.

42. Apart from this payment to Mr Hussey no other employee received money from the trustee other than in the form of a loan. Other investments were made for employees but held by the trustee.

Events after 2000

43. The payments to the employee benefit trust ceased in 2000 when the Appellant was taken over by Enron. Enron's policy was to reward employees through shares and stock options. However, after 2000 the trustee continued to make loans to, and investments for, employees from the existing funds.

44. On 3 September 2002 the Special Commissioners gave their decision in *Dextra Accessories Ltd v Macdonald* 77 TC 146. In that case the Special Commissioners decided that contributions to an employee benefit trust were not potential emoluments within the meaning of section 43(11) of the 1989 Act and so were deductible from the profits of the company when the payments were made to the trust. The Revenue appealed against that decision and meanwhile the law was changed by section 143 and schedule 24 of the 2003 Act which applied after 27 November 2002. The new legislation provided that payments made to another person to use for the provision of benefits to employees were not deductible when they were made unless and until they

gave rise to an employment income tax charge and a liability to pay national insurance contributions.

45. On 9 January 2003 Mt Management Limited retired as trustee of the employee benefit trust in favour of an associated company, MTM (Isle of Man) Limited, of which Mr Gittins was a director and shareholder.

2003 –The discussions about the family benefit trust

46. Meanwhile, in late 2002 discussions commenced within the Appellant with a view to putting in place a new structure to replace the employee benefit trust in the light of the provisions of schedule 24 of the 2003 Act. Mr Gittins suggested that a trust for relatives and/or dependants (referred to as a Guardian Trust) would not be caught by those provisions and so payments made by the Appellant to such a trust would be deductible for the purposes of corporation tax under general principles and payments by the trustee would not give rise to an employment income tax charge or to a liability to pay national insurance contributions.

47. Mr Tregar held a meeting with senior employees and explained the proposal for a family benefit trust. No minutes of the meeting were available. Mr Tregar told the meeting that the beneficiaries of the trust would be such family members of the employee as were nominated by the employee. He also explained that beneficiaries would be able to leave any funds allocated to them within the trust where they would be invested by the trustee and this would avoid capital gains tax on the investments. Alternatively the beneficiary could request a loan from the trustee; interest would be payable on the loan and the loan itself would be repayable but was likely to be rolled forward by the trustee. Also, on the death of a beneficiary the loans would reduce the size of the beneficiary's estate for the purposes of inheritance tax. Finally, Mr Tregar explained that the Appellant would contribute 70% of the gross amount of each bonus to the trust and, if there were no challenge from the Revenue, might later contribute the remaining 30%; if a bonus were paid through the payroll the employee would receive only 60% of the amount.

2003 - The establishment of the family benefit trusts

48. Approval from the Appellant's holding company was obtained in July 2003. and on 23 July 2003 the board of directors of the Appellant resolved to establish a trust "in order to provide an incentive for the employees to remain with the company". It was also resolved to make a payment to the trust of £1,958,000 based on the accounts for the year ending on 31 December 2002.

49 On 25 July 2003 the Appellant as settlor executed a deed of trust which established what was called a Guardian Trust. The trustee was MTM (Isle of Man) Limited, a company of which Mr Gittins is a director and shareholder. The initial trust fund was £1,000. The trust period was eighty years or any earlier date specified by the trustee. The beneficiaries were the members of the family of the present or former directors, officers or employees of the settlor and any charitable body but neither the settlor nor any former, present or future employee of the settlor could be a beneficiary. "Family" was widely defined and included spouse, widow or widower, cohabiting life partner, parents, children and siblings.

50. The trust deed gave the trustee power to hold the initial trust fund, and any added property, upon trust for sale with very wide powers of investment. In addition, the trustee was given power to lend all or any part of the trust fund to any beneficiary (whether or not including provision for the payment of interest) as the trustee thought fit. The trustee was also given power to appoint, by deed, capital and income for the benefit of all or one or more of the beneficiaries and, failing such appointment, to apply the income for the benefit of any beneficiary in its absolute discretion. The trust deed also provided that, in the exercise of its powers and discretions, the trustee should consider any written suggestions made by the settlor but was not bound to comply with such recommendations.. Any capital or income not wholly disposed of by the trustee was to be held in trust for the charity Mėdėcins Sans Frontières.

Payments by the Appellant to the family benefit trust

51. After the family benefit trust had been established it was operated in a way very similar to the way in which the employee benefit trust had been operated. Each year a decision was first made about the total amount of the bonus pool, which was usually the same percentage of the amount of the pre-tax profits for that year. Mr Tregar then asked each employee if he would like his bonus paid into the family benefit trust or whether he would prefer to take it in cash through the payroll or whether he would prefer a mixture of the two. The Appellant's parent company then approved the total amount of the bonus pool.

52. When the total amount of the bonus pool had been approved, the directors of the Appellant decided how it was to be allocated among the employees. The allocation depended upon the performance of the individual employees and the contribution they had made to the Appellant during the course of the relevant year. The amount recommended for an employee might normally be the same amount as his annual salary but in a good year could amount to a significant multiple of his annual salary. The allocations were approved by the Appellant's parent company. After approval, Mr Tregar communicated the amount of each employee's bonus to the employee. Most employees chose to have payments made to the family benefit trust rather than take their bonuses in cash and at least one chose to take part of his bonus in cash and have the rest paid to the family benefit trust. The total amount allocated to employees who had chosen to have equivalent sums paid into the family benefit trust were then paid to the trustee.

53. Details of the annual payments made by the Appellant to the family benefit trust in each of the accounting years from 2002 to 2006 are:

Accounting years	*Amount*
2002	£1,936,000
2003	£1,267,000
2004	£3,867,500
2005	£ 315,000
2006	£4,239,900

54. The amounts were shown as a constructive liability in the accounts; only 70% of the amount of each bonus equivalent sum was paid to the trust to protect the Appellant

against the risk of the non-deductibility of the payments.

55. The Appellant also paid to the trustee a fee equal to 3% of the amount of the payments made to the trust.

The administration of the family benefit trust

56. Each year the Appellant sent to the trustee a sum equal to the amount of the bonuses awarded to employees who had chosen that their bonuses should be paid to the family benefit trust together with a list of such employees and the amounts allocated to each The trustee holds all the payments made to it as a single fund which is informally and notionally allocated amoung the nominated beneficiaries. Although the trustee had a discretion not to adopt the recommendations of the directors of the Appellant about the allocation of the annual payment between nominated beneficiaries the trustee never failed to adopt the recommendation. Mrs Daniel told us that her husband had put money into the trust for her and that it was there for her.

57. Each employee was given an opportunity of indicating which beneficiary he wished to benefit from the amount of his bonus. Nineteen out of thirty employees nominated their spouses; three nominated their cohabiting life partners and eight nominated other members of their families. Many of the nominated beneficiaries had no demonstrable income. The trustee did not investigate the means of the nominated beneficiaries. On behalf of the trustee Mr Tregar gave to each employee a “Know your Customer” form and asked the employee to ensure that it was completed by his nominated beneficiary. The forms were required under Isle of Man money laundering legislation. Mr Tregar collected the completed forms and sent them to the trustee together with the usual supporting documentation. Representatives of the trustee did not interview the nominated beneficiaries.

58. Mr Tregar kept records of all the amounts paid by the Appellant to the trustee and of all the recommendations made by the Appellant about the allocation of those amounts among the named employees. He assisted the employees with the documentation nominating the beneficiaries The beneficiaries usually contacted the trustee through their husbands or Mr Tregar. Mrs Daniel told us that she never had occasion to contact the trustee directly. Mr Daniel told us that he had never had any direct contact with the trustee save on one occasion when Mr Tregar had been away and he (Mr Daniel) had faxed through some documents to the trustee.

59. The payments received by the trustee were mainly invested in the making of loans to the nominated beneficiaries and in interest bearing deposits.

The loans to nominated beneficiaries

60. A nominated beneficiary could choose either to receive a loan from the trust or to have her allocated funds invested by the trustee. Thirty-one of the thirty-two nominated beneficiaries requested loans. No application for a loan by a beneficiary was rejected.

61. The loans made by the trustee of the family benefit trust were made in a way which was similar to the way in which the trustee of the employee benefit trust had made loans. The nominated beneficiary was told by her husband how much she could

borrow from the trustee. A loan request form was obtained from Mr Tregar and brought to her by her husband. She completed the form and her husband returned it to Mr Tregar who sent it to the trustee. A few days later the trustee sent a loan agreement to Mr Tregar who gave it to the husband who took it home to the beneficiary who signed it after which the husband returned it to Mr Tregar who returned it to the trustee. A few days later the money was transferred to the bank account directed by the nominated beneficiary. Sometimes this was a joint account held by the nominated beneficiary and the employee. Mr Tregar maintained records of the amount of loans taken out by the individual beneficiaries.

62. Loans were for a specified term which initially was for three years and later for five years. Loans were renewable. The trustee had a discretion as to whether any loan should be repaid. So far no loans have been repaid. Mr Daniel told us that he had never given much thought to repayment and thought that if he left the Appellant on good terms the trustee would probable allow the loans to remain outstanding. Mrs Daniel told us that she had never thought in detail about the repayment of the loans but was confident that she and her husband would be able to repay them. She had used one of the loans to pay off the mortgage on the family home which was owned jointly by herself and her husband. Mr Daniel told us that other loans had been used to buy two flats in the joint names of himself and his wife; they had been purchased with a mortgage and Mrs Daniel had used the loans from the family benefit trust to pay off the mortgages. Mr Sellars told us that he assumed that the loans would be repaid on the death of his wife, which would have advantages from an inheritance tax point of view, otherwise he assumed that the loans would be renewed.

63. The nominated beneficiary was not restricted as to the use of the money lent. Interest at the rate of 5% was payable but before 2004 was not paid.

64. One example from the evidence will give an indication of the individual amounts involved. The nominated beneficiary of one employee was his wife. At the date of the hearing of the appeal she had, in total, borrowed £380,000 from the family benefit trust. The total amount of (unsecured) loans outstanding from her husband to the employee benefit trust, and from her to the family benefit trust, was about £950,000.

Loans to a nominated beneficiary who was an ex-employee

65. In another case a very substantial loan was made to another nominated beneficiary in August 2003. However, it was discovered in November 2003 that that nominated beneficiary had previously been an employee of the Appellant. Accordingly, in December 2003 the beneficiary signed a "discounted instrument of indebtedness" under which she agreed to repay on 28 August 2008 a sum which was higher than the amount of the loan. That sum included an "income element" which we were told reflected a discounted commercial rate of interest which was 6% simple or 5.3% compound. The instrument recorded that the loan was unsecured. The instrument also contained a provision that it would become void unless presented for payment within a period of one year from the maturity date. The repayment of the higher sum was guaranteed by a separate deed signed in December 2003 by the husband of the beneficiary (who was of course an employee of the Appellant). The hearing of the appeal took place before the date for repayment.

66. On 21 April 2004 the trustee agreed to make another substantial loan to the same nominated beneficiary who signed another instrument of indebtedness agreeing to repay a higher sum on 21 April 2007; the latter sum included an "income element". The loan was unsecured and was advanced on 28 April 2004. The repayment of the higher sum was guaranteed by a separate deed signed on 1 June 2004 by the husband of the beneficiary (who was of course an employee of the Appellant). Mr Gittins for the trustee said that the loan had been made before the guarantee had been signed because the trustee trusted the husband to sign the guarantee. The loan was not repaid on 21 April 2007. The beneficiary entered into a further discounted instrument of indebtedness which renewed the instrument of 21 April 2004 and under which the beneficiary agreed to repay a still higher sum on 21 April 2011. That instrument appeared to have been signed in January 2007 but in the light of the other evidence before us we find that it was most probably signed in January 2008.

Loans to property companies

67. One nominated beneficiary chose that some of her allocated amount should be invested by the trustee in real property chosen by her. (Two employees had previously chosen that some of their allocated amounts should be invested by the trustee of the employee benefit trust in real property chosen by them.) For the purpose of limited liability the trustee purchased the property through one of a number of companies which were tax resident in the Isle of Man and of which the trustee was the director and sole shareholder. Each company instructed its own solicitors to act for it on the purchase of the property. For each property, the trustee made a loan to the company. The loan agreement was in very similar terms to the agreements used where loans were made direct to nominated beneficiaries with similar provisions as to term and interest and stating that the loan was unsecured. During the purchase of one of the properties the nominated beneficiary personally contacted the agents about the completion and the car parking arrangements but was informed by the trustee that all the negotiations had to be conducted by it. The same beneficiary also chose to take another part of her allocated amount as a loan direct to herself to fund the purchase of a house. One of the properties purchased through a company was occupied by the daughter of the employee (who was the step-daughter of the nominated beneficiary).

Loans - general

68. As at 31 December 2007 the trustee had made loans amounting to £12,568,150. This included loans to the companies which purchased property requested by the nominated beneficiaries.

69. In some cases nominated beneficiaries indicated that they did not wish to receive loans immediately and the trustee invested their allocated funds in separate fixed term deposit accounts.

2004 –Interest is paid on loans from both trusts

70. As mentioned above, no interest was paid to the trustee on any loan until 2004. The Revenue had commenced an investigation and, as part of the settlement made in 2004, interest was paid to the trustee on loans from both trusts in respect of periods prior to 2004 but only where the employee remained in the employment of the Appellant. For example, in 2004 Mr Sambrook, who had taken loans from the trustee of the employee benefit trust and who had left the Appellant in 1997, paid interest for the

period up to 1997 but not for the period after 1997. Similar arrangements were made for interest to be paid to the trustee of the family benefit trust during the time that the employee remained employed by the Appellant but no interest was charged after an employee left the Appellant's employment. Interest was not paid at the rate of 8% but at a lower rate acceptable to the Revenue; the difference between the two rates was "forgiven" by the trustee.

71, In one case the interest paid to the trustee of the family benefit trust was paid by cheque drawn by the named beneficiary on a joint account which she held with her husband who was an employee of the Appellant. In another case interest on a loan to a beneficiary from the family benefit trust was paid on behalf of the beneficiary by the employee from his sole account direct to the trustee.

72. When the trustee received the interest it allocated it and held it for the benefit of the paying employee or beneficiary. Frequently amounts similar to the interest received by the trustee were loaned to the same employee or beneficiary by means of an extra loan. Mrs Daniel told us that the interest had to be paid but she got another loan similar to the interest paid. Interest was not paid by the nominated beneficiaries on the loans which had been made to the property companies to purchase real property chosen by the nominated beneficiaries: Mr Gittins explained that this was because the trustee held, as part of the trust fund, the shares in the property company to which the loans were made.

73 In the light of those findings of fact we now turn to consider each of the issues for determination in the appeal.

Issue 1 – Wholly and exclusively

74 The first issue is whether the payments made by the Appellant to the employee benefit trust and later to the family benefit trust were wholly and exclusively expended for the purposes of the Appellant's trade within the meaning of section 74(1)(a) of the 1988 Act.

75 Section 74(1) of the 1988 Act provides that, in computing the amount of profits to be charged to corporation tax, no sum shall be deducted in respect of:

> **"(a) any disbursement or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade; … "**

76. For the Appellant Mr Thornhill argued that before 1995 the Appellant awarded bonuses to its employees. After 1995 the employees could choose to have their bonuses in cash or have the amounts paid to the employee benefit trust (or later to the family benefit trust). After 1995 the amounts of the payments to the trusts were agreed in a process very similar to that which had been used to establish the amounts of the bonuses. The employees who benefited from the payments were successful and contributed to the success of the Appellant and the payments enabled the Appellant to retain their services.

77. For the Revenue Mr Brennan argued that the payments by the Appellant to both trusts were only wholly and exclusively laid out for the purposes of the Appellant's trade if they were for the benefit of its employees. It was his case (both in respect of this

issue and of issue (4)) that the payments were for the benefit of the employees.

78. We find that the payments to both trusts were made to preserve and maintain the competitiveness of the Appellant in the market in which it operated. In that market it is normal to remunerate senior employees at least partly by way of discretionary bonus. The payments made to both trusts were made because the relevant employees chose that their bonuses should be paid in that way rather than in cash. The employees made that choice because they had been consulted and given information which was sufficient to convince them that the amount of their bonuses would be allocated to them and available to them (under the employee benefit trust) or their nominated beneficiary (under the family benefit trust). Also, the employees were of the view that the payment of their bonuses to the trusts had advantages over the payment of their bonuses through the payroll. Accordingly, the payments to both trusts were for the benefit of the employees.

79. We conclude that the payments made by the Appellant to both the employee benefit trust and the family benefit trust were wholly and exclusively expended for the purposes of the Appellant's trade within the meaning of section 74(1)(a) of the Income and Corporation Taxes Act 1988

Issue 2 – Generally accepted accountancy practice

80. The second issue is whether the profits of the trade of the Appellant were computed in accordance with generally accepted accountancy practice within the meaning of section 42(1) of the 1998 Act.

81. For periods of account beginning after 6 April 1999 section 42(1) of the 1998 Act provided:

> **"(1) For the purposes of Case I or II of Schedule D the profits of a trade, profession or vocation must be computed on an accounting basis which gives a true and fair view, subject to any adjustment required or authorised by law in computing profits for those purposes."**

82. With effect from 24 July 2002 the words "in accordance with generally accepted accountancy practice" were substituted for the words "on an accounting basis which gives a true and fair view" by section 103(5) of the Finance Act 2002.

The expert evidence about the employee benefit trust

83. Mr Holgate in his first report identified the issue as being whether the payments made by the Appellant to the employee benefit trust should have been reported as an asset or expense of the Appellant. The narrower issues were: whether the payments flowed from an earlier constructive obligation and whether, as a result of that obligation and the way it was discharged, the expense was properly recorded.

84 Mr Holgate concluded that the Appellant had an established pattern of paying bonuses at a certain level of pre-tax profits and therefore the Appellant had, for accounting purposes, a constructive obligation to those in the bonus scheme. The bonuses were, under UK generally accepted accountancy principles, accrued and treated as an expense in the year to which they related. That was the year whose profits were the basis of the calculation, even though the payment of the bonuses occurred during

the following year. If the amounts paid to the trust had been held by the trustee in cash, or other assets, it would have been appropriate to continue to regard the amounts as an asset of the Appellant until such time as the trustee allocated the amounts to identified employees, at which time the amounts would have been treated as an expense or liability of the Appellant. In the present case, because of the pattern and expectation of bonuses, and because there was an unconditional allocation by the trustees to identified individuals, it was appropriate to treat the amount of the bonuses as an expense in the year to which the bonuses related. The one exception was the amount of £2,250,000 paid in September 1997 and treated as an expense at that time when it should have been expensed in 1998.

85. Mr Bath in his first report agreed with the reasoning and conclusions of Mr Holgate. In his opinion the substance of the various arrangements was that the Appellant had been operating a bonus scheme the payments under which were routed through the employee benefit trust. Although the trust was legally separate it was considered under UITF (Urgent Issues Task Force) 13 to be under the *de facto* control of the Appellant. The payment of a sum of money into the trust did not itself give rise to an expense in the Appellant's profit and loss account because cash held by the trust would be shown as an asset of the Appellant; however, when the amounts unconditionally vested in the employees they became an expense. Accordingly there should be an expense in the profit and loss account for the period to which the bonuses related because that was when the benefits vested unconditionally in the employees.

86. At their meeting on 16 September 2003 both expert witnesses recorded their agreement about the accountancy treatment of the payments made by the Appellant to the employee benefit trust.

The expert evidence about the family benefit trust

87. Mr Holgate's supplementary report dealt with three matters, namely, changes in the accounting regulations since the date of his first report, changes in the operation of the employee benefit trust since the date of his first report and the differences between the employee benefit trust and the family benefit trust. He concluded that the changes in the accounting regulations did not affect his previous conclusions. The changes in the operation of the employee benefit trust included the payments of interest in 2004 and he concluded that these changes did not affect the accounting treatment.

88. Mr Holgate went on to note that one main difference between the employee benefit trust and the family benefit trust was that the beneficiaries of the latter were not employees of the Appellant but were family members of the employees. However, Mr Holgate's opinion was that the incentivisation aspect of the family benefit trust worked in the same was as that of the employee benefit trust and therefore gave rise to an employee-related expense as with the employee benefit trust. The other main difference between the employee benefit trust and the family benefit trust was that interest on loans was charged and paid almost from the beginning whereas under the employee benefit trust it had not been charged and paid until 2004. Mr Holgate's opinion was that the fact that the trustee received in 2004 interest on loans previously advanced had no bearing on the payments made by the Appellant to the trust in later years and so the Appellant could not be said to benefit from the receipt by the trustee of interest. Mr Holgate concluded that the changes since his first report did not affect the views he had

then expressed in relation to the employee benefit trust and his conclusions applied also to the family benefit trust.

89. Mr Bath's updated report concluded that the financial statements for the Appellant for 2002 to 2005 had been correctly prepared in accordance with UK GAAP (generally accepted accountancy practice); the substance of the arrangements with the family benefit trust was that there was a constructive obligation to pay year-end bonuses to employees in respect of their services which obligation was met by making payments (by way of loans) to relatives of the employees with the agreement of the employees. The contributions to the family benefit trust, together with the allocations made by the trustee, discharged that obligation as there had been actual allocations by the trustee. The expense should be recognised in the profit and loss account in the relevant year (namely, the period to which the bonuses related). The accounting treatment could not be affected by what happened after the allocations had been made by the trustee. If the trustee were to make genuine commercial and arms' length loans to the beneficiaries they would remain assets of the Appellant but if the loan was never truly considered recoverable it would be wrong to treat it as an asset. The treatment adopted by the Appellant was consistent with the fact that the loans made by the family benefit trust were not assets of the Appellant.

The arguments

90. For the Appellant Mr Thornhill argued that both experts agreed that the profits of the Appellant had been computed in accordance with generally accepted accountancy practice. The amount of each employee's bonus had been unconditionally vested in him at the time that the directors resolved to make recommendations to the trustee about the amounts available for each employee and before the trustee approached the employee or beneficiary about taking out a loan. In the light of the expert evidence these arguments were not disputed by Mr Brennan for the Revenue.

Conclusion

91. In the light of the agreement between the expert witnesses we conclude that in relation to payments made by the Appellant to the employee benefit trust and to the family benefit trust the profits of the trade of the Appellant were computed in accordance with generally accepted accountancy practice.

Issue (3) - Were the payments to the employee benefit trust deductible?

92. The third issue is whether the payments made by the Appellant to the employee benefit trust were deductible for the purposes of corporation tax when they were made having regard to the provisions of section 43 of the Finance Act 1989.

93. After 5 April 1989, and at the time that payments were made by the Appellant to the employee benefit trust, the relevant parts of section 43 of the Finance Act 1989 provided:

> **"43 Schedule D: computation**
>
> **(1) Subsection (2) below applies where-**
>
> **(a) a calculation is made of profits or gains which are to be charged under Schedule D and are for a period of account ending after 5 April 1989,**
>
> **(b) relevant emoluments would (apart from that subsection) be**

deducted on making the calculation, and

(c) the emoluments are not paid before the end of the period of nine months beginning with the end of that period of account.

2) The emoluments-

(a) shall not be deducted in making the calculation in subsection (1)(a) above, but

(b) shall be deducted in calculating profits or gains which are to be charged under Schedule D and are for the period of account in which the emoluments are paid. …

(10) For the purposes of this section "relevant emoluments" are emoluments for a period after 5 April 1989 allocated either-

(a) in respect of particular offices or employments (or both), or

(b) generally in respect of offices or employments (or both).

(11) This section applies in relation to potential emoluments as it applies in relation to relevant emoluments, and for this purpose-

(a) potential emoluments are amounts or benefits reserved in the accounts of an employer, or held by an intermediary, with a view to their becoming relevant emoluments;

(b) potential emoluments are paid when they become relevant emoluments which are paid."

94. Thus the scheme of the legislation was that, although on ordinary accounting principles a liability to pay emoluments accrued in the year in which there was a liability to pay them, for tax purposes there could only be a deduction from profits when the emoluments were actually paid to the employees and this applied also to potential emoluments which were defined as "amounts or benefits reserved in the accounts of an employer, or held by an intermediary, with a view to their becoming relevant emoluments".

95. The Appellant argued that the payments to the employee benefit trust were not potential emoluments because they were neither "held by an intermediary" nor were they held "with a view to their becoming relevant emoluments" within the meaning of section 43(11)(a) of the 1989 Act. The Revenue argued that the payments were potential emoluments because they were held by the trustee, who was an intermediary, and because they were held with a view to becoming relevant emoluments. We consider these arguments separately and have found it convenient to consider first whether the payments were held with a view to becoming relevant emoluments.

(1) Were the payments held with a view to becoming relevant emoluments?

96. For the Appellant Mr Thornhill cited the judgment of the House of Lords in *Dextra* (77 TC 192): there had to be a "realistic possibility" that the sums paid by the employer to the trustee will be used to pay emoluments, as determined from an analysis of the trust deed construed in the light of the relevant background. He argued that the trust deed in this appeal was very broadly drafted; the trustee could have made formal appointments and paid emoluments that way but did not do so. The relevant background included the fact that the Appellant did not intend that emoluments would be paid to the employees by the trustee. The employees were informed that, if their bonuses were paid to the trustee, the employee could ask for a loan or for the amount to

be invested by the trustee. The intention was that the loans would last indefinitely and were not repayable if an employee left the company and on death were renewed to members of the employee's family. The Appellant had been so confident that no taxable loans would be made that it added 10% (the amount of the national insurance contributions) to the amount it paid to the trustee. The case of Mr Hussey (to whom outright payment was made of his allocated fund) was very exceptional and very unusual. It followed that there was no realistic possibility that the payments to the trustee would be used to provide emoluments.

97. For the Revenue Mr Brennan also relied upon *Dextra* but argued that the facts of this appeal were indistinguishable from the facts in *Dextra.* The payments by the Appellant to the employee benefit trust were potential emoluments and, in the case of Mr Hussey, they were actual emoluments. Mr Brennan cited *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 at 912F-913D for the principle that, in interpreting the terms of any document, relevant background did not include the previous negotiations of the parties and their declarations of subjective intent.

98. In considering the arguments of the parties we begin with *Dextra*. In that case there was an employee benefit trust very similar to that which was established in the present appeal. The House of Lords held that the trustees had power to use the funds to pay emoluments to employees but also to make payments which were not emoluments. The question was whether the payments were held by the trustees "with a view to becoming relevant emoluments" within the meaning of section 43(11)(a). That question had to be answered solely by reference to the terms of the trust deed construed in the light of any relevant background and paying regard to what might realistically happen. The funds were held with a view to becoming relevant emoluments if they were held on terms which allowed a realistic possibility that they would become relevant emoluments. All the funds could be used to pay emoluments and so they were all potential emoluments. Although the sums in question might or might not be used to pay emoluments, there was at least a realistic possibility that they would be.

99. Applying those principles to the facts of the present appeal we find that the trust deed in this case was the deed of settlement of 26 September 1995. That gave the trustee a wide discretion to lend money to the beneficiaries (who were the employees) to appoint capital and income for their benefit, and to apply the income for the benefit of any beneficiary in its absolute discretion. The trust deed also provided that, in the exercise of its powers and discretions, the trustee should consider any written suggestions made by the settlor but was not bound to comply with them. Thus, under the terms of the trust deed, the trustee had power to use the funds in paying emoluments to the employees but also power to make payments which were not emoluments. Not only was it a realistic possibility that the funds might be used to pay relevant emoluments, this actually occurred in the case of Mr Hussey. Accordingly, in our view all the funds were potential emoluments.

100. Mr Thornhill argued that we should consider the wider background including the meetings before the trusts were established. He distinguished *Investors Compensation Scheme* on the grounds that it concerned contractual arrangements rather than trusts; that it had not been referred to by Lord Hoffmann in *Dextra;* and that Lord

Hoffmann's references to relevant background in Dextra were a summary of the views of the Court of Appeal. However, the principle in *Investors Compensation Scheme* was not disapproved in *Dextra;* the passage from *Investors Compensation Scheme* relied upon by Mr Brennan was also a judgment of Lord Hoffmann; and the views of the Court of Appeal in *Dextra* were upheld by the House of Lords. Accordingly we follow the principles established in *Investors Compensation Scheme* and have not considered the previous negotiations of the parties and their declarations of subjective intent when considering the terms of the trust. However, even if we had done so we would not have reached a different view. The fact remains that the trustee had power to pay emoluments, and did so to Mr Hussey, and, it is reasonable to surmise from that instance, would have been prepared to do so again at least in similar circumstances. It follows, in our view, that all the funds were potential emoluments.

101. We conclude that the payments made by the Appellant to the employee benefit trust were held with a view to becoming relevant emoluments.

(2) Were the amounts held by an intermediary?

102. For the Appellant Mr Thornhill argued that in *Dextra* it had been conceded that the trustee was an intermediary and that concession had been accepted by the higher courts. However, he cited *Baker v The Queen* [1975] AC 774 and *Barrs v Bethell* [1982] Ch 294 for the principle that, where a court assumes a proposition of law to be correct without addressing its mind to it, the decision of that court was not binding authority for that proposition. He went on to argue that trustees could be intermediaries but did not have to be and cited *Heather v P-E Consulting Group Ltd* (1971) 48 TC 293 as an example of a case where a trustee was not an intermediary. He also referred to the Oxford English Dictionary at pages 1115 and 1116 where intermediary was defined as "one who acts between others; an intermediate agent; a go-between, middleman, mediator". He accepted that a trustee who distributed emoluments would be an intermediary, and that a trustee could be described as an intermediary in passing over money out of the trust fund to a beneficiary by way of loan, but it was his argument that, once the loan was made, the trustee ceased to be an intermediary and held an investment.

103. Mr Thornhill cited *Dextra* at 167D at [25] as authority for the principle that the relevant time for deciding whether amounts or benefits were held by an intermediary was after the expiry of the nine-month period mentioned in section 43(1)(c). At that time in every case save one (which occurred in September 1997 when a payment of £2.25M had been paid to the trustee but was not available to the employees until September 1998) the funds had been lent out by loan within the nine-month period. Once the loan had been made the trustee ceased to be an intermediary and held an investment. Mr Thornhill referred to section 203B(4)(b) of the 1988 Act which specifically provided that a payment of income was made by an intermediary of the employer if it was made by trustees holding property for any person, who included the employee. That section illustrated that trustees were not necessarily intermediaries. He also referred to sections 49 and 50 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) which defined the use of the word intermediary

104 For the Revenue Mr Brennan argued that the trustee was an intermediary. He accepted that the concession made in *Dextra* was not binding on the Special

Commissioners but argued that it was rightly made and had been expressly approved by the High Court (at 165D and 165I) and by the Court of Appeal (at 187G). The trustee occupied a position which was intermediate between the employer and the employee. The definitions in section 203B and in the IR 35 legislation were made within different statutory contexts and enacted at different times and in different circumstances.

105. In considering the arguments of the parties we first accept that the concession made in *Dextra* is not binding on the Special Commissioners. However, we bear in mind that in *Dextra* the High Court expressed the view that in that case it had rightly been accepted that the trustee was an intermediary and the Court of Appeal reached the same view. The judgment of the Court of Appeal was upheld by the House of Lords. The facts in this appeal are very similar to the facts in *Dextra* and that points to the conclusion that the trustee could well be an intermediary. We have not found *Heather v P-E Consulting Limited* to be of assistance to us. It concerned a scheme set up in 1963 which was well before the enactment of section 43 of the 1989 Act and so did not concern the meaning of the word intermediary in the context of section 43(11)(a). The passage in *Dextra* which was relied upon by Mr Thornhill, as authority for the principle that the relevant time for deciding whether amounts were held by an intermediary was after the expiry of the nine-month period mentioned in section 43(1)(c), is contained in the judgment of Neuberger J in the High Court. As that judgment was not followed by the Court of Appeal or the House of Lords we have not relied upon it.

106. Section 203B(4)(b) of the 1988 Act was inserted by section 125 of the Finance Act 1994 and defines when a payment is made by an intermediary but only for the purposes of that section. Sections 49 and 50 of ITEPA re-enacted what has become known as the IR35 legislation and apply when a worker personally performs services for a client where the services are provided under arrangements involving a third party who is defined as the intermediary. In both these examples the legislation defines the use of the word intermediary for the purposes of the relevant section but no wider and we have not found these examples helpful in deciding on the meaning of the word intermediary in section 43 of the 1989 Act.

107. In our view the best authority for the meaning of the word intermediary in section 43 is the view of the Court of Appeal in *Dextra* at 187G. That view was that it had been rightly accepted in that case that the trustee of the employee benefit trust was an intermediary for the purposes of section 43. As, in relation to this point, we see nothing on the facts in this appeal which distinguishes it from the facts in *Dextra*, we conclude that the trustee of the employee benefit trust in this appeal was also an intermediary for the purpose of section 43.

Conclusion

108. We therefore conclude that the payments made by the Appellant to the employee benefit trust were potential emoluments because they were held by the trustee, who was an intermediary, and because they were held with a view to becoming relevant emoluments. That means that the payments were not deductible by the Appellant for the purposes of corporation tax when they were made having regard to the provisions of section 43 of the Finance Act 1989.

Issue (4) - Were the payments to the family benefit trust deductible?

109. The fourth issue is whether the payments made by the Appellant to the family benefit trust were deductible when they were paid having regard to the provisions of section 143 and Schedule 24 of the 2003 Act.

110. Section 143 of the 2003 Act introduced schedule 24 and the relevant paragrahs of schedule 24 provide:

> **"1 (1) This Schedule applies where—**
>
> > **(a) a calculation is required to be made for tax purposes of a person's profits for any period, and**
> >
> > **(b) a deduction would (but for this Schedule) be allowed for that period in respect of employee benefit contributions made, or to be made, by that person ('the employer').**
>
> **but it does not apply to a deduction of a kind mentioned in paragraph 8.**
>
> **(2) For the purposes of this Schedule an employer makes an 'employee benefit contribution' if—**
>
> > **(a) he pays money or transfers an asset to another person ('the third party'), and**
> >
> > **(b) the third party is entitled or required, under the terms of an employee benefit scheme, to hold or use the money or asset for or in connection with the provision of benefits to employees of the employer.**
>
> **(3) The deduction in respect of employee benefit contributions mentioned in sub-paragraph (1) is allowed only to the extent that—**
>
> > **(a) during the period in question or within nine months from the end of it—**
> >
> > > **i) qualifying benefits are provided out of the contributions, or**
> > >
> > > **ii) qualifying expenses are paid out of the contributions, or**
> >
> > **(b) where the making of the contributions is itself the provision of qualifying benefits, the contributions are made during that period or within those nine months.**
>
> **2 (1) For the purposes of this Schedule qualifying benefits are provided where there is a payment of money or transfer of assets, otherwise than by way of loan, that—**
>
> > **(a) gives rise both to an employment income tax charge and to an NIC charge, or would do if the conditions in sub-paragraph (3) were met, or**
> >
> > **(b) is made in connection with the termination of the recipient's employment with the employer.**
>
> **9 (1) In this Schedule—**
>
> > **'employee benefit contribution' shall be read in accordance with paragraph 1(2);**
> >
> > **'employee benefit scheme' means a trust, scheme or other arrangement for the benefit of persons who are, or include, [present or former] employees of the employer; …".**

111. The words "present or former" in paragraph 9 (1) were inserted by section 245

of the Finance Act 2004 with effect from 6 April 2006. They therefore apply only to one of the years the subject of this appeal.

112. Thus the scheme of the 2003 legislation is that employee benefit contributions are not deductible unless and until they give rise to an employment income tax charge and a liability to pay national insurance contributions. Employee benefit contributions are made if an employer makes payments to another person to use for the provision of benefits to employees under an employee benefit scheme. An employee benefit scheme is a trust, scheme or other arrangement for the benefit of persons who include employees.

The arguments

113. For the Appellant Mr Thornhill argued that the family benefit trust was not an employee benefit scheme as the employees were excluded from benefit under the terms of the trust. He accepted that the payments to the trust were beneficial to the employees (and so were deductible under general principles) because it was in the interest of the employees that members of their family should benefit. However he argued that the word "benefit" in the definition of employee benefit scheme meant a settlement or some enforceable arrangement which had as its beneficiary the employee and it was not enough that it was beneficial to the employee. It followed that the provision of benefits to a named member of the employee's family were not "for the benefit of" the employee.

114. Mr Thornhill contrasted the benefit in kind rules. He argued that, at the time of the first payment to the family benefit trust, the relevant legislation had been contained in section 154(1)(a) of the 1988 Act which applied where benefits in kind were provided, by reason of his employment, for a employee "or for others being members of his family or household". Similar provisions were now in sections 174(1)(a) of ITEPA which defined an employment-related loan as "a loan made to an employee or a relative of an employee" and in section 201(2) of the same Act which defined an employment-related benefit as a benefit provided for an employee or for a member of an employee's family or household. These provisions indicated that a benefit provided to a member of an employee's family was not regarded as a benefit provided to the employee unless that were specifically stated. Paragraph 9 of schedule 24 referred only to employee benefit schemes for the benefit of persons who included employees of the employer.

115. Mr Thornhill also contrasted the income tax settlement provisions. He referred to the Income Tax (Trading And Other Income) Act 2005. Section 624(1)(b) provided that income which arose under a settlement was treated for income tax purposes as the income of the settlor if it arose from property in which the settlor had an interest. Section 625(1)(b) provided that a settlor was treated as having an interest in property if there were circumstances in which the property was applicable for the benefit of the settlor or the settlor's spouse or civil partner (but not if it was for the benefit of the settlor's child),. There were separate provisions in section 629 which provided that income arising under a settlement was treated as the income of the settlor if it was paid to or for the benefit of his minor child who was unmarried and not in a civil partnership. These provisions also indicated that a benefit provided to a member of an employee's family was not regarded as a benefit provided to the employee unless that were specifically stated. He cited *Commissioners of Inland Revenue v Wachtell* 46 TC 543 at

556F for the principle that there was only a benefit to a settlor if there was a legally enforceable advantage; no employee had a legally enforceable right to benefit from the family benefit trust.

116. For the Revenue Mr Brennan argued that the family benefit trust was an employee benefit scheme for two reasons. First, taking a narrow view, the family benefit trust was beneficial for the employees, and was for the benefit of employees, because it benefited employees for their families to be given access to financial security. If the family benefit trust was not beneficial to the employees then the payments made by the Appellant to it would not be deductible under section 74(1)(a) of the 1988 Act because the payments would not be expended for the purposes of the Appellant's trade. In some cases the employees did benefit directly because the payments made to their nominated beneficiaries were either paid into joint bank accounts, or used to discharge loans on property owned jointly, or used to purchase jointly owned property. Paragraph 9 did not require the benefit to be direct nor did it require the employees to obtain a legal or beneficial title to the trust property.

117. Alternatively Mr Brennan argued that, taking a wider view, the family benefit trust was an "arrangement" for the benefit of employees. There was an established practice of the payment of bonuses; each employee was given the choice of taking his bonus in cash or by way of payment to the trust; each employee could nominate a beneficiary and most chose their spouses; the arrangements worked in such a way that the employees could benefit directly (through payments into joint bank accounts or for the purchase or discharge of loans on joint property); and the full amount of each bonus awarded to an employee was allocated to his nominated beneficiary.

118. Finally, Mr Brennan argued that analogies with other statutory provisions were unhelpful; in section 154 of the 1988 Act the focus was on "the benefit provided".

Our views

119 The dispute between the parties is whether the family benefit trust is a trust, scheme or other arrangement *for the benefit of* persons who are, or include, employees of the Appellant. The Appellant argues that the word "benefit" means a settlement or other enforceable arrangement which has as its beneficiary the employee; the Revenue argues that the meaning goes wider than that and extends to arrangements which are beneficial for employees.

120. We might have had more sympathy with the arguments of the Appellant if paragraph 9(1) had referred to "a trust for the benefit of employees" as that would have made it easier to have read it as meaning that the employees had to be direct beneficiaries. However, paragraph 9(1) refers to a "trust, *scheme or other arrangement* for the benefit of employees" and the whole phrase indicates that a much wider meaning is to be given to the words used. In our view, the use of the wider phrase means that we should ask whether the arrangements enabled the employees to benefit from them and we find that they did. The employees benefited both indirectly because of the financial payments to their families, and directly in those cases where the loans by the trustee to the nominated beneficiaries were paid into joint accounts with the employee or to discharge loans on jointly owned property.

121. We have not found the references to other statutory provisions to be helpful. Section 154 of the 1988 Act applies to the provision of benefits to employees or members of their family. There the word benefit is used as a noun and the phrase “for the benefit of” is not used. The settlement provisions are self-contained and are not meant to have a wider effect. *Wachtell* concerned the settlement provisions in the Income Tax Act 1952 and did not concern schedule 24; in any event having regard to the facts relating to the family benefit trust, we cannot find that any beneficiary had a legally enforceable right to benefit from it but we do not regard legal enforceability as the right test under schedule 24.

Conclusion

122. Accordingly we conclude that the payments made by the Appellant to the family benefit trust were not deductible when they were paid having regard to the provisions of section 143 and Schedule 24 of the 2003 Act.

Issue (5) - Were the payments made by the Appellant earnings of the employees?

123. The fifth issue in the appeal is whether the payments made by the Appellant to both trusts constituted the payment of emoluments or earnings to its employees giving rise to an obligation to deduct income tax and pay it to the Revenue.

124. For accounting periods ending before 5 April 2003 the relevant legislation about employment income was contained in the 1988 Act. Section 19(1) provided that tax under Schedule E should be “charged in respect of any office or employment on emoluments therefrom”. Section 131 provided that the expression “emoluments” included “all salaries, fees, wages, perquisites and profits whatsoever”. Section 203(1) provided that, on the making of any payment of any income assessable under Schedule E, income tax should be deducted by the person making the payment in accordance with regulations made by the Board. The regulations made under the provision of section 203 were the Income Tax (Employments) Regulations 1993 SI 1993 No. 744. Regulation 6 provided that an employer, on making any payment of emoluments to an employee, should deduct tax and regulation 26 provided that the employer should pay to the Revenue the amounts of tax which he was liable to deduct.

125. For accounting periods ending after 5 April 2003 the relevant legislation about employment income is contained in ITEPA. Section 1 imposes a charge to income tax on employment income. Section 6 provides that the charge to tax extends to general earnings and specific employment income and these are further defined in subsequent sections including section 62 which defines earnings as: “(a) any salary, wages or fee, (b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money’s worth, or (c) anything else that constitutes an emolument of the employment”. Section 684 provides that the Revenue must make regulations with respect to the assessment, charge, collection and recovery of income tax in respect of PAYE income. Under the provisions of section 684 the Revenue have made Income Tax (PAYE) Regulations 2003 SI 2003 No. 2682. Under the regulations an employer must deduct tax from payments of, or on account of, any taxable earnings and pay the tax to the Revenue. Regulation 80 provides that, if it appears that there may be tax payable by an employer which has not been paid, the Revenue may determine the amount of that tax and serve notice of their determination on the employer.

The arguments

126. For the Appellant Mr Thornhill argued that the trustee had not exercised its powers of appointment under the trusts and so the beneficiaries were not absolutely entitled to any amounts allocated to them within the trust fund. Sections 175 and the following sections of ITEPA recognised that beneficial loans were loans; they were not earnings or emoluments and were not an absolute payment. Mr Thornhill also pointed out that the definition of qualifying benefits in paragraph 9(2) of schedule 24 of the 2003 Act did not include payments by way of loan. Finally, he relied upon the decision of the Special Commissioners in *Dextra* at 158E-H and argued that the loans were genuine loans and not disguised distributions and that the trustee exercised the discretion subject to which it held the funds it received from the Appellant.

127. For the Revenue Mr Brennan argued that the words emoluments and earnings meant rewards for acting as an employee. The employees were entitled to their remuneration and chose to have part of it paid to the trusts. The payments by the Appellant to the trusts satisfied the obligation of the Appellant to pay remuneration to the employees. The payments became emoluments and earnings when they vested unconditionally in the employees and that occurred when the amounts were allocated by the trustee to the individual employees or their nominated beneficiaries. At that stage the money was available to the employee either by way of direct payment, or by way of loan to himself or a nominated beneficiary, or by way of investment in a property chosen by the employee or his nominated beneficiary. The legislation should be afforded a purposive construction, relying on *Barclays Mercantile Business Finance Ltd v Mawson* 76 TC 446 at [36]. Although both trusts were discretionary trusts it was necessary to consider the scheme as it was intended to operate without regard to the possibility that it might not work as planned, relying upon *Inland Revenue Commissioners v Scottish Provident Institution* [2004] UKHL 52; [2005] STC 15 at [22] and [23]. Mr Brennan also cited *Garforth v Newsmith Stainless Ltd* [1979] 1 WLR 409 and *Paul Dunstall Organisation Ltd v Hedges* [1999] STC (SCD) 26 for the principle that money placed unreservedly at the disposal of an employee amounted to payment. Finally Mr Brennan cited *DTE Financial Services Ltd v Wilson* 74 TC 14 at paragraphs 41 to 43 for the principle that the interposition of a trust did not make a difference.

Our views

128. We begin our consideration of this issue by placing it within the context of the issues in the appeal as a whole. The first four issues concern the deductibility of the payments by the Appellant to the trusts from the profits of the Appellant for the purposes of its corporation tax liability. We have found that the payments were expended wholly and exclusively for the purposes of the Appellant's trade and that the payments were deductible in accordance with generally accepted accountancy practice. However, we have also found that the payments were not deductible when they were made because of the special provisions of section 43 of the 1989 Act (which applies to the employee benefit trust) and section 143 and schedule 24 of the 2003 Act (which applies to the family benefit trust).

129. However, both section 43 of the 1989 Act and schedule 24 of the 2003 Act provide that the payments become deductible when emoluments are paid to the employees (from the employment benefit trust) or when there is a payment of money

(from the family benefit trust) giving rise both to an employment income tax charge and to a national insurance contribution charge. From that it follows that, if the payments made by the Appellant do constitute the payment of emoluments or earnings, and so gave rise to an obligation to deduct and pay tax under Schedule E, and a liability on the Appellant to pay national insurance contributions, then the payments also become deductible from the Appellant's profits for corporation tax purposes.

130. We begin our consideration of the arguments of the parties by returning to the legislation about employment income and identifying the question we have to answer. For accounting periods ending before 5 April 2003 we have to ask whether the Appellant made payments of emoluments (as widely defined) to its employees. For periods of account ending after 5 April 2003 we have to ask whether the Appellant made payments of earnings to its employees. From the facts that we have found it is clear that the Appellant did not make payments direct to its employees. So the question is whether the payments made by the Appellant to the trusts constituted the payment of "perquisites or profits" (before April 2003) or the payment of "any other profit or incidental benefit of any kind being money or money's worth" (after 5 April 2003).

131. In order to answer these questions we have first considered the authorities cited to us to see what principles they establish.

132 The first three authorities concern the meaning of the word payment. In G*arforth* (1979) two directors were voted bonuses; each was paid part of the money and his balance was credited to his account in the books of the company. The issue was whether the crediting of the bonuses amounted to payment for the purposes of the predecessor of section 203 of the 1988 Act. Walton J said at 410 that it was not necessary, or perhaps even possible, to give an exhaustive definition of the word payment and the real question was whether the circumstances disclosed fell within the word. At 412G he said:

> "Now there can be no doubt at all, I think … that the word "payment" is a word which has no one settled meaning but which takes its colour very much from the context in which it is found."

133. And later at 414B he said:

> " … I have no hesitation at all in saying that, in my judgment, when money is placed unreservedly at the disposal of the directors by a company that is equivalent to payment . …"

134. He went on to hold that the sums credited to the directors' accounts had been placed unreservedly at the disposal of the directors and that there had accordingly been a payment for the purposes of what is now section 203.

135. *Paul Dunstall* (1999) concerned the payment of a bonus in the form of land to a director of a property company. The issue was whether the word payment in section 203 of the 1988 Act, and regulations 6 and 13 of the 1973 Regulations, meant payment in money or whether it included payments in money's worth. The Special Commissioner held that in the context of section 203, and regulations 6 and 13, the

reference was to the payment of emoluments, which included perquisites and profits. Since placing money unreservedly at the disposal of an employee was equivalent to payment, the placing of a perquisite or profit unreservedly at the disposal of an employee was equivalent to payment. The taxable subject matter was the value received, namely what the recipient would get if he sold it.

136. *DTE* (2001) concerned a scheme to avoid the payment of national insurance contributions and the application of the PAYE system on bonuses paid to directors of the taxpayer company. On 21 April a discretionary trust was established by an Isle of Man company with £40,300 which had been borrowed. On 24 April the trustee appointed the trust capital to the Isle of Man company contingent upon that company remaining in existence on 28 April. On 25 April the taxpayer company paid £40,000 to the Isle of Man company in consideration for the assignment to the taxpayer company of the contingent interest in the trust. On 26 April the taxpayer company assigned that contingent interest to a director. On 28 April the borrowing was repaid, the trustee confirmed that the contingency had occurred, and transferred £40,000 to the director,

137. The Court of Appeal held that, in the context of the statutory provisions relating to PAYE, the concept of payment was a practical, commercial concept; although in some statutory contexts the concept of payment might include the discharge of the employer's obligation to the employee, for the purposes of the PAYE system, payment ordinarily meant actual payment, that is a transfer of cash or its equivalent. On the facts there had been a payment to the director.

138. *Barclays Mercantile Business Finance Ltd v Mawson* and *Scottish Provident* identify general principles applicable to the construction of taxing statutes. *Barclays Mercantile* at [36] establishes the principle that, in the application of any statutory provision, it is necessary first to decide, on a purposive construction, exactly what transaction will answer to the statutory description and, secondly, to decide whether the transaction in question does so. *Scottish Provident*, at [22] and [23], concerned the approach to a composite transaction which had been deliberately structured to include one element of uncertainty so that it could not be said that the outcome was pre-ordained. The element of uncertainty had no commercial purpose and, although it created a real commercial risk, the odds were favourable enough to make it acceptable to the parties. The House of Lords held that the composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectation of the parties, it might not work as planned.

139. From those authorities we derive the following principles. Payment is a word which has no settled meaning but takes its meaning from its statutory context. In the context of section 203 of the 1988 Act and regulations 6 and 13 of the 1973 regulations, when money is placed unreservedly at the disposal of the directors by a company that is equivalent to payment. Bearing in mind the definition of emolument, the placing of a perquisite or profit unreservedly at the disposal of an employee can also be equivalent to payment. However, the concept of payment is a practical, commercial concept and, for the purposes of the PAYE system, payment ordinarily means actual payment, that is a transfer of cash or its equivalent and not merely the discharge of the employer's obligation to the employee, More generally, it is necessary first to decide, on a

purposive construction, exactly what transaction will answer to the statutory description and, secondly, to decide whether the transaction in question does so. If a transaction is deliberately structured to include an element of uncertainty with no commercial purpose then the composite effect should be considered as it was intended to operate without regard to the possibility that it might not work as planned.

140. We now turn to apply those principles to the facts of the present appeal and what we have to ask is whether money, or its equivalent in cash, was placed unreservedly at the disposal of the employees; a discharge of an employer's obligation to the employee will not suffice for this purpose.

141. The facts are that in relation to both trusts employees requested the Appellant to make payments to the trusts of amounts which they would otherwise have received in cash as bonuses. The discussions with the employees before the trusts were established persuaded them that there were advantages for the employees in the trust arrangements. None of the employees would have accepted the arrangements if they had considered that there was a realistic possibility that the sums otherwise received as bonuses would not be available to them in one form or another and it was highly likely that all requests for loans would be accepted. The trustee always accepted the Appellant's allocation of the total bonus pool between the individual employees and the amount equivalent to each employee's bonus was allocated by the trustee to him and was available to him. A very small part of the funds paid to the trustee was unallocated. Each employee chose what he wished to do with his allocated amount. The loans made by the trustee to the beneficiaries had some features which were non-commercial. Thus, for example, very large sums were lent on unsecured loans and some of the nominated beneficiary recipients had no other income. Interest was not charged until 2004 and then when paid could be re-borrowed. When interest was paid in 2004 it was not demanded at the contractual rate but at a lower rate acceptable to the Revenue; the interest paid was re-allocated to the same beneficiary. There was a general expectation that the loans would not have to be repaid except in exceptional circumstances. The loans which were repaid were repaid voluntarily and the amount was re-allocated to the same beneficiary.

142. Although the facts which we summarise show that the employees benefited from the arrangements in our view they do not lead to the conclusion that the payments made by the Appellant to the trusts amounted to the payment of money or a profit equivalent to cash to the employees. Mr Brennan asked us to find that the payments by the Appellant to the trusts were placed unreservedly at the disposal of the employee and that that was equivalent to payment to the employees. It was his case that the monies held by the trustee vested unconditionally in the employees when the amounts were allocated by the trustee. However, like the Special Commissioners in *Dextra* at page 158E-H, on the evidence before us we are unable to make the finding requested. To do so would be to ignore the existence of the trusts, the continuing discretion of the trustee, and the existence of the loans in those cases where loans were made. The employees (or their nominated beneficiaries) were not free to do whatever they liked with their allocated funds; they could apply for loans, or request the making of other investments, but the final decision remained at the discretion of the trustee. We agree that the trustee was likely to comply with reasonable requests but that does not mean that the trustee was a cipher who did what it was told. Having heard the evidence of Mr Gittins, a director of the trustee, we formed that view that he well understood the obligations of a

trustee.

143. We heard in at least one instance (in the evidence of Mr Hutchinson to which we have already referred in paragraph 34 above) of a case where the trustee refused to apply funds in a manner requested by a beneficiary. As to the loans, albeit that they were on terms which reflected the employee benefit nature of the arrangements rather than an arm's length commercial relationship between trustee/lender and beneficiary/borrower, they were nevertheless real loans on which interest was paid, and in respect of which, in some cases, principal was repaid. If an employee required funds to be placed unreservedly at his disposal, as was eventually the case with Mr Hussey, the trustee was required to take further and specific action to bring that about. The circumstances are far removed from that of the directors in *Garforth* or the director in *DTE Financial Services Ltd*.

144. We conclude that when the Appellant made payments to the trusts, no transfer of cash or its equivalent was placed unreservedly at the disposal of the employees. That means that there was no payment by the Appellant of emoluments or earnings giving rise to an obligation to deduct income tax and pay it to the Revenue.

Issue (6) – Were the payments by the Appellant earnings paid for the benefit of earners?

145. The sixth issue is whether the payments made by the Appellant to both trusts constituted earnings paid for the benefit of earners giving rise to a liability on the Appellant to pay national insurance contribution.

146. The legislation about national insurance contributions is contained in the Social Security Contributions and Benefits Act 1992 (the 1992 Act). Section 6 provides that where in any week earnings are paid for the benefit of an earner then both a primary Class I contribution and a secondary Class I contribution are payable. Section 6(4) provides that, subject to the provisions of schedule 1, the primary contribution is the liability of the earner and the secondary contribution is the liability of the employer. Paragraph 3 of schedule 1 provides that the employer is liable to pay both the secondary contribution of his own and also, in the first instance, the earner's primary contribution "on behalf of and to the exclusion of the earner".

147. Accordingly the liability of the Appellant to pay national insurance contributions arises if the payments made by the Appellant to both trusts were earnings paid for the benefit of earners. The arguments put to us about this issue were the same as the arguments on the fifth issue and we therefore reach the same conclusions

148. Our decision on the sixth issue in the appeal is that the payments made by the Appellant to both trusts did not constitute the payment of earnings paid for the benefit of earners and so did not give rise to a liability on the Appellant to pay national insurance contribution.

Decision

149. Our decisions on the first four issues for determination in the appeal are:

(1) that the payments made by the Appellant were wholly and exclusively expended for the purposes of the Appellant's trade; and

``(2) that the profits of the trade of the Appellant were computed in accordance with generally accepted accountancy practice; but

(3) that the payments made by the Appellant to the employee benefit trust were not deductible for the purposes of corporation tax having regard to the provisions of section 43 of the Finance Act 1989; and

(4) that the payments made by the Appellant to the family benefit trust were not deductible for the purposes of corporation tax having regard to section 143 and Schedule 24 of the Finance Act 2003.

150. Those decisions mean that the appeals against the assessments to corporation tax and the amendments to the corporation tax self-assessments are dismissed.

151. Our decisions on the last two issues for determination in the appeal are:

(5) that the payments made by the Appellant to both trusts did not constitute the payment of emoluments or earnings to its employees and so did not give rise to an obligation to deduct income tax and pay it to the Revenue; and

(6) that the payments made by the Appellant to both trusts did not constitute earnings paid for the benefit of earners and so did not give rise to a liability on the Appellant to pay national insurance contribution.

152. That means that the appeals against the notices of determination and decisions dated 30 March 2007 and 2 November 2007 are allowed.

153. This is a written decision in principle under Regulation 18(5)(b) and we therefore adjourn the making of the final determination until after this decision in principle has been issued.

Authorities referred to in argument but not mentioned in Decision

Foulser v MacDougall [2005] STC (SCD) 374

This Decision was originally released to the parties on 12 June 2008. This is a corrected version under Regulation 25(3).

NUALA BRICE

EDWARD SADLER

SPECIAL COMMISSIONERS

RELEASE DATE: 7 July 2008

SC 3052/2003
SC 3008/2004
SC 3016/2007
26.06.08