TC02977

Appeal number: TC/2012/06305

Income tax – Funded Unauthorised Retirement Benefits Scheme – sections 386 & 392 ITEPA 2003 – whether employer's contributions within tax charge - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

DEREK McWHINNIE **Appellant**

- and -

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

TRIBUNAL: JUDGE MALACHY CORNWELL-KELLY

Sitting in public at 45 Bedford Square, London on 9 October 2013

Mr Alan Pink, of Alan Pink Tax, for the appellant

Mr Peter Kane, HMIT, for the respondents

DECISION

Introduction

1 This case concerns a scheme entered into by the taxpayer's employer, Habilis IT Recruitment Limited ('Habilis') of which he was a director and the controlling shareholder. The scheme involved the use of a funded unapproved retirement benefit scheme known as the 'Habilis FURBS' ('the FURBS'). The FURBS was established by a trust deed dated 28 February 2005, to which were annexed the Rules governing it. The trustees of the scheme were the taxpayer himself and a company called D A Phillips & Co Limited.

2 The appeal is against a discovery assessment of 22 October 2007 made under s.29 of the Taxes Management Act 1970 in relation to the discovery that no return had been made in the taxpayer's self-assessment return for 2005 of the employment income arising from the contributions made into the FURBS by his employer on his behalf. The assessment charged to tax under section 386 of the Income Tax (Earnings and Pensions) Act 2003 ('ITEPA') the value of contributions *in specie* made by Habilis to the FURBS on 15 March 2005, namely a declaration of trust by Habilis in favour of the trustees of the FURBS of its ownership of two freehold properties valued at £475,000. The tax assessed amounted to £190,486.17.

Legislation

3 At the material time, sections 386 and 392 of ITEPA were as follows:-

> *386 Charge on payments to non-approved retirement benefit schemes*
> (1) A sum paid by an employer –
> (a) in accordance with a non-approved retirement benefits scheme, and
> (b) with a view to the provision of relevant benefits for or in respect of an employee of the employer,
> counts as employment income of the employee for the relevant year.
>
> (2) The 'relevant tax year' is the tax year in which the sum is paid.
>
> (3) Subsection (1) does not apply if or to the extent that the sum is chargeable to income tax as the employee's income apart from this section.
>
> (4) But if, apart from this section, the payment of the sum would be a payment to which Chapter 3 of this Part (payments and benefits on termination of employment etc) would apply, subsection (1) applies to the sum (and accordingly that Chapter does not apply to it).

(5) In this Chapter –
(a) 'employee' includes a person who is to be or has been an employee,
(b) section 5(1) (application to offices) does not apply, but 'employee', in relation to a company, includes any officer or director of the company and any other person taking part in the management of the affairs of the company,
(c) 'employer' and 'employment' have meanings corresponding to the meaning of 'employee' given by paragraphs (a) and (b),
(d) 'director' has the meaning given by section 612(1) of ICTA, and
(e) 'relevant benefits' has the meaning given by that section, and section 612(2) of ICTA applies to references in this Chapter to the provision of relevant benefits as it applies to such references in Chapter 1 of Part 14 of ICTA.

(6) For the purposes of this Chapter benefits are provided in respect of an employee if they are provided for the employee's spouse, widow or widower, children, dependents or personal representatives.

(7) Any liability to tax arising by virtue of this section is subject to the reliefs given under –
(a) (relief where no benefits are paid or payable), and
(b) section 266A of ICTA (life assurance premiums paid by employer).

392Relief where no benefits are paid or payable
(1)An application for relief may be made to the Inland Revenue if-
(a)a sum is charged to tax by virtue of section 386 in respect of the provision of any benefits,
(b)no payment in respect of, or in substitution for, the benefits has been made, and
(c)an event occurs by reason of which no such payment will be made.

(2)The application must be made within 6 years from the time when the event occurs.

(3)The application must be made by the employee or, if the employee has died, the employee's personal representatives.

(4)If the Inland Revenue are satisfied that the conditions in subsection (1) are met in relation to the whole sum, they must give relief in respect of tax on it by repayment or otherwise as appropriate, unless subsection (6) applies.

(5)If the Inland Revenue are satisfied that the conditions in subsection (1) are met in relation to part of the sum, they may give such relief in respect of tax on it as is just and reasonable, unless subsection (6) applies.

(6)This subsection applies if-
(a)the reason why no payment has been made in respect of, or in substitution for, the benefits, or
(b)the event by reason of which there will be no such payment,
is a reduction or cancellation of the employee's rights in respect of the benefits, or part of the benefits, as a consequence of a pension sharing order or provision.

(7)In subsection (6) "pension sharing order or provision" means any such order or provision as is mentioned in-
(a)section 28(1) of WRPA 1999 (rights under pension sharing arrangements), or
(b)Article 25(1) of WRP(NI)O 1999 (provision for Northern Ireland corresponding to section 28(1) of WRPA 1999).

4 In this context, it was decided in the Court of Appeal, in *Irving v RCC* [2008] STC 597, that the reference to 'a sum paid by an employer' in the predecessor of section 386 included a contribution *in specie*.

Facts

5 The taxpayer, Mr McWhinnie, gave sworn evidence to the tribunal. Mr McWhinnie's memory of events was poor and he appeared to attach, and at the time of the events in question to have attached, little importance either to exactitude or to compliance with his legal obligations, notwithstanding that he was both a director of Habilis and a trustee of the FURBS with the formal responsibilities that holding those offices entailed.

6 Mr McWhinnie held 60% of the shares in Habilis which had, in the period before the contribution to the FURBS was made, done very well and the company had accumulated substantial profits which he had decided in 2004 to invest in two properties, 51 Gloucester Road, Bristol, and 8 Chester Street, Bristol; these were the properties of which a trust was declared in favour of the trustees of the FURBS. Mr McWhinnie said that he had read about QED Tax Consulting in a newsletter and, having sought their advice on tax planning and accountancy, they had proposed the setting up of the FURBS and the transfer of these properties to its trustees.

7 Accordingly, the transfers were made in the way I have described on 15 March 2005 and in its corporation tax return for the period ended 31 October 2005 Habilis claimed a corporation tax deduction of £475,500 to reflect (i) its *in specie* contributions to the FURBS and (ii) a payment to the trustees of £500 in cash for the same purpose. The deduction was described in the Habilis accounts as "Director's pension contributions".

8 On 19 March 2007, the company's accountants A4G Accounting LLP (who I was told are chartered accountants) wrote to the Revenue as follows in the context of answering eight Revenue queries on Habilis's accounts:

> The directors' pension contribution of £475,500 is made up of the initial cash contribution of £500 on 28 February 2005 and a contribution *in specie* of the two freehold properties that were disposed of for proceeds of £475,000. The contributions were made to the Habilis FURBS and Mr D McWhinnie is the sole beneficiary of the scheme.

9 Similarly, the report of the trustees of the Habilis FURBS for the year ended 5 April 2005 stated:-

> *Beneficiaries*
> The beneficiaries of the scheme during the year were:-
> Mr Derek McWhinnie.

10 Mr McWhinnie's personal tax return for the year ended 5 April 2005 disclosed as 'Income from Employment' under the heading 'Other Benefits' the £500 which had been paid on his account in cash to the FURBS trustees on 28 February 2005. Mr McWhinnie could not explain why this had been done since, in his view, he had not been an identified beneficiary of the FURBS. The return was sent in to the Revenue on 19 January 2006 under a covering letter from QED Accountancy and Mr McWhinnie commented that this entry in his return had possibly "been done by a junior" in the firm.

11 In his witness statement, Mr McWhinnie said that at the time of the company's contribution to the FURBS he had been the sole director. He continued:-

> I understand that there is a common practice for contributions to be allocated to specific individuals on being made. In consequence, the value represented by the contribution is "ring fenced" for the specified individual. In the case in question, no formal allocation of the contribution in kind was made. My understanding was, on the basis of professional advice, that the contribution would qualify for corporation tax relief in the company's accounts, and this was the reason for making the contribution.
>
> At the time of the contribution, the company was running a profitable business in the sphere of IT recruitment (as its name suggests). IT recruitment is particularly dependent on the talents of high performing employees, and the existence of a company pension scheme was potentially important for the purpose of attracting such new talent. In the event, no new members have been admitted to the FURBS, due to a subsequent major downturn in the company's business.

12 In oral evidence, Mr McWhinnie was adamant that no allocation of Habilis's contributions had been made to him, that he had never applied to become a Member of the scheme and that the beneficiaries of the contributions remained unascertained; the reference to "no new members" having been admitted to the scheme did not in his view imply that there was an existing member, namely Mr McWhinnie himself. No contributions other than the two properties and the £500 were ever made to the FURBS.

13 Mr McWhinnie's evidence about the employees of Habilis at this time was equivocal. The company's returns to the Revenue for 2005-06 and 2006-07 show that there were no forms P14 submitted for employees in those years, which Mr McWhinnie said "had to be a mistake". Two persons, Alex Mudd and David Combes, had at the time been what Mr McWhinnie described as "part of the Habilis equation", and although they were not paid a salary they had drawn cash from the business but Mr McWhinnie could not recall how much.

14 When pressed on whether or not these two persons were employees, Mr McWhinnie was unable to be categorical and said that it depended on how one defined 'employee'; he added that neither person had been "on the scene" in March 2005 and were introduced to him in mid to late 2005. The two did not become directors of the company - though they were, Mr McWhinnie claimed, intended as potential beneficiaries of the FURBS if it should transpire that their contributions to the business merited it. In the event, business had taken a turn for the worse at the end of 2005 and during 2006, involving the loss of major clients, and Messrs Mudd and Combes left the business which he said stopped trading in 2007.

15 No records or minutes with regard to the company's decision to contribute almost half a million pounds to the FURBS had been made. There were similarly no minutes of the trustees about the matter, or about a subsequent decision to put the control of the properties (which were redeveloped) into a body called Tuscott LLP, whose members were shown in 2009 as including Mr McWhinnie himself, the trustees of the FURBS and Habilis, together with others.

16 The other trustee of the FURBS was, as we have seen, a company called D A Phillips & Co Ltd, introduced to Mr McWhinnie by QED. Mr McWhinnie said that he had on occasion spoken to a Mr Kevin Phillips, whom he described as one of the principals of that company, and sought advice about bank statements and the like; Mr McWhinnie said he had not asked or expected them to prepare minutes of the FURBS, though he thought they would act in a professional capacity, and he had now lost touch with them. On reflection, Mr McWhinnie accepted that company and trust minutes should have been kept.

17 There are some loose ends in this account of the evidence. The first is that although Mr McWhinnie claimed that at the time of the contribution to the FURBS he was the sole director of Habilis, company searches in the papers suggest that a Mrs Janis Brown Clark was also at that time a director since she held that position in several subsequent years; the Directors' Report of the company to 31 October 2005 also shows Mrs Clark as a director. The second is with regard to Mr Alex Mudd, whom Mr McWhinnie claimed to have been introduced to in 2005: Mr Mudd was shown by Companies House records to have been a director of the company between February 2002 and October 2003, but Mr McWhinnie could not recall this or explain the apparent contradiction of what he had said about Mr Mudd's involvement.

The instruments establishing the FURBS

18 Clause 7(a) of the deed establishing the FURBS provided that "the trustees will on the instructions of the Members and subject as herein provided invest all or any part of the assets of the Scheme in the investments set out in paragraph (b) of this clause". Similarly, clause 8 provided that the "trustees will on the instructions of the Members sell or realise or transfer or vary any investment or property whether for the purpose of reinvesting the proceeds in the manner set out in clause 7 or for other purposes of the Scheme" and that "the trustees will on the instructions of the Members appoint and remunerate a nominee or nominees to hold the investments of the Scheme". Clause 9 provided that the "trustees may with the consent of the Members . . . raise or borrow any sum or sums of money". Several other clauses made it clear that action by the trustees was to be with the consent of the Members or on their instructions. Terms defined were:-

> "Eligible Employee" means a person who is or has been in the service of a Participating Employer who has been informed that he is eligible for admission to the scheme and has consented to become a Member of the Scheme and may include a Director or a former Director of a Participating Employer and "Eligible" shall be construed accordingly. The decision of the Principal Employer as to whether or not a person is at any particular time in the service of a Participating Employer and whether or not he has been informed of his eligibility for admission to the Scheme shall be final and conclusive.
>
> "Member" means a person who is or has been an Eligible Employee and who has been admitted to membership under Rule 2 and whose membership has not ceased in accordance with these Rules and "Membership" shall be construed accordingly.

> "Members Deemed Share" means that part of the investments of the scheme representing the aggregate amount contributed by the scheme by the participating employer on behalf of the Member and the interest or income accrued to the scheme on the foregoing amounts after deducting expenses incurred in managing the scheme."

19 Rule 2 then provided:-

> *2 Membership of the scheme*
> An Eligible Employee who is invited by the Principal Employer to become a Member and who completes and submits such applications for membership (if any) as the Trustees shall determine shall be admitted to membership on the first day of the Scheme Year coincident with or if not coincident with next following (sic) the acceptance by the Trustees of his application or on such other dates as the Trustees shall determine and shall remain a Member as long as he is entitled or prospectively entitled to rights or benefits under the Rules.
>
> If an Eligible Employee does not apply for membership when first invited to do so his application for membership shall be accepted by the Trustees only with the consent of the Principal Employer and subject to such conditions and on such terms (including variation of his rights to benefits) as the Trustees consider appropriate.
>
> The Principal Employer shall determine whether an Eligible Employee's application for membership is made at the first opportunity.

20 Rule 26 stated:-

> The trustees shall cause true and full records to be kept of all monies passing through their hands and also true and full records of all persons receiving benefits and of all other matters that are appropriate and proper to be recorded so as to show the full facts relating to the Scheme.

Submissions – the taxpayer

21 The taxpayer's case is essentially that the Habilis contributions to the FURBS have not been allocated to Mr McWhinnie, and remain in the trust pending attribution to an eligible employee in accordance with the Rules. According to this argument, no application for Membership has been made to the trustees of the FURBS by Mr McWhinnie and therefore it is not the case that the company's contribution was made "with a view to the provision of relevant benefits for or in respect of an employee of the employer" as required by section 386(1)(b). In consequence, there is no charge to tax and the assessment must be vacated.

22 This thesis would be supported by the company having two directors at the relevant time, either of whom could have been potential beneficiaries of the FURBS, and by the real possibility that others would come within the scope of the trust and that it would be desirable to incentivise them by giving or promising them benefits under it. Mr McWhinnie was not, therefore, the only potential beneficiary and there was no evidence that the trustees of the FURBS had made any decision in that regard.

23 To accept that section 386 imposed a tax charge in these circumstances would produce an arbitrary and inequitable result in which the tax charge did not correspond to any benefit, actual or potential, received by the taxpayer subject to the charge. It is not sufficient for the taxpayer simply to have a hope, or even a likely prospect, of receiving a benefit from the FURBS. This approach is borne out by the terms in which the deed establishing the trust and its Rules are framed, requiring specific and identifiable Members giving clear and definite instructions to the trustees as to the management of the assets and to benefit from any income they might produce. In this case, no specific person is identifiable as a Member.

24 Although the burden of displacing the assessment rests on the taxpayer, he is faced it is said with the very difficult task of proving a negative, namely that no allocation of the contribution to the FURBS has been made and that no Membership in accordance with the Rules has been established. Moreover, the fact that the establishment of the FURBS is characterised as 'tax avoidance' should have no bearing on the interpretation of the facts or the law applicable, and the case should be approached on the same basis as any other.

25 While the absence of records is regrettable, there is no evidence to suggest that their absence is a deliberate attempt to conceal the truth and no basis for finding that Mr McWhinnie has lied to the tribunal about events. It was entirely credible that Mr McWhinnie's advisors and he had not always acted together and that uncorrected mistakes had been made by the advisors in some of the statements and filings they had made, and there was no evidence to support a finding that the taxpayer had collaborated with his advisors to paint a false picture of what happened.

26 In response to a suggestion by Mr Kane that section 392 offered a potential relief from an early application of section 386, Mr Pink pointed out that section 392(4) would not be sufficient to afford relief except possibly in respect of a reallocation of the whole sum originally allocated. If therefore it were to be held that section 386 had imposed a charge on Mr McWhinnie coincident with the contribution being made to the FURBS, it would only be possible to escape the charge retrospectively if the entirety of the assets thus contributed were allocated by trustees to a person other than him; a part reallocation would not suffice. In any event, it was hard to see how section 392(1)(c) could be satisfied merely by a reallocation occurring after the initial contribution had been made.

Submissions – the Crown

27 Mr Kane's primary submission for the Revenue was that a realistic appraisal of the facts showed that the contributions – the value of the properties and the payment of £500 – had been made with a view to providing a benefit to Mr McWhinnie. The contemporary documents referred to above all indicated that that was so, and the course of events subsequently showed that Mr McWhinnie had in fact remained throughout in control of what had been contributed – as a trustee of the FURBS and as a member of the limited liability partnership which had been given management and control of the assets.

28 A particular pointer to the reality of the situation was the cash payment of £500 made by Habilis to the FURBS. That payment had been returned by Mr McWhinnie himself as a taxable benefit and it followed that the trustees of which he was one had accepted it as a benefit contributed "for or in respect of an employee" who was identified as Mr McWhinnie. If that was so for the payment of £500, why should the *in specie* contributions be supposed to be different? By reason of the treatment of the cash payment, it was inevitable that Mr McWhinnie must be regarded as having been accepted as a Member of the FURBS as provided for by Rule 2; if he was so accepted for one part of the contribution, it must be concluded that he had also been accepted as a Member in respect of the rest of the contribution made by the employer.

29 Mr McWhinnie's evidence was an unsatisfactory and unreliable basis on which to conclude that the improbable was the case, namely that valuable assets had been contributed to the FURBS only to be left in limbo when the contemporary evidence, such as it was, indicated the contrary. The complete absence of the statutory minutes recording the company's decision to transfer the properties to the FURBS, and the similar absence of trust minutes in breach of the categorical requirements of Rule 26, in practice told against the taxpayer since the burden was on him to displace the otherwise clear inference to be drawn from the circumstances; in the event, he had been unable to do so convincingly in the absence of documentary support for his assertions and in view also of his very poor recollection of the detail of events.

30 As we have seen, Mr Kane also submitted that the charge imposed by section 386 upon a contribution being made did not preclude a reallocation of the benefit being recognised under section 392 in the event that other persons should become Members of the FURBS. Relief under that section would therefore temper any perceived hardship resulting from the charge under section 386 falling prematurely on a taxpayer who did not finally enjoy the benefits on which he had been taxed.

Conclusions

31 I find as a fact that the contributions made to the FURBS by Habilis on 28 February and 15 March 2005 were made with a view to the provision of relevant benefits for an employee of Habilis, namely Mr Derek McWhinnie. My reasons are as follows; where I refer to matters being 'probable' it is on the basis of the balance of probabilities.

- Firstly, the letter from the company's accountants of 19 March 2007 to the Revenue described Mr McWhinnie as "the sole beneficiary of the scheme" and I think it unlikely that a firm of chartered accountants would describe the position so categorically in error; the probability is that their letter was composed carefully and was an accurate description of what had occurred.

- Secondly, the report of the trustees of the FURBS for the year to 5 April 2005 also described Mr McWhinnie as a beneficiary of the FURBS scheme. I think it is likewise improbable that this formal document was produced carelessly.

- Thirdly, Rule 2 of the scheme does not require a formal application for Membership to be made, and the absence of one is not therefore necessarily significant but it is consistent with the lack of attention to formality which characterised the behaviour of Mr McWhinnie and D A Williams & Co Ltd as trustees.

- Fourthly, the cash payment of £500 was unarguably made by Habilis with a view to the provision of a benefit for Mr McWhinnie as he acknowledged it himself in his personal tax return. There is no evidence to support Mr McWhinnie's speculation that the return may have been incorrectly completed "by a junior in the firm" and it is again probable that it was carefully and accurately prepared. In this context, it is clear that Mr McWhinnie had been accepted by the trustees as a Member of the scheme and it is probable that the two contributions to it were made with the same purpose.

- Fifthly, Mr McWhinnie's evidence was punctuated by poor recollection and inconsistencies, examples being the confusion over the numbers of Habilis directors in 2005, the status of Messrs Mudd and Combes and how they were remunerated, and the years in which Mr Mudd had played a role in the company. Although I do not find Mr McWhinnie's evidence consciously dishonest, I consider that his poor recollection and inattention to matters of detail mean that his evidence is unreliable except where it can be corroborated elsewhere.

32 The absence of company and trust minutes means that there is no contemporary documentary evidence to support Mr McWhinnie's claim that the contributions made by Habilis were not with a view to his benefit, and there are the several factors I have listed to indicate that the probability is that they were.

33 In view of these findings, it is unnecessary to express a view on Mr Kane's submissions on the role of section 392. It is difficult, however, to see that it would be apt to fulfil the function for which he contended given that, in this type of case at least, the character of the trusts established for the FURBS is not discretionary and that the trustees could scarcely revisit the recognition of a specific benefit to an individual once made, and attracting tax under section 386, in favour of another later-admitted Member. The issue arose in the course of a short discussion about the theoretical possibility of a contribution to a FURBS being made by an employer, but without there being immediately an identifiable beneficiary to link it to. Evidently, it is now unnecessary to address that question in this appeal.

34 For the reasons given, the discovery assessment must stand good and the appeal be dismissed. This document contains the full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal no later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

MALACHY CORNWELL-KELLY
TRIBUNAL JUDGE

RELEASE DATE: 18 October 2013