[2017] UKFTT 198 (TC)

TC05686

Appeal number: TC/2013/00504
TC/2014/04642
TC/2013/01274

***CORPORATION TAX – whether payments made to employee benefit trusts are deductible in computing profits – no – whether amendments to trust deed had retrospective effect – no – whether Tribunal had jurisdiction to consider issues of estoppel or legitimate expectation – no – whether to exercise case management powers barring HMRC from defending appeal on grounds of delay – no – applicability or otherwise of s43 Finance Act 1989 and Schedule 24 Finance Act 2003 – effect of decision in* Murray Group Holdings**

FIRST-TIER TRIBUNAL
TAX CHAMBER

ALWAY SHEET METAL LIMITED **Appellants**
PRAZE CONSULTANTS LIMITED
J C McCAHILL LIMITED

- and -

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

TRIBUNAL: JUDGE JONATHAN RICHARDS

Sitting in public at The Royal Courts of Justice, Strand, London on 25 to 27 January 2017

Joseph Howard and Stephen Hackett, instructed by Griffin Law, for the Appellant

Aparna Nathan, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This decision deals with appeals made by three companies: Alway Sheet Metal Limited ("Alway"), Praze Consultants Limited ("Praze") and J C McCahill Limited ("JCM"). The appeals raise similar issues relating to the deductibility for corporation tax purposes of payments made to discretionary trusts established for the benefit of employees (and in Praze's appeal, consultants) and their family members and descendants ("EBTs"). Since the appeals raise similar issues, the Tribunal directed that they be heard together.

Evidence

2. During the hearing, I heard evidence from the following witnesses:

(1) Mr James McCahill, a shareholder and director in JCM;

(2) Mr Jason Larke and Mr Alan Mee, who were the two shareholders and directors of Alway; and

(3) Dr Philip Hallwood, who was at relevant times, one of the two directors and shareholders of Praze.

3. Ms Nathan cross-examined all of these witnesses. They all expressed difficulties in recalling matters that went back to as early as 1997, which is entirely understandable. I have concluded that on some issues, their recollections were incorrect and I will give specific instances later in this decision. However, I am satisfied that all witnesses gave their evidence honestly.

4. HMRC did not rely on any witness evidence. There was also evidence in the form of several bound volumes of documents.

The issues arising and structure of this decision

5. Appendix One to this decision contains details of the corporation tax assessments against which these appeals have been brought.

6. In overview, this appeal involves the following issues which, after making relevant findings of background facts, I will deal with in separate self-contained parts of this decision:

(1) Issue 1 is whether, as a result of what the appellants consider to be HMRC's excessive delay, HMRC were precluded from making the assessments by principles of estoppel, abuse of process or legitimate expectation. If the appellants succeed on that point, all the assessments would fall away, which is why I will deal with it first.

(2) Issue 2 relates only to Alway. HMRC have made a single assessment on Alway relating to its accounting period ended 30 April 1998. That assessment was made only for £2,100 but HMRC are asking the Tribunal to increase the

assessment to £126,492.21. Alway argues that HMRC are not entitled to claim the higher figure.

(3) Issue 3 relates to all three appellants and involves the fundamental question of whether payments that they made to the EBTs were expended wholly and exclusively for the purposes of their respective trades. My conclusion that no appellant's payments meet this condition (apart from in a relatively small respect) reduces the significance of subsequent issues. However, since other issues were argued before me (some of which were said to be relevant to Issue 3, although I do not necessarily agree that they were), I will also include a brief analysis of these other issues.

(4) Issue 4 relates to the question of whether certain amendments that the appellants made to their EBTs by means of Deeds of Amendment and Rectification took effect retrospectively, from the date of execution of the original trust deeds. Ms Nathan submitted that this had some relevance to Issue 3 (though I have concluded that it does not). However, it does have some relevance to the applicability or otherwise of s43 of Finance Act 1989 ("Section 43") and Schedule 24 of Finance Act 2003 ("Schedule 24") which is why I deal with it before considering Issue 6.

(5) Issue 5 is whether, applying the decision of the Inner House of the Court of Session in *Murray Group Holdings Ltd and others v Revenue and Customs Commissioners* [2016] STC 468, sums that the appellants paid to the EBTs were simply "indirect remuneration". Mr Howard submitted that this question had some bearing on Issue 3 (though I do not believe it does). However, it is of potential relevance to Issue 6 which is why I deal with it before Issue 6.

(6) Issue 6 relates to Section 43 and Schedule 24. These are provisions which could apply if the appellants' contributions to the EBTs were otherwise deductible for corporation tax purposes. Since I have concluded (as Issue 3) that the payments were not deductible to a material extent, Issue 6 is of less importance than it would otherwise have been.

FINDINGS OF FACT

7. The facts set out at [8] to [84] were either determined by the Tribunal or agreed. (These are certain relevant background and primary facts. Later in this decision I will set out additional factual conclusions on questions such as whether the expenses at issue in these appeals were incurred wholly and exclusively for the purposes of the relevant companies' trades.)

Findings specific to J C McCahill Limited

The establishment of the employee benefit trust and contributions to it

8. JCM was incorporated in 1983. Until 21 June 2002 it was known as "Noblegreen Limited". At times material to this appeal, it carried on a trade as a consultant engineer and as a manufacturer and supplier to the oil industry.

9. At all material times Mr McCahill owned two shares in JCM. The remainder of the share capital, consisting of 100 shares, was held by a succession of different trust companies on trusts whose terms were not disclosed. Mr McCahill described this as the "Kintara" trust, but was not able to explain the nature of the trust or who the beneficiaries were. It follows that I have not been able to make findings as to the precise terms on which these additional 100 shares were held.

10. At all material times, JCM had two directors: Mr McCahill and his wife, Mrs Catherine McCahill. Mr McCahill is an engineer and he played a key part in JCM's business. Mrs McCahill has a background in nursing and had little knowledge of JCM's business. Therefore, Mr McCahill accepted that, if he proposed something at directors' meetings, it was likely that the proposal would be adopted. JCM had two other employees: Mr Cosford, who was an engineer and a secretary, Ms Halfyard.

11. In 1997, Mr McCahill's brother, who was a financial consultant, introduced Mr McCahill to Mr Bill Auden of Baxendale Walker, a firm of solicitors who advised extensively on tax-efficient methods of rewarding employees[1]. Following some discussions with Mr Auden, JCM indicated that it was amenable to establishing an employee benefit trust (the "JCM EBT").

12. On 11 December 1997, JCM resolved at a board meeting to make its first contribution to the JCM EBT. Mr McCahill chaired that board meeting and referred to the terms of a trust deed that would need to be executed in order to establish the JCM EBT. Mr McCahill noted that the trust deed had been "settled by leading tax Counsel".

13. On 18 December 1997, JCM executed a trust deed establishing the JCM EBT (the "JCM Trust Deed") and, for the purposes of the JCM Trust Deed, was defined as the "Founder". The trustee of that trust (the "JCM Trustee") was Matheson Trust Company (Jersey) Limited, a company incorporated in Jersey. Clause 2 of the JCM Trust Deed provided that the trustee was to hold the "Trust Fund" (which included the initial contribution of £100 and any future contributions to the trust) and income thereon on discretionary trust for the "Beneficiaries". Clause 1.4 of the JCM Trust Deed defined the "Beneficiaries" as follows:

> "the Beneficiaries" means the present, past and future employees from time to time of the Founder [i.e. JCM] and the wives husbands widows widowers children step-children and remoter issue of such employees and the spouses and former spouses (whether or not remarried) of such children and remoter issue … PROVIDED THAT no Excluded Person shall be a Beneficiary;

14. Clause 1.5 of the JCM Trust Deed defined "Excluded Person" as follows:

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[1] I was not shown any evidence that demonstrated that Baxendale Walker had a specific expertise in tax matters: all parties regarded that as simply obvious and uncontentious. I am nevertheless satisfied that Baxendale Walker had such an expertise given the findings of fact that the High Court made in *Barker v Baxendale Walker Solicitors and Paul Baxendale-Walker* [2016] EWHC 664.

> "Excluded Person" means any of the persons named in Schedule 2 to this Deed, provided that the widows widowers children stepchildren and remoter issue of such Excluded Persons and the spouses and former spouses (whether or not remarried) of such children and remoter issue shall be Beneficiaries unless any of the same is an Excluded Person.

Schedule 2 of the Trust Deed listed "Excluded Persons" as follows:

> 1. The Founder
>
> 2. Any Participator in the Founder.
>
> 3. Any person "connected with" the Founder.
>
> For the purposes of this Deed, the words "Participator" and "connected with" shall have the meanings ascribed to them by the Income and Corporation Taxes Act 1988.

15. Clause 12 of the JCM Trust Deed prevented the trustee from exercising its power or discretion so as to cause any part of the Trust Fund to be used to provide "Prohibited Benefits" which were defined in Clause 1.6 of the JCM Trust Deed as meaning:

> (1) "relevant benefits" for the purposes of s612 of the Income and Corporation Taxes Act 1988 ("ICTA") which relates broadly to pensions, lump sums and gratuities given in connection with retirement or death; and
>
> (2) any payment that would constitute emoluments of any person formerly employed by, or holding office with, JCM.

The evident purpose of this provision was to prevent the JCM EBT from being a "retirement benefits scheme" that would be subject to the special tax regime set out in Part XIV of ICTA as in force at the relevant time.

16. It was common ground that the effect of the Trust Deed was that, even though Mr McCahill was an employee of JCM, he was not a "Beneficiary" because, since he held shares in JCM he was a "Participator" in JCM and so an "Excluded Person". However, even though Mr McCahill was not a "Beneficiary" as defined, the JCM Trust Deed did not prevent the JCM Trustee from making loans (as distinct from outright gifts) to Mr McCahill.

17. Mr McCahill could not recall the detail of discussions with Baxendale Walker leading up to the decision to establish the JCM EBT. However, he said in his witness statement that those discussions were lengthy and touched on complex issues. He could not recall details of any tax advice that JCM received but did not deny that it received tax advice. I have concluded that JCM did receive tax advice on the arrangements as a whole before they were implemented not least because of the reference to "leading tax counsel" in the board minutes referred to at [12] and because Mr McCahill accepted in cross-examination that Baxendale Walker (with their specific tax expertise) was the only set of advisers to whom JCM was speaking about the JCM EBT. Specifically, I have inferred that Baxendale Walker would have mentioned to Mr McCahill (i) that any contributions that JCM made to the JCM EBT

were expected to be deductible for corporation tax purposes, (ii) that contributions that JCM made to the JCM EBT would not, at the time payment to the EBT, be subject to PAYE or national insurance contributions ("NIC"), (iii) that there was a tax reason why Mr McCahill could not be a beneficiary of the JCM EBT (and so could not receive absolute distributions of trust property)[2] but (iv) (while it was a matter for the JCM Trustee), the trustee might well be prepared to advance long-term loans to Mr McCahill following receipt of a letter of request so that Mr McCahill would have effective access to money held by the JCM Trustee. These were obviously relevant features of the arrangements that Baxendale Walker were proposing. I do not believe that they would have failed to mention them to Mr McCahill or JCM.

18. Appendix Two to this decision contains details of the contributions that JCM made to the JCM EBT together with distributions to Beneficiaries (in the forms of outright payments as distinct from loans) that the JCM Trustee made following requests from JCM. It will be seen from that summary that in periods relevant to this appeal, JCM paid £2,087,550 to the JCM EBT and only asked the JCM Trustee to exercise its discretion to pay some £30,000 of that money outright to a single employee, Mr Cosford.

19. Mr McCahill has borrowed some £395,000 from the JCM EBT since it was established of which he has repaid around £30,000. I had no evidence as to the interest rate (if any) payable on those loans.

20. The JCM EBT also purchased a property (in which Mr McCahill resides) for £650,000. Mr McCahill pays the JCM EBT a monthly rent of £850.

The subsequent amendment to the terms of the JCM EBT

21. Clause 11 of the JCM Trust Deed permitted JCM to alter (by deed) any provision of the JCM Trust Deed subject to certain limitations which are not relevant to this appeal.

22. On 28 September 2005, the JCM Trustee, Mr McCahill and Mrs McCahill entered into a "Deed of Amendment and Rectification"[3]. Recital 2 to that deed explained that:

> The Protector and the Trustees wish to rectify the [JCM Trust Deed] so as to give effect to [JCM's] intention in establishing the trusts of [the JCM Trust Deed].

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[2] Mr Howard invited me to conclude from the evidence that Mr McCahill and JCM were unaware that Mr McCahill was an "Excluded Person". However, I have not done so as the JCM Trust Deed stated expressly that Mr McCahill was an Excluded Person. That cannot have been an oversight given the senior role that Mr McCahill had at JCM and Baxendale Walker would be bound to mention it in their advice. Moreover, Mr McCahill subsequently requested loans from the JCM EBT (rather than outright payments) and I consider that must have been because he realised that outright payments were not possible.

[3] Mr and Mrs Cahill were expressed to be signatories to this deed in their capacities as "Protector" of the JCM EBT but the JCM Trust Deed did not set out any such role.

23. Clause 1 of the Deed of Amendment and Rectification stated that a new clause A1 was to be inserted in the JCM Trust Deed this inclusion to take effect from the date of execution of the JCM Trust Deed. Clause 1, therefore, purported to make retrospective amendments to the terms of the JCM Trust Deed. Clause A1 provided as follows:

> (1) It provided that the JCM Trustee had no power to pay an "emolument" as defined in ICTA.
>
> (2) It provided that the JCM Trustee could not pay or apply the trust property in such a manner as to cause any sums that JCM contributed to the JCM EBT to be "potential emoluments" within the meaning of Section 43.
>
> (3) It provided that, as from 1 November 2002, the beneficiaries of the JCM EBT would not include any employee or former employee of JCM (although spouses, dependents and remoter descendants of employees could continue to be beneficiaries).

The conduct of HMRC's investigations into the tax treatment of the JCM EBT

24. All accounting periods of JCM in which it sought a deduction for contributions to the JCM were subject to the self-assessment regime which was introduced for corporation tax purposes in the Finance Act 1998. It was common ground at the hearing that HMRC opened valid enquiries for each relevant accounting period of JCM.

25. Mr Hackett made no criticism of HMRC's investigations into the tax treatment of the JCM EBT up until 2005 (when the decision of the House of Lords in *MacDonald (Inspector of Taxes) v Dextra* [2005] UKHL 47 was released) as he accepted that that decision was relevant to the transactions that JCM had entered into. I will not, therefore, make any detailed findings as to the nature of HMRC's enquiries up until then beyond noting that HMRC engaged in correspondence with JCM with a view to establishing what HMRC considered to be the correct tax treatment of those transactions.

26. On 3 October 2005, Baxendale Walker wrote to HMRC to outline their view that the execution of the Deed of Amendment and Rectification meant that, despite the decision in *Dextra*, Section 43 did not apply to the JCM EBT. Some correspondence ensued and HMRC said that they would take their own legal advice on this issue.

27. On 11 July 2007, HMRC wrote to Baxendale Walker explaining, inter alia, that HMRC did not consider that the Deed of Rectification and Amendment had the retrospective effect for which Baxendale Walker were arguing. They evidently wrote similar or identical letters in relation to a number of Baxendale Walker's clients (including Alway and Praze) who had entered into Deeds of Amendment and Rectification.

28. As a result, on 18 July 2007, Baxendale Walker wrote to HMRC to suggest that there be litigation to determine, inter alia, whether the Deeds of Amendment and Rectification had retrospective effect with one of Baxendale Walker's clients being a

"test case" and other clients being "inevitably bound by the final outcome of this test case". On 31 July 2007 HMRC broadly accepted Baxendale Walker's proposal and agreed to leave enquiries in abeyance pending determination of a test case.

29. Between July 2007 and January 2011, approximately once a year, HMRC wrote to Baxendale Walker referring to their "ongoing enquiry into contributions to the company's EBT/RT". Those letters reminded Baxendale Walker of HMRC's view that the Deed of Amendment and Rectification did not have retrospective effect and that interest was continuing to accrue on what HMRC considered to be an amount of corporation tax that JCM owed. Those letters typically stated the amount of corporation tax that was said to be due with the total interest that HMRC considered had accrued up until the date of the letter. All of these letters were copied to JCM as well as being sent to Baxendale Walker.

30. HMRC sent a shorter letter on 9 March 2013 to both JCM and Baxendale Walker that referred to "ongoing enquiries" into JCM's EBT arrangements and recorded HMRC's view that interest was continuing to accrue.

31. On 2 May 2014, HMRC closed their enquiries and issued a closure notice amending JCM's returns for the relevant accounting periods. JCM appealed to HMRC against those closure notices on 27 May 2014. That appeal was rejected and JCM requested a review. HMRC notified JCM of the conclusion of that review (which was to uphold the closure notices as issued) by letter dated 18 July 2014. JCM notified its appeal to the Tribunal on 15 August 2014.

32. JCM reflected its ongoing dispute with HMRC in its accounts for the years ended 31 December 2010, 2011, 2012, 2013 and 2014. A note to those accounts dealt with "contingent liabilities" and in that context stated that JCM and EBT were engaged in ongoing correspondence with HMRC in relation to the JCM EBT and set out the amount of additional corporation tax (and interest) that would be payable if HMRC's challenge was successful. Mr McCahill accepted in cross-examination that JCM did not consider at any point that its dispute with HMRC had "gone away".

33. While HMRC was pursuing its enquiries into the JCM EBT, a number of events took place that have impacted on JCM's practical ability to put its case in Tribunal proceedings. The memory of JCM's principal witness, Mr McCahill, inevitably faded. In addition, Mr McCahill inevitably aged during those enquiries and he was 78 years old at the date of the hearing. JCM has moved offices three times since the JCM EBT was established and has lost relevant documents. It has also changed IT systems and has no records from the year 1997. The local accountant from whom JCM took advice at the time it established the JCM EBT has passed away.

Findings specific to Alway Sheet Metal Limited

The establishment of the Alway EBT and contributions to it

34. Alway Sheet Metal Limited ("Alway") was incorporated on 10 May 1985. Its principal activity is sheet metal working. At all material times, 50% of the shares in

Alway were held by Mr Alan Mee and 50% by Mr Jason Larke. Mr Mee and Mr Larke were, at material times, the only two directors in Alway.

35. As at the date of the hearing, Alway has around 16 employees. In 1997 and 1998 (when it was considering setting up the employee benefit trust to which this appeal relates) it had around 8 or 9 employees (and I concluded from Mr Mee's evidence that this figure included the two directors since, when asked how many employees Alway had when it was formed he answered "Two. Both directors." suggesting that he counted directors as employees).

36. Mr Mee said that he currently earned around £100,000 per year (and I have inferred that his fellow director Mr Larke earns a similar amount). Of the remaining employees around two of them are described as "team leaders" with a salary of around £50,000 with the remaining employees earning around £20,000 to £30,000 a year depending on the hours they work.

37. In 1997 or 1998, Alway had what Mr Mee described as a "good year". Mr Mee and Mr Larke spoke to Rothschilds who were, at the time providing financial advice to Alway about increasing pension payments. Rothschilds suggested that Alway might wish to consider establishing an employee benefit trust and put them in touch with Bill Auden at Baxendale Walker.

38. Following those discussions, on 12 May 1998, Alway resolved at a board meeting to establish an employee benefit trust (the "Alway EBT"). Those board minutes recorded that:

> … for the purposes of inheritance tax and capital gains tax, all "Participators" in the Company and all persons "connected" with such persons are excluded from benefits under the trusts of the Scheme.

39. On the same day, Alway executed a trust deed establishing the Alway EBT (the "Alway Trust Deed") and, for the purposes of the Alway Trust Deed, was defined as the "Founder". The trustee of that trust (the "Alway Trustee") was Capco Trust Jersey Limited, a company incorporated in Jersey.

40. The terms of the Alway Trust Deed were in all material respects identical to those outlined at [13] to [16]. Therefore, both Mr Mee and Mr Larke (by virtue of being shareholders in Alway) were "Excluded Persons" and thus prevented from being beneficiaries of the Alway EBT but there was no impediment to them receiving loans of trust property.

41. On 3 July 1998, the Alway Trustee entered into two declarations of trust ("Alway Subtrusts"), one relating to Mr Mee (the "Mee Subtrust"), and one to Mr Larke (the "Larke Subtrust"), in respect of the trust property of the Alway EBT. Each Alway Subtrust provided that the Alway Trustee would hold 45% of the "Trust Fund", which included the assets of the Alway EBT at the date of the relevant subtrust together with any additions to that trust property, on discretionary trust for the "Principal Beneficiaries". The Mee Subtrust relating to Mr Mee defined "Principal Beneficiaries" as follows:

> "the Principal Beneficiaries" means the widow, widowed children and remoter descendants of Alan Mee…

The Larke Subtrust used a similar definition though referencing Mr Larke rather than Mr Mee.

42. Clause 4.1.1 of both the Larke Subtrust and the Mee Subtrust permitted the Alway Trustee, to transfer property to the trustees of any other settlement if the Alway Trustee considered that the provisions of that other settlement would be beneficial to the Principal Beneficiaries (whether or not that other settlement had beneficiaries other than the Principal Beneficiaries).

43. Therefore, the position following execution of the Alway Subtrusts was as follows:

> (1) 10% of the Alway EBT trust property was held in a "main fund" on discretionary trust for "Beneficiaries" (broadly employees of Alway and certain relatives and descendants of those employees).
>
> (2) 45% of the Alway EBT trust property was held subject to the terms of the Mee Subtrust on discretionary trust for the widow, widowed children and remoter descendants of Mr Mee. The Mee Subtrust therefore had no beneficiaries until Mr Mee's death.
>
> (3) 45% of the Alway EBT trust property was held subject to the terms of the Larke Subtrust on discretionary trust for the widow, widowed children and remoter descendants of Mr Larke. The Larke Subtrust also had no beneficiaries until Mr Larke's death.
>
> (4) Neither Mr Mee nor Mr Larke were beneficiaries of either the main fund or an Alway Subtrust. However, there was no impediment to the trustee of any such trust or subtrust making loans to Mr Mee or Mr Larke.
>
> (5) The Alway Trustee could, by exercising the power pursuant to Clause 4.1.1 where permitted to do so, have altered the proportions of assets that were held on the various trusts set out at [(1)] to [(3)]

44. Mr Mee was pressed in cross-examination as to whether he was aware that the subtrusts would be created at the time Alway first resolved to make contributions to the Alway EBT. We took his responses to mean that the "main" fund and the subtrusts were part of the same overall arrangement and that he was aware right from the beginning that subtrusts would be created subsequently. Since Mr Mee was aware of this fact, Alway was aware of it as well.

45. There was some dispute as to whether Baxendale Walker explained the tax effects of the arrangements. Mr Mee in his evidence stated categorically that Baxendale Walker did not explain that payments that Alway made to an employee benefit trust were expected to be tax-deductible. Mr Larke was more equivocal: when asked whether Alway's interest in making contributions to an employee benefit trust stemmed from a desire to obtain a tax deduction for those payments he said only that he "wouldn't have thought so" and did not say that he was unaware of the very possibility of a tax deduction being available. Moreover, he said that Alway set the

trust up "under the expert guidance of Baxendale Walker" who, as I have noted, were experienced in tax matters. Mr Mee also confirmed that Alway "took their [i.e. Baxendale Walker's] word" in relation to the Alway EBT. This evidence, and a similar line of reasoning to that set out at [17], has caused me to conclude that Mr Mee was mistaken and that Baxendale Walker did provide Alway, Mr Mee and Mr Larke with tax advice before Alway decided to establish the Alway EBT and that the substance of that tax advice was similar to that outlined at [17].

46. Appendix Two to this decision contains details of the aggregate amount of contributions that Alway made to the EBT and the amount of outright payments that the Alway Trustee paid to employees following requests from Alway. In summary, Alway contributed £490,000. Of this amount, it asked the Alway Trustee to exercise its discretion to pay £7,620 (including a £305 contribution towards a staff Christmas party) to employees. All of these payments were made on 15 March 1999.

47. Between June 1998 and February 2000, the Alway Trustee made various loans to Mr Mee for an aggregate principal amount of £224,634. These loans are trust property held subject to the terms of the Mee Subtrust. Interest is chargeable on those loans but, instead of being paid, it has been added to the principal amount of the loans. Those loans had an initial term of 10 years. However, on falling due for payment, the trustee re-advanced the principal and accrued interest, so Mr Mee has never had to pay the trustee cash in respect either of principal or interest on the loans to him.

48. Between 8 October 1998 and 1 February 2000, the trustee of the Alway EBT advanced an aggregate principal amount of £240,134 to Mr Larke. Those loans are held subject to the terms of the Larke Subtrust and the arrangements relating to them are substantially similar to those outlined at [47].

Subsequent amendments to the terms of the Alway EBT

49. Clause 11 of the Alway Trust Deed permitted Alway, with the written consent of the trustees, to execute a deed altering or adding to any of the provisions of the Alway Trust Deed. That power was subject to some limitations which are not relevant in the circumstances of this appeal.

50. On 5 October 2005, Alway and the trustee executed a Deed of Amendment and Rectification. The amendments made by that deed were in all material respects identical to those made in connection with the JCM EBT referred to at [22] and [23] above. Those amendments were expressed to take effect, retrospectively, on and with effect from the date of the Alway Trust Deed.

51. Alway also made an application to the High Court for rectification of the Alway Trust Deed (so as to include the amended provisions contained in the Deed of Amendment and Rectification). In a judgment handed down on 22 May 2014, Nugee J refused this application broadly for the reasons that since Alway had executed a trust deed that contemplated benefits being paid to employees (which was referred to as an "employee benefits trust"), he was not satisfied that, when that deed was executed, Alway could have had the intention to exclude employees from benefits.

The conduct of HMRC's investigations into the tax treatment of contributions to the Alway EBT

52. The accounting periods in which Alway claimed deductions for contributions to the Alway EBT were not subject to the self-assessment regime. Instead, they were subject to the predecessor "pay and file" regime.

53. On 3 June 1999, having received Alway's accounts for the year ended 30 April 1998 and corporation tax computations, HMRC wrote to Alway's accountants to ask for more information on the deduction claimed for payments to the Alway EBT of £490,000. That letter also asked a number of other questions on the detail of Alway's tax computation.

54. On 12 July 1999, HMRC had evidently not received a response and they wrote another letter, requesting either a response to the request for information or reasons for the delay. Alway's accountants sent a holding response on 15 July 1999 explaining that HMRC's questions had been referred to Alway's solicitors (Baxendale Walker) for their comments.

55. On 6 September 1999, HMRC made an assessment on the basis that Alway had net tax payable for its accounting period ended on 30 April 1998 of £2,100. This assessment was marked with the letter "E" and Ms Nathan submitted that this meant the assessment was an "estimated" assessment. However, since I had no evidence from HMRC as to HMRC's internal thought processes when issuing the assessment, I will not make any finding to the effect that this was an "estimated" assessment or what significance HMRC attached to it being such an assessment. Alway appealed to HMRC against that assessment.

56. I will not make any further findings as to the conduct of HMRC's discussions with Alway until 2005 (when the decision in *Dextra* was released) as Mr Hackett accepted that this decision was of relevance to those discussions.

57. From 2005 onwards, the course of correspondence between HMRC and Baxendale Walker was very similar to that relating to the investigation into the JCM EBT referred to at [26] to [29]. In October 2005, Baxendale Walker explained what they considered to be the effect of the Deed of Amendment and Rectification. HMRC took their own advice on the issue and, on 11 July 2007, sent a letter to Baxendale Walker in virtually identical terms to that set out at [27] saying that they did not agree. By 31 July 2007, HMRC and Baxendale Walker had agreed that HMRC's enquiries would be left in abeyance while litigation on a "test case" dealing with the effect of the Deeds of Amendment and Rectification was pursued. Between 31 December 2007 and 26 January 2011, HMRC sent periodic letters to Baxendale Walker (copied to Alway) similar to those referred to at [29] providing ongoing updates on the amount of tax and interest that HMRC considered to be due.

58. On 17 October 2012, HMRC sent Alway a "view of the matter" letter explaining in detail their position on relation to the contributions that Alway had made to the Alway EBT. Baxendale Walker requested a review of that decision on 31 October 2012 and HMRC informed Alway and Baxendale Walker of the conclusions of that

review by letter dated 18 December 2012. Alway appealed to the Tribunal on 10 January 2013.

59. I have accepted Mr Mee's evidence that, over the long history of this dispute, his memory of the advice he received has faded (as has that of Mr Larke). I also accept that early correspondence relating to the Alway EBT that was sent by fax has faded and emails have been lost as a consequence of IT upgrades, that correspondence has been lost in office moves and that staff changes and retirements, both at Alway and its advisers, have made it more difficult for Alway to pursue its appeal.

Findings of fact specific to Praze Consultants Limited

The establishment of the Praze EBT and contributions to it

60. Praze Consultants Limited ("Praze") was incorporated on 23 April 1999. It succeeded to a business involving the provision of consultancy services in the health care industry that was previously carried on by Dr Hallwood and Mr John Kettleborough in partnership. Praze used the trading name of "The Kite Consultancy".

61. At all times material to this appeal, 50% of the shares in Praze were held by Dr Hallwood and 50% by Mr Kettleborough. Dr Hallwood and Mr Kettleborough were also, at material times, the only two directors of Praze. They divided responsibilities between themselves: Dr Hallwood is a medical doctor and provided medical expertise; Mr Kettleborough was a chartered accountant and he dealt with financial matters. Mr Kettleborough passed away in 2014.

62. At times material to its appeal, Praze had around eight employees. It also used external consultants who it would pay in return for business opportunities provided.

63. In or around 1999, Mr Kettleborough spoke to a financial adviser. The gist of that conversation was that Praze's profits could fluctuate markedly from one year to the next and there may be some benefit in retaining some income each year to incentivise employees, or external consultants, of Praze. That led to Praze being introduced to Baxendale Walker.

64. In the course of those discussions, Baxendale Walker prepared a report for Praze's board of directors. That report explained in detail the tax consequences that Baxendale Walker expected to flow from the establishment of the Praze EBT. In particular, Baxendale Walker explained that payments to the Praze EBT would be deductible provided that they were made wholly and exclusively for the purposes of the trade. They also explained that contributions to the Praze EBT would not be subject to PAYE or NIC and summarised their view that Section 43 would not apply (a view that was inevitably based on their understanding of the law prior to *Dextra*). In addition, Baxendale Walker set out their view that:

> The Company's sole purpose in establishing the Trust is to operate a commercial executive incentive program. The Company derives no corporation tax advantage from the Trust since direct bonus payments

> would themselves by fully deductible in computing the Company's taxable profits.

65. Much of the report referred to at [64] appeared to constitute privileged legal advice. However, Mr Howard did not suggest that Praze was asserting privilege in relation to the document. I have concluded from that document that all of Praze, Dr Hallwood and Mr Kettleborough were aware of the tax effects that were considered to flow from the establishment of the Praze EBT and received tax advice in terms similar to that outlined at [17].

66. Following discussions with Baxendale Walker, on 25 November 1999, Praze resolved to make a contribution of £400,000 to a trust to be established for the benefit of, among other people, employees of Praze and persons providing consultancy services to Praze. Those board minutes recorded that establishment of the trust ought to promote employee loyalty and that the trade of Praze would thereby be benefited.

67. On 26 November 1999, Praze executed a deed establishing a trust (the "Praze EBT") and was defined as the "Founder" for the purposes of that trust. The trustee of that trust (the "Praze Trustee") was Matheson Trust Company (Jersey) Limited. The trust was declared over the "Trust Fund" (which included an initial £100 and any amounts contributed by way of further settlement). The terms of the Praze EBT were similar to those of the JCM EBT and the Alway EBT and, as with those trusts, the Trust Fund was held on discretionary trust for "Beneficiaries". The definition of "Beneficiaries" for these purposes was as follows:

> "the Beneficiaries" means the present, past and future employees and consultants to from time to time of the Founder and the wives husbands widows widowers children step-children and remoter issue of such employees and consultants and the spouses and former spouses (whether or not remarried) of such children and remoter issue … provided that no Excluded Person shall be a Beneficiary.

68. Thus, the definition of "Beneficiaries" was similar to that used for the purposes of the JCM EBT and the Alway EBT except that it referred to "consultants" as well as employees. The definition of "Excluded Person" was similar to that applicable to the JCM EBT and the Alway EBT with the result that both Dr Hallwood and Mr Kettleborough were "Excluded Persons" as they owned shares in Praze.

69. On 3 March 2000 the trustee of the Praze EBT executed two declarations of trust: one relating to Dr Hallwood (the "Hallwood Subtrust") and one relating to Mr Kettleborough (the "Kettleborough Subtrust").

70. Pursuant to the Hallwood Subtrust, the trustee declared that it held 56.15% of the "Trust Fund" (which included the assets of the Praze EBT together with amounts added thereto by way of further settlement) on discretionary trust for the Principal Beneficiaries being:

> the widow, and after his death only, the children and remoter descendants of Dr Philip Malcolm Hallwood, provided that no Excluded Person shall be a Principal Beneficiary….

71. Pursuant to the Kettleborough Subtrust, the trustee declared that it held 43.85% of the "Trust Fund" (which had an identical definition to that used in the Hallwood Subtrust) on discretionary trust for "Principal Beneficiaries" – the definition of that term being the same as set out at [70] but referencing Mr Kettleborough rather than Dr Hallwood.

72. Clause 2.3 of both the Kettleborough Subtrust and the Hallwood Subtrust permitted the Praze Trustee, provided other conditions were met, to take property of those subtrusts and pay it to the trustees of another settlement provided that the transfer would be beneficial to the Principal Beneficiaries (whether or not that other settlement had beneficiaries in addition to the Principal Beneficiaries).

73. Therefore, following the creation of the Hallwood Subtrust and the Kettleborough Subtrust, there were three relevant arrangements that made up the Praze EBT. Firstly, there was the Hallwood Subtrust (accounting for 56.15% of the trust property). Secondly, there was the Kettleborough Subtrust (accounting for 43.85% of the trust property). Neither the Hallwood Subtrust nor the Kettleborough Subtrust had any beneficiaries until the death of Dr Hallwood or Mr Kettleborough respectively. Finally, there were the trusts of the "main fund" created by the Praze EBT. On the face of it, following creation of the subtrusts, no assets were held subject to the trusts of this main fund. However, Clause 2.3 of the Kettleborough Subtrust and the Hallwood Subtrust permitted assets of the subtrusts to be transferred back to the "main fund". Such transfers took place on 15 December 2004 when all the assets of both subtrusts were transferred back to the main fund. In addition, on 14 February 2005, certain shares held by the Hallwood Subtrust were transferred to the main fund.

74. In his oral evidence, Dr Hallwood could not remember if he and Mr Kettleborough were aware that the subtrusts would be created when Praze made its first contributions to the Praze EBT. However, he made it quite clear in his evidence that he took little interest in the financial aspects of the business (which were Mr Kettleborough's responsibility). Therefore, the fact that he could not remember this detail does not demonstrate that a decision to create the subtrusts was taken only after the Praze EBT had been established. I consider it more likely than not that Baxendale Walker informed all relevant parties that the subtrusts would be created before the Praze EBT was established. The subtrusts clearly formed part of the overall set of arrangements. The report to the board referred to at [64] demonstrated that Baxendale Walker took care to communicate their advice clearly to Praze. In those circumstances, I do not consider that Baxendale Walker would have neglected to mention the subtrusts in discussions.

75. Since Mr Kettleborough sadly passed away in 2014, I had no evidence as to how, if at all, assets of the Praze EBT were made available for his benefit. Dr Hallwood seemed to have very little knowledge of his own financial affairs and I do not have a very clear picture of how he has accessed sums held by the Praze EBT. However, I have concluded from his evidence:

(1) Neither he nor a company owned or controlled by him has ever taken a loan from the Praze EBT.

(2) However, the Praze EBT purchased at least a part share in a property in Barbados (that Dr Hallwood identified). Dr Hallwood used that property when he went on holiday with his family (and did not have to pay to do so). When Dr Hallwood was not using the property it was let out to holiday-makers.

(3) He suggested that the Praze EBT make a commercial loan of £150,000 to a building development company located in the town where he lives.

(4) The private home that Dr Hallwood occupies is owned by a company and Dr Hallwood rents it from that company. He was not able to give specifics as to which company actually owns that home but seemed to agree that part of the funds used to acquire it came (perhaps through an intermediary company) from the Hallwood Subtrust by way of loan.

(5) In January 2003, Dr Hallwood received £10,000 from the Hallwood Subtrust (which was converted into US dollars in cash) which he used to furnish the Barbados property.

76. Appendix Two to this decision contains details of contributions to the Praze EBT and payments that the Praze EBT made to employees and consultants of Praze. In summary, Praze contributed £2,660,100 to the Praze EBT and, following requests from Praze, the Praze Trustee distributed some £76,700 to employees and consultants by way of outright payments.

Subsequent amendments to the Praze EBT

77. Clause 9 of the Praze Trust Deed permitted Praze to execute a deed adding to, or altering, any of the provisions of the Praze Trust Deed. That power was subject to certain limitations which are not relevant in the context of this appeal.

78. On 13 September 2005, Praze and the trustee of the Praze EBT entered into a Deed of Amendment and Rectification. The amendments made by that deed were in all material respects identical to those made in connection with the JCM EBT referred to at [22] and [23] above. Those amendments were expressed to take effect, retrospectively, on and with effect from the date of the Praze Trust Deed. On the same day, corresponding changes were made to the terms of the Hallwood Subtrust and the Kettleborough Subtrust (that were also expressed to take effect from the date of creation of those subtrusts).

HMRC's investigations into the tax treatment of payments to the Praze EBT

79. All of Praze's accounting periods relevant to this appeal are subject to the self-assessment regime for corporation tax. It was common ground at the hearing that HMRC had opened valid enquiries into all of these accounting periods.

80. I will not make any findings as to the conduct of HMRC's enquiries up until 2005 given that Mr Hackett made no criticism up until that point. After 2005 up until 2011, the course of HMRC's enquiries followed much the same path as outlined at [26] to [29] with the text of letters they exchanged being in all respects identical to those referred to in those paragraphs. By 31 July 2007, HMRC and Baxendale Walker had

reached agreement that enquiries would be placed into abeyance while a test case on the effect of the Deeds of Amendment and Rectification was pursued.

81. Between 13 December 2007 and 27 January 2011, HMRC sent letters similar to those outlined at [29] both to Baxendale Walker and to Praze.

82. In Praze's unaudited accounts for the year ended 31 May 2011, Praze included a note referring to the ongoing dispute with HMRC in the following terms:

> H M Revenue & Customs consider that the company is not entitle[d] to a deduction, for the purposes of calculating its profits for Corporation Tax, in respect of contributions to an Employee Benefit Trust in the 3 years to 31 May 2002 and are claiming £793,972 plus interest. In the opinion of the director, based on advice given by the company's legal advisors, no provision is necessary in these Accounts for any additional Corporation Tax liabilities.

83. On 2 October 2012, HMRC issued closure notices relating to all of the accounting periods relevant to this appeal and accompanied those closure notices with a letter setting out their "view of the matter". Praze appealed to HMRC against those closure notices and accepted HMRC's offer of a review. On 22 January 2013, HMRC notified Praze and Baxendale Walker of the outcome of their review and Praze appealed to the Tribunal.

84. I have accepted Dr Hallwood's evidence that, during the long course of this dispute with HMRC, some events have occurred which have made it difficult for Praze to pursue its appeal. In particular, Mr Kettleborough passed away in 2014 and, since he was deeply involved with events relating to the Praze EBT, Praze can no longer draw on his knowledge. In addition, Praze's accountant retired in 2015 and Praze has no means of contacting him for assistance in connection with the appeal.

ISSUE 1 – THE "PROCEDURAL ARGUMENT"

Overview of the argument and the parties' respective positions

85. Mr Hackett presented what was referred to at the hearing as the "procedural argument" namely that applying common law and equitable principles, HMRC were precluded from assessing the appellant companies for all or any of the following reasons:

(1) because HMRC's delay in making the assessments amounted to an "abuse of process";

(2) because HMRC's delay in making the assessments created a legitimate expectation that no assessment would be made; or

(3) in all the circumstances of the delay, HMRC are estopped from making the assessments.

86. Ms Nathan argued that the Tribunal does not have jurisdiction to consider these arguments and, even if it did, they should be dismissed.

Statutory provisions relevant to the procedural argument

87. It was common ground that the extent of the Tribunal's jurisdiction to deal with the procedural argument had to be determined by reference to the statutory provisions governing the appellants' appeal as the Tribunal is a creature of statute with no inherent jurisdiction.

88. Section 31 of the Taxes Management Act 1970 ("TMA 1970") applies to Alway's appeal which is in relation to an accounting period under the "pay and file" regime which preceded the currently applicable self-assessment regime. Section 31 provides taxpayers with a right of appeal (to HMRC) in the following terms:

> **31 Appeals: right of appeal**
>
> (1) An appeal may be brought against—
>
> …
>
> (d) any assessment to tax which is not a self-assessment

89. All other appeals are against amendments of tax returns that HMRC have made following the issue of "closure notices" under the provisions of paragraph 32 of Schedule 18 of Finance Act 1998 ("Schedule 18"). The relevant right of appeal against those determinations is set out in paragraph 34(3) of Schedule 18 which provides as follows:

> An appeal may be brought against any such amendment of a company's tax return.

90. The appeals referred to in [88] and [89] must initially be made to HMRC. Section 49D of TMA 1970 (which applies equally to appeals under s31 of TMA 1970 and appeals under paragraph 34(3) of Schedule 18 given the definition of "appeal" set out in s48(1)(a) of TMA 1970) provides for such appeals to be "notified" to the Tribunal and it was common ground that all appellants' appeals had been duly notified.

91. The Tribunal's powers on an appeal notified to it (both in relation to "pay and file" and "self-assessment" periods) are set out in s50 of TMA 1970 as follows:

> (6) If, on an appeal notified to the tribunal, the tribunal decides—
>
> …
>
> (c) that the appellant is overcharged by an assessment other than a self-assessment,
>
> the assessment or amounts shall be reduced accordingly, but otherwise the assessment or statement shall stand good.
>
> (7) If, on an appeal notified to the tribunal, the tribunal decides
>
> …
>
> (c) that the appellant is undercharged by an assessment other than a self-assessment,
>
> the assessment or amounts shall be increased accordingly.

Whether the Tribunal has jurisdiction to consider the procedural argument

92. Mr Hackett made eloquent submissions on the effect of a number of authorities on the extent of the Tribunal's jurisdiction including *Oxfam v Revenue and Customs Commissioners* [2010] EWHC 3078 (Ch), *Hok v Revenue and Customs Commissioners* [2012] UKUT 363 (TCC), *Foulser v Revenue and Customs Commissioners* [2013] UKUT 38 and *Noor v Revenue and Customs Commissioners* [2013] UKUT 071.

93. Mr Hackett submitted that there is a difference of judicial opinion on whether the Tribunal is able to take account of arguments based on public law. He submitted that *Oxfam* is authority for the proposition that the Tribunal can entertain public law arguments in appropriate circumstances. He acknowledged that later decisions of courts of co-ordinate jurisdiction (in *Hok* and *Noor*) could be read as reaching a different conclusion, although he submitted that, on a close reading, the points of difference were not as significant as might appear. He also acknowledged that the Court of Appeal in *BT Pension Scheme v Commissioners for HMRC* [2015] EWCA Civ had made apparently broad statements to the effect that the Tribunal has no power to consider matters of "legitimate expectation". However, he argued that read in context, the Court of Appeal was simply confirming that the Tribunal had no original jurisdiction to consider legitimate expectation and it remained possible for Parliament, in statutory provisions dealing with appeals, to confer such a jurisdiction on the Tribunal.

94. At the heart of Mr Hackett's submissions was the proposition that, notwithstanding the points made at [93], there is no impediment to the Tribunal considering questions of private law, and he submitted that *Noor* made this clear. Since he characterised the appellants' arguments as relating to matters of private law, he submitted that the Tribunal could consider them.

95. I believe that the relevant principles are set out in the decision of the Upper Tribunal in *Noor* which contains a detailed examination of both *Oxfam* and *Hok*. The Upper Tribunal's conclusion is set out in paragraph 87 of the decision as follows:

> In our view, the FTT does not have jurisdiction to give effect to any legitimate expectation which Mr Noor may be able to establish in relation to any credit for input tax. We are of the view that Mr Mantle is correct in his submission that the right of appeal given by s 83(1)(c) is an appeal in respect of a person's right to credit for input tax under the VAT legislation. Within the rubric 'VAT legislation' it may be right to include any provision which, directly or indirectly, has an impact on the amount of credit due but we do not need to decide the point. Thus, if HMRC have power (whether as part of their care and management powers or some other statutory power) to enter into an agreement with a taxpayer and that agreement, according to its terms, results in an entitlement to a different amount of credit for input tax than would have resulted in the absence of the agreement, the amount ascertained in accordance with the agreement may be one arising 'under the VAT legislation' as we are using that phrase. In contrast, a person may claim a right based on legitimate expectation which goes behind his

> entitlement ascertained in accordance with the VAT legislation (in that sense); in such a case, the legitimate expectation is a matter for remedy by judicial review in the Administrative Court; the FTT has no jurisdiction to determine the disputed issue in the context of an appeal under s 83.

96. That paragraph demonstrates that the Upper Tribunal took the following approach:

(1) Its task was to construe the statutory provision dealing with the taxpayer's right of appeal which, in that case, was s83(1)(c) of the Value Added Tax Act 1994.

(2) Having considered the intention of Parliament and having, at [77] and elsewhere of the decision, considered the statutory regime establishing the Tribunal and the fact that the Tribunal has no judicial review function, it reached the conclusion that Parliament only intended the Tribunal, on an appeal under s83(1)(c), to consider a person's right to credit under the VAT legislation.

(3) If HMRC entered into an *intra vires* contract with a taxpayer setting out the amount of input tax credit that is due, the terms of that contract may be within the Tribunal's jurisdiction. The reason is that, by entering into the contract, HMRC would be exercising its statutory powers in accordance with VAT legislation with the result that the terms of that contract may involve a person's right to credit under VAT legislation. However, the Upper Tribunal made no conclusive decision on this point.

97. Having considered the statutory provisions dealing with the rights of appeal, I have concluded that the Tribunal has no jurisdiction to consider the arguments that Mr Hackett is advancing as to estoppel and legitimate expectation. There is no material difference between the right of appeal set out in s31 of TMA 1970 (or paragraph 34(3) of Schedule 18) and that set out in s83(1)(c) of the Value Added Tax Act 1994. All the statutory provisions confer a right of appeal against specified HMRC decisions and none makes any reference to matters other than the statutory provisions dealing with the taxes concerned. If Parliament did not intend s83(1)(c) to give the Tribunal jurisdiction to consider matters other than a person's right to credit under VAT legislation, I see no reason why Parliament could have intended it to consider, on an appeal under s31 of TMA 1970 or paragraph 34(3) of Schedule 18, questions of estoppel and legitimate expectation which go beyond the relevant statutory provisions. If anything, the provisions of s50(6) and s50(7) of TMA 1970 make this even clearer in the context of this appeal than it was in the VAT appeal being considered in *Noor,* as those sections emphasise that the Tribunal's focus should be on the amount of the assessments being made and leave no room for a consideration of whether considerations of legitimate expectation or estoppel prevent HMRC from making the assessments.

98. In his oral submissions, Mr Hackett submitted that the Tribunal had a general power to supervise HMRC's discretions, including the decision on whether or not to issue an assessment. He relied, in this respect on the following passage from *Noor*.

> The FTT has no general supervisory jurisdiction over the decisions of HMRC. That does not mean that under s 83(1)(c) the FTT cannot

> examine the exercise of a discretion, given to HMRC under primary or subordinate VAT legislation relating to the entitlement to input tax credit, and adjudicate on whether the discretion had been exercised reasonably (see eg *Best Buys Supplies Ltd v Customs and Excise Comrs* [2011] UKUT 497 (TCC) at [48]–[53], [2012] STC 885 at [48]–[53]—a discretion under reg 29(2) of the VAT Regulations). Although that jurisdiction can be described as supervisory, it relates to the exercise of a discretion which the legislation clearly confers on HMRC. That is to be contrasted with the case of an *ultra vires* contract or a claim based on legitimate expectation where HMRC are acting altogether outside their powers.

99. I do not agree with Mr Hackett's interpretation of this passage. As I understand it, the passage is simply stating that, in certain contexts, HMRC are given a statutory discretion on a particular matter. For example, under Regulation 29(2) of the Value Added Tax Regulations, they have a discretion to accept evidence that input tax has been incurred in a form other than a VAT invoice. If HMRC refuse to exercise their statutory discretion in a particular case, a taxpayer can appeal (under s83(1)(c) of the Value Added Tax Act 1994 since that matter relates to input tax recovery) in which case the Tribunal must determine whether HMRC exercised their discretion correctly. That is very different from saying that the Tribunal has a general jurisdiction to police HMRC's discretion as to whether or not to issue an assessment. Moreover, Mr Hackett's argument is also at odds with the statement of Nicholls LJ in *Aspin v Estill* [1987] STC 723 where he said:

> The taxpayer is saying that an assessment ought not to have been made. But in saying that, he is not, under this head of complaint, saying that in this case there do not exist in relation to him all the facts which are prescribed by the legislation as facts which give rise to a liability to tax. What he is saying is that, because of some further facts, it would be oppressive to enforce that liability. In my view that is a matter in respect of which, if the facts are as alleged by the taxpayer, the remedy provided is by way of judicial review.

100. Nor do I agree with the general distinction that Mr Hackett sought to draw between "public law" and "private law" arguments. I accept, following *Noor*, that if the appellants were arguing that HMRC had entered into an *intra vires* contract not to assess the appellants (or to assess them only for a particular sum), the Tribunal may have jurisdiction to consider whether HMRC's assessments complied with the terms of that contract. However, that does not mean that every argument that can be labelled a "private law" argument is within the scope of the Tribunal's jurisdiction.

101. Mr Hackett's argument relating to "abuse of process" is somewhat different. In the course of his oral submissions he clarified that he was not asking the Tribunal, in determining the appellants' appeals under s31 TMA 1970 or paragraph 34(3) of Schedule 18, to discharge the assessments on the grounds of excessive delay in making them. Rather, he was asking the Tribunal to exercise its case management powers to make appropriate directions (which may include barring HMRC from resisting the appeal) on the grounds that HMRC's delay in making the assessments means that the Tribunal will not be able to deal with the appeal fairly and justly. I

agree with Mr Hackett that the decision of the Upper Tribunal in *Foulser v HMRC* [2013] UKUT 038 means that I have jurisdiction to consider whether it is possible to deal with this appeal fairly and justly and, if I cannot, to make appropriate directions.

Analysis of particular aspects of the procedural argument

Legitimate expectation and estoppel

102. I have concluded that I have no jurisdiction to consider these aspects of the procedural argument. Even if I had jurisdiction, I would not have accepted Mr Hackett's submissions.

103. Central to Mr Hackett's argument on "legitimate expectation" was his submission that, given the prolonged period during which HMRC took no substantive step to pursue its demands for tax, the Appellants formed the view that the challenge to the EBT was over. This submission is simply not borne out by the evidence. All three appellants agreed with HMRC that enquiries would be put in abeyance while a lead case relating to the efficacy of the retrospective amendments in their Deeds of Amendment and Rectification was pursued. While those enquiries were in abeyance, they all received letters reminding them that the dispute remained on foot and that interest on the amount HMRC considered to be due was continuing to accumulate. Having received those letters, none of the three appellants could have had any expectation, legitimate or otherwise, that their dispute with HMRC was over. Moreover, JCM and Praze acknowledged the existence of the dispute, and its potential consequences, in their accounts.

104. In order to succeed with any argument based on estoppel, Mr Hackett would need to show (in addition to a number of other matters) that the appellants had progressed their business affairs on the basis that that HMRC considered the matter closed. The chain of correspondence between all three appellants and HMRC, and the notes to JCM's and Praze's accounts, show that this cannot have been the case.

Abuse of process

105. As I have noted, I consider that I do have jurisdiction to consider this argument. It amounts to an invitation that, if I consider HMRC's delay means this appeal cannot be dealt with fairly and justly, I should use my case management powers to make appropriate directions (which may include barring HMRC from defending the appeal). I will not, however, make any such directions.

106. The Tribunal has case management powers to regulate the conduct of litigation that is before it. Yet Mr Hackett is not making any complaint as to how HMRC have conducted the litigation from the point at which the appellants notified their appeals to the Tribunal. He is, therefore asking the Tribunal to punish HMRC for what the appellants consider to be unacceptable delay before Tribunal proceedings were commenced. I do not consider that would be a proper exercise of case management powers. The authorities that Mr Hackett showed me dealt primarily with delay after proceedings were commenced and, although *Foulser* was not focused on questions of

delay, it dealt with a situation where HMRC were argued to have taken certain prejudicial actions while proceedings before the Tribunal were current.

107. In any event, I do not accept Mr Hackett's submissions that HMRC were guilty of inordinate delay before Tribunal proceedings commenced. Mr Hackett made no criticism of HMRC up until 2005. Between late 2005 and July 2007 the parties were engaged in discussions on the appellants' arguments as to the retrospectivity of the Deeds of Amendment and Rectification. This was quite a lengthy period of time, but the appellants were advancing a novel proposition and I certainly do not think this delay was even approaching unreasonable. Delays between July 2007 and 2011 or so arose as a result of all relevant parties agreeing that enquiries would be placed in abeyance pending the outcome of a "test case". The appellants can scarcely complain of delay occasioned by an arrangement which they initiated and agreed to. I do not know precisely when it became clear that the "test case" was not going ahead. I therefore do not know whether matters were progressed speedily after that point. However, by 2011 the vast majority of the delay had passed. HMRC took final steps to determine the tax liabilities of Alway and Praze in 2012. JCM had to wait until 2014 to receive a closure notice and it was not clear to me why that was the case. However, I was not satisfied that this period of delay justified the sanction of barring HMRC from defending the appeal.

108. None of the appellants pointed to any positive steps that they took to progress matters. Praze and JCM were within the corporation tax self-assessment regime and could have applied, under paragraph 33 of Schedule 18, for HMRC to end their enquiries and issue a closure notice within a specified period, but Mr Hackett accepted that they had not done so. From that I have drawn the inference that Praze and JCM were content with the ongoing delay, although they may subsequently have come to regret that decision.

109. In the circumstances, I see no reason to exercise case management powers to bar HMRC from defending the appeal.

ISSUE 2 – THE AMOUNT OF THE ASSESSMENT ON ALWAY

Overview of the issue

110. As noted at [52], the relevant assessment on Alway was made under the "pay and file" regime for corporation tax, rather than the "self-assessment" regime that prevails currently. That assessment was made on 6 September 1999 in an amount of £2,100. HMRC are arguing that the assessment should be increased to £126,492.21, the amount that they calculate as Alway's additional corporation tax liability for the relevant accounting period on the basis that contributions to the Alway EBT were not deductible. Mr Hackett made the following arguments as to why Alway should not be liable for the higher figure:

(1) When they issued the assessment, HMRC could not have been intending to disallow a deduction for contributions made to the EBT as otherwise, they would not have assessed only £2,100. Therefore, the "philosophy" underpinning

the assessment could not have related to the EBT and, accordingly, the assessment could not form a basis for disallowing contributions to the EBT.

(2) If they were seeking to disallow deductions to the EBT, they made no serious or reasonable attempt to determine the additional tax that would be due as a result. Therefore, even if it could take effect as denying a deduction for contributions made to the EBT, the assessment was not made to the best judgment of the assessing officer.

(3) While Mr Hackett accepted that the assessment for £2,100 was made within the statutory time limit, HMRC are out of time to assess the higher figure they were asking for at the hearing.

111. Ms Nathan submitted that, even though there was no witness statement from the assessing officer, I should infer from the relevant correspondence that the assessment was made to "best judgment" at a time when there was genuine uncertainty as to whether contributions to the Alway EBT were deductible. There was, therefore, a valid, in-time assessment against Alway (albeit an assessment for only £2,100) and the Tribunal should exercise its power under s50(7) of TMA 1970 to increase that assessment.

Relevant legal principles

112. The assessment relevant to Issue 2 was made under s29 of TMA 1970 as it had effect for "pay and file" accounting periods of companies. As in force the time this assessment was made, s29 provided, so far as relevant, as follows:

> **29 Assessing procedure**
>
> (1) Except as otherwise provided, all assessments to tax shall be made by an inspector, and—
>
> (a) if the inspector is satisfied that any return under the Taxes Acts affords correct and complete information concerning profits in respect of which tax is chargeable, he shall make an assessment accordingly,
>
> (b) if it appears to the inspector that there are any profits in respect of which tax is chargeable and which have not been included in a return under Part II of this Act, or if the inspector is dissatisfied with any return under Part II of this Act, he may make an assessment to tax to the best of his judgment.
>
> (c) where income tax is charged for a year of assessment in respect of income arising in that year, the inspector may make an assessment during that year to the best of his judgment, by reference to actual income or estimated income (whether from any particular source or generally), or partly by reference to one and partly by reference to the other.
>
> (1A) Where an assessment is made by virtue of subsection (1)(c) above, any necessary adjustments shall be made after the end of the year (whether by way of assessment, repayment of tax or otherwise) to secure that tax is charged in respect of income actually arising in the year.

113.As noted at [91], the legislative basis for the Tribunal's power to increase an assessment is found in s50(7) of TMA 1970. In *Glaxo Group Ltd and others v Inland Revenue Commissioners* [1996] STC 191, Millett LJ described that power in the following terms:

> Section 50(7) of the Taxes Management Act 1970, however, preserved the right, and as it seems to me the duty, of the commissioners to increase the assessment on the hearing of the taxpayer's appeal if the evidence shows this to be appropriate.

114.I therefore consider that the Tribunal has the power, and indeed the duty, to increase an assessment if satisfied that the amount assessed is an undercharge. Ms Nathan submitted that, in such a case, the taxpayer still bore the burden of proving the correct amount of the assessment due. Mr Hackett submitted that, where HMRC were relying on s50(7), HMRC had the burden of proof by applying the general principle that a person asserting a particular fact generally had the burden of proving it. However, neither Mr Hackett nor Ms Nathan was able to refer to any authority in support of their respective propositions.

115.I have concluded that the statutory words of s50(7) suggest that, before I can increase the assessment, I must be satisfied on a balance of probabilities that the taxpayer is undercharged and that, as Mr Hackett submits, HMRC bear the burden of proof. Some support for that proposition is found in the following extract from the decision of the High Court in *Duchy Maternity Ltd v Hodgson (Inspector of Taxes)* [1985] STC 764 in which Walton J considered whether HMRC are entitled to make a further assessment in circumstances in which they considered an earlier assessment was insufficient:

> There is no tie-up that I can necessarily see between s 29 and s 50. Indeed, from a purely practical point of view one can see great advantages in the Revenue, albeit after an appeal has been lodged, putting in an additional notice of assessment which brings the figure on which they will rely bang up to date; and it also has the important advantage from the Crown's point of view that where an assessment has been put in the onus is shifted to the taxpayer, if he is appealing against an assessment, to prove, show and demonstrate that it is wrong.

116. The power to issue assessments to the best of an officer's judgment was considered (albeit in a VAT context, rather than in the context of assessments made under s29 of TMA 1970) by the Court of Appeal in *Pegasus Birds Limited v Commissioners of HM Customs and Excise* [2004] EWCA Civ 1015. I have concluded from that decision, that it by no means automatically follows that, if an assessment is not issued to the best of an officer's judgment, the entire assessment should be set aside. That can be seen from the following extracts of the judgment of Carnwath LJ (as he then was):

> 28.Where, however, the complaint in substance is not against the assessment as such, but is that the amount has not been arrived at by "best of their judgment", I see nothing in the statute or in principle which requires the whole assessment to be set aside. Clearly much will depend on the nature of the breach…

> 29.In my view, the Tribunal, faced with a "best of their judgment" challenge, should not automatically treat it as an appeal against the assessment as such, rather than against the amount. Even if the process of assessment is found defective in some respect applying the *Rahman (2)* test, the question remains whether the defect is so serious or fundamental that justice requires the whole assessment to be set aside, or whether justice can be done simply by correcting the amount to what the Tribunal finds to be a fair figure on the evidence before it. In the latter case, the Tribunal is not required to treat the assessment as a nullity, but should amend it accordingly.

Discussion and conclusion

117. Mr Hackett's arguments summarised at [110(1)] and [110(3)] can be dismissed briefly. The Tribunal is not concerned to identify the "philosophy" underpinning the assessment against Alway. Rather, s50(6) and s50(7) TMA 1970 make it clear that the primary focus is on the amount of the assessment. Moreover, by giving the Tribunal the express power (and duty) to increase assessments where a taxpayer is undercharged, Parliament has made it clear that, in order for an assessment to be valid, it need not specify all the tax that HMRC consider, at the hearing, to be due. Therefore, HMRC have not, as Mr Hackett submitted, made an out of time assessment for £126,492.21. They have made an in-time assessment for £2,100 and are asking the Tribunal to increase this assessment, under s50(7) of TMA 1970, to £126, 492.21.

118. I am satisfied, based on the limited evidence that I have seen, that HMRC's assessment for £2,100 was made to the best of the assessing officer's judgment. The correspondence referred to at [53] and [54] suggests that HMRC had asked questions about the EBT, but those questions had not been answered. HMRC therefore had no information on which they could determine, one way or the other, whether payments to the Alway EBT were deductible or not. The assessing officer could not have been criticised if he or she had chosen to wait for answers to the questions before issuing the assessment. However, s29 of TMA 1970 gave the officer power to make an assessment based on the limited information available, and, having exercised that power, in the light of that limited information, I consider the assessment was to best judgment.

119.However, even if I had not reached the conclusion at [118], I would not have set aside the assessment in its entirety. *Pegasus Birds* emphasises that the Tribunal's focus should be on determining the correct amount of the taxpayer's liability to tax (and not on separate questions as to whether the assessing officer met some objective standard of "best judgment" when issuing assessments). The presence of s50(7), giving the Tribunal power to increase that assessment, only serves to reinforce that conclusion. I do consider, however, that HMRC bear the burden of proving that the assessment should be increased under s50(7).

ISSUE 3 – WHETHER PAYMENTS WERE INCURRED WHOLLY AND EXCLUSIVELY FOR THE PURPOSES OF THE APPELLANTS' TRADES

Relevant legal principles

120. Section 74 of ICTA as in force at times material to this appeal provided as follows:

> **74 General rules as to deductions not allowable**
>
> (1) Subject to the provisions of the Tax Acts, in computing the amount of the profits[4] to be charged under Case I or Case II of Schedule D, no sum shall be deducted in respect of -
>
> (a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession or vocation…

121. The parties were therefore agreed that, if the amounts that the three appellants paid to the EBTs were not expended wholly and exclusively for the purposes of their respective trades, those amounts would not be deductible for corporation tax purposes.

122. Both parties referred to the decision of the Upper Tribunal in *Scotts Atlantic Management Ltd and another v Revenue and Customs Commissioners* [2015] UKTUT 66 (TCC) as authority for the principles that I should apply when deciding whether the sums were expended wholly and exclusively for the purposes of the companies' trades or professions. From that authority (and the authorities referred to in it), I have concluded that the relevant principles are as follows:

(1) If expenditure is incurred partly for a purpose other than that of a trade or profession, it will not be incurred "exclusively" for the purposes of the trade or profession and so will not be deductible.

(2) The "wholly and exclusively" issue must be determined by reference to the object of the taxpayer in incurring the expenses. In order to determine the taxpayer's object, the Tribunal must "look into the taxpayer's mind at the moment the expenditure is made" (in the words of Lord Brightman in *Malalieu v Drummond* [1983] AC 861).

(3) What must be determined is the object of the taxpayer in making the payment. This is not the same as considering the effect of the payment. A payment can, therefore, be incurred wholly and exclusively for the purposes of a taxpayer's trade even if the effect of the payment is to secure a private advantage, whether for the taxpayer or someone else (*Vodafone Cellular v Shaw* [1997] STC 734).

(4) Where a payment is part of a wider set of arrangements, the relevant question is still the object of the payment (and not the purpose of the wider

[4] The version of s74 in force from 19 March 1997 to 30 July 1998 referred to "profits or gains" (and not merely "profits"). However, neither party suggested that this had any significance for this appeal and therefore, I reproduce the wording in force from 1 July 1999 to 31 March 2004.

arrangements). However, the Tribunal may consider, as part of its fact-finding exercise, that the existence of the wider arrangements was relevant to the taxpayer's object in making the payments at issue (*Scotts Atlantic*).

(5) A taxpayer is perfectly entitled to order its affairs in a way which incurs the least tax liability. Therefore, the mere fact that a choice is influenced or dictated by tax consequences does not of itself mean that a taxpayer has a duality of purpose in incurring the expense. (*Scotts Atlantic*).

(6) The mere fact that a company pays a sum as remuneration to its directors does not compel the conclusion that the payment is wholly and exclusively for the purposes of its trade. (*Copeman (Inspector of Taxes) v William Flood & Sons Limited* 24 TC 53).

123. Mr Howard in his oral submissions argued that it is now clear, following the decision of the Court of Session in *Murray Group Holdings Limited v HMRC* [2016] STC 468, that payments that the companies made to the EBTs were "emoluments" for tax purposes. That point is dealt with as Issue 5, but Mr Howard submitted it was relevant to Issue 3 as well as if the payments the appellants made were emoluments they should be deductible on the same basis as ordinary emoluments are deductible. Given that the Tribunal's task is to "look into the taxpayer's mind at the moment the expenditure is made", I do not consider that the actual decision in *Murray Group Holdings Limited* has any bearing on the companies' object in making the payments (since that decision was made several years after most of the payments were made). Moreover, *Copeman v Flood* demonstrates that deductibility is not determined by whether payments are labelled as remuneration or not: what matters is a company's object in making the payment. However, I accept that the companies' understanding of relevant tax law at the time they made the payments could be relevant to the question of whether the payments were made "wholly and exclusively" for the purposes of their trades.

124. In a similar vein, Ms Nathan argued that, if the appellants were correct in their arguments on Issue 4 (so that the Deeds of Amendment and Rectification took effect retrospectively), employees of the appellants were never beneficiaries of the EBTs and so the appellants could not have made payments to the EBTs with the object of providing remuneration to their employees. I do not accept that argument either. The relevant consideration is what was actually in the mind of the directors at the time the appellants made the payments. It follows that I consider Issue 3 can be determined separately from Issue 4 and Issue 5.

The payments made by JCM

Determination of JCM's object in making the payments

125. The direct evidence as to JCM's object in making the payments to the JCM EBT was quite scanty and in places contradictory. Even though he was one of two directors of JCM who took part in board meetings to approve the payments, Mr McCahill said little, if anything, in his witness statement as to why those payments were made. He emphasised repeatedly in his oral evidence that he had little recollection of, or

involvement in, the decision to establish the EBT. When asked directly in cross-examination why JCM decided to make its second contribution to the EBT he could only say that it seemed sensible at the time.

126. Despite his hazy recollection of the details of the JCM EBT, Mr McCahill did say in other parts of his oral evidence that JCM's object in making payments to the JCM EBT was to incentivise staff so that they would have a feeling of security and would enjoy their job with the result that they would generate new ideas that were needed in the oil and gas industry at the time. However, I am not satisfied that this can provide the rationale, or the whole rationale, for the payments. As noted at [10], at times material to this appeal, JCM had only four employees, two of whom were Mr McCahill and his wife. If the object of the payments to the JCM was to incentivise employees generally it might be expected that JCM would ask the JCM Trustee to provide incentives to employees generally. The findings in Appendix Two demonstrate that JCM contributed over £2m to the JCM EBT and yet only asked the JCM Trustee to distribute £30,000 outright to employees and all of that amount went to Mr Cosford.

127. Mr Howard sought to persuade me that one can draw a distinction between "incentivising" employees and "rewarding" them. He argued that, even if they were not receiving substantial payments from the JCM EBT, employees knew that funds were available that could (if the JCM Trustee saw fit) be applied for their benefit, or the benefit of their families. This, he argued, promoted employee loyalty. I had little, if any evidence, as to the effect of the JCM EBT on employee loyalty. However, as noted at [122(3)], what needs to be determined is JCM's object in making the payments (and not the effect of the payment). I do not accept that its object in making such large payments was to obtain a nebulous benefit consisting of a general sense of employee wellbeing which might serve to make employees more loyal. That is particularly the case since, Mr and Mrs McCahill, as founders of JCM could be presumed to be adequately incentivised already and therefore, on Mr Howard's formulation, JCM was making payments of over £2m to incentivise one engineer and one secretary. For this reason, and that set out at [126], I have concluded that JCM's object in making the payments was not simply to incentivise employees of JCM generally.

128. In his oral submissions, Mr Howard invited me to conclude from the evidence that the statements as to the incentivisation of employees generally were, in effect, sales patter that Baxendale Walker had provided and that, while JCM believed that sales patter, the true object in making payments to the JCM EBT was to remunerate Mr McCahill specifically. He submitted that neither JCM nor Mr McCahill was aware of the precise terms of the JCM EBT. He therefore suggested that JCM must have thought, when it was paying sums to the JCM EBT, that it was paying money that would be available for Mr McCahill's sole benefit and that, accordingly, its object in making the payment was simply to remunerate Mr McCahill. However, as I have found, JCM was aware when it made its contributions to the JCM EBT that Mr McCahill was not a beneficiary of that trust. If JCM's object was simply to reward Mr McCahill, it would not have made payments to a trust of which he was not a beneficiary as there were other much more straightforward ways of putting money in

Mr McCahill's hands. That suggests that there was at the very least some other additional purpose of making contributions to the JCM EBT.

129. In most, if not all, of the board minutes of JCM resolving to make further payments to the JCM EBT, the following statement appears:

> The Chairman noted that the establishment of the Scheme and past bonus receipts from it appeared to be promoting employee loyalty to the Company and that the trade of the Company is thereby being benefited.

That wording tends to suggest that the object of the payments was to incentivise employees generally. Yet, as I have concluded at [126] and [127] this was not JCM's object. It therefore follows that the board minutes of JCM have been drafted so as to put forward a misleading impression of JCM's true object in making payments. Mr Howard sought to gloss over the board minutes by arguing that they were standard-form board minutes prepared by Baxendale Walker. However, even if Baxendale Walker prepared draft minutes in advance (which is perfectly proper) by adopting and signing those minutes, the directors of JCM adopted those draft minutes as their own. It must follow that there was some reason why they did not want JCM's true object in making the payments to be stated clearly and unambiguously.

130. I therefore consider that JCM's object cannot simply be determined by reference to contemporaneous board minutes or Mr McCahill's oral evidence at the hearing and instead a wider examination of relevant factors is needed. My overall conclusion is that JCM's objects in making payments to the JCM EBT were (i) to provide the JCM EBT with funds that could be put at the disposal of Mr McCahill in such a way as to defer (perhaps indefinitely) the PAYE and NIC costs that would arise on a "straightforward" payment of a cash bonus while, at the same time obtaining a corporation tax deduction for the payment and (ii) to provide the JCM EBT with a small fund from which (small) outright payments could be made to Mr Cosford. My reasons for that conclusion are as follows:

(1) I have already explained at [126] and [127] why JCM's object was not simply to reward or incentivise employees generally. I have explained at [128] why its object was not simply to reward or incentivise Mr McCahill specifically. I accept that it had <u>some</u> object of incentivising employees (as it did ask the JCM to make relatively modest payments to Mr Cosford). I also accept that it had <u>some</u> object of placing funds at Mr McCahill's disposal (as it would have been aware from advice from Baxendale Walker that, while Mr McCahill was not a beneficiary of the JCM EBT, he could obtain loans from it). Therefore, the task is to identify JCM's other objects in making the payments.

(2) Those additional objects can only be explained by reference to the tax consequences that were thought to flow from making the payments namely that the payments were deductible and there was the possibility of deferring (perhaps indefinitely) PAYE and NIC on funds placed at Mr McCahill's disposal. No other explanation has been put forward as to why JCM would adopt such a convoluted arrangement that necessitated the formation of an offshore trust and

the obtaining of advice from specialist tax advisers. Those consequences must have been explained in the tax advice referred to at [17] as they were the predominant tax consequences that would flow from making payments to the JCM EBT.

(3) I recognise that my task is to determine JCM's object in making payments to the JCM EBT (and not to discern the purpose of the wider arrangements that were implemented). Mr Howard argued that JCM could not have had an object of securing PAYE efficiency as that result flowed from the terms of the JCM EBT (and the JCM Trustee's practice of making loans to Mr McCahill) rather than from JCM's payments to the JCM EBT. I have not accepted that argument. When JCM made its payments to the JCM EBT it knew that the payments would be held on the terms of that trust. Moreover, having received tax advice from Baxendale Walker, it would have known that deferral of PAYE and NIC was possible. The JCM EBT would not exist without payments by JCM and without those payments, there could be no conceivable PAYE or NIC benefit. In those circumstances, I see no reason why an examination of JCM's object in making the payments should ignore tax consequences that were thought to flow as a direct result of making the payments.

(4) I also recognise that my task is to determine the object and not the effect of the payments that JCM made. However, I do not consider that the tax results I have identified were merely effects of the payments. While JCM could perhaps (and subject to the points I make at [133] below), have obtained a corporation tax deduction for a "straightforward" bonus that it paid to Mr McCahill, such a bonus would have been fully subject to PAYE and NIC. If JCM had sufficient distributable reserves, it could have paid a dividend to Mr McCahill. That might well not have been subject to PAYE and NIC (and Mr McCahill would have a reduced tax obligation on such a dividend because of the tax credit attaching to it). However, payment of a dividend would not be tax deductible for corporation tax purposes. JCM, therefore, was seeking to obtain the best of both worlds: the same tax deduction that would attach to a payment of a bonus, but without the immediate PAYE and NIC liability that attach to a straightforward payment of salary or bonus. That was not a result that flowed straightforwardly. To achieve that result (as it thought), it needed to adopt a convoluted method of rewarding Mr McCahill and take tax advice from Baxendale Walker. In those circumstances, I consider that the tax result ceased to be a mere "effect" of the payments and became an object in making them.

Overall conclusion on deductibility

131. JCM's objects in making the payments included the obtaining of a corporation tax deduction and the obtaining of a PAYE and NIC benefit. I am not satisfied on the evidence in front of me that incurring expenditure with those objects was wholly and exclusively for the benefit of JCM's trade. Indeed, Mr Howard made no detailed submissions as to why such objects were for the purposes of its trade and concentrated his efforts in seeking to persuade me that they were no part of JCM's objects.

132. More specifically, any PAYE advantage that arose would be for Mr McCahill's benefit (as he would have access to cash that had not been reduced by the payment of tax under the PAYE regime). JCM has not explained why obtaining a tax benefit for Mr McCahill benefited the conduct of its trade. In making this point, I am not purporting to make a general statement to the effect that providing tax benefits to employees can never be wholly and exclusively for the purposes of a company's trade. For example, if a company can demonstrate that an employee would be prepared to work for a lower salary if that salary could be paid tax-free, it is conceivable that the company could establish that its object in making a tax-free payment was wholly and exclusively for the purposes of its trade. However, JCM has not put forward any convincing reason why, in the circumstances of this appeal, the object of securing a tax benefit for Mr McCahill was wholly and exclusively for the benefit of JCM's trade. A similar point can be made of the object of securing a corporation tax deduction. While, of course, it was financially desirable for JCM to obtain such a deduction, I have not been able to conclude that the object of obtaining such a deduction was for the purposes of its trade specifically.

133. Even if I had accepted Mr Howard's submissions that JCM's object was solely to place funds at Mr McCahill's disposal, I would not have been satisfied that the payments to the JCM EBT were deductible. Mr Howard's argument proceeded on the basis that, if he could establish that the payments by JCM were emoluments paid in order to reward Mr McCahill, it would automatically follow that they are deductible for corporation tax purposes. He suggested that there was a presumption that sums paid to employees were deductible and that particular special circumstances would be needed to displace this presumption. I have not, however, accepted these submissions as I believe that *Copeman v Flood* makes it clear that there is no such presumption. In any case where a company makes a payment to an employee, in order to obtain a deduction for that payment, it must establish that the payment is "wholly and exclusively" for the purposes of the trade. Of course in many situations, it will be straightforward to establish this: for example, if an ordinary employee is paid an ordinary arm's length salary for his or her services, the company will generally find it easy to establish that the salary was paid to secure those services and was a cost of carrying on the trade. That may be so straightforward to demonstrate that HMRC (or a Tribunal) may take it as read. However, that is not the same thing as a presumption.

134. In the circumstances of this case, JCM paid over £2m to the JCM EBT. No doubt Mr McCahill could expect a sizeable salary and bonus given the central and senior role he had at JCM. However, JCM has not explained why such a significant amount was an expense of the trade even if it was all paid with the object of rewarding Mr McCahill. It seems to me likely that a large part of the £2m payment was not an expense that JCM incurred in order to earn the profits of its trade, but rather was a payment to Mr McCahill (in his capacity as shareholder) of profit that the trade had generated. If JCM had wished to demonstrate otherwise, it would have needed to put forward more evidence as to Mr McCahill's total salary and bonus package over the years in dispute and demonstrate why, in the light of that evidence, the £2m payment represented compensation for Mr McCahill's duties as a director. It would also have needed to give more detail as so the ownership of the share capital of JCM (including details of the "Kintara" trust) so that the Tribunal could consider the expectations that

Mr McCahill would have had as to distributions of profit and compare them with his expectations as to salary and bonus. However, JCM has not sought to do this (no doubt because it considered that any payment that is labelled as "remuneration" to Mr McCahill would necessarily be deductible).

135. For all of the above reasons, I am not satisfied that payments that JCM made to the JCM EBT were wholly and exclusively for the purposes of its trade. In her submissions, Ms Nathan suggested that HMRC did not have any objection to JCM obtaining a deduction for the amount that the JCM Trustee actually used to fund outright bonuses to employees. A deduction is, therefore, available for £30,000 in aggregate of the contributions. I will leave HMRC and JCM to seek to agree the accounting periods in which those deductions should be given.

The payments made by Alway

Determination of Alway's objects

136. Whether the payments made by Alway to the Alway EBT were deductible or not depends on the specific circumstances surrounding those payments. I have therefore considered this question separately from the similar question that arises in relation to Praze and JCM. However, while I have considered the question separately, parts of my reasoning draw on principles that I have applied in relation to the other appellants and, therefore, I will set out my reasoning more briefly drawing, where relevant, on those other principles.

137. Neither Mr Mee nor Mr Locke said much, in their witness statements, about the objects of Alway in making contributions to the Alway EBT. I have therefore approached this question by considering their oral evidence and the documentary evidence within the hearing bundles.

138. I was shown a document dated 19 June 2000 signed by Mr Mee and Mr Locke that purported, among other matters, to document the reasons why Alway established the Alway EBT. That document included the following paragraphs:

> The Company established the Benefits Trust in a good year when the Company could afford to put some money into a separate fund for the future good of the staff and the business…
>
> The contributions made by the Company represented an irrevocable commitment to the present and future well being of the workforce and the business, because they are one and the same thing.

139. Both Mr Mee and Mr Larke referred to their belief that the Alway EBT incentivised employees of Alway in their oral witness evidence. Moreover, the minutes of board meeting on 12 May 1998 at which Alway determined to make contributions to the Alway EBT contained a statement to the effect that the Alway EBT "ought to promote employee loyalty". Subsequent board minutes approving further payments to the Alway EBT contained identical statements to those summarised at [129] suggesting that the establishment of the Alway EBT was having an effect on employee loyalty.

140. I have not, however, accepted that the object of Alway in making payments to the Alway EBT was to incentivise employees generally, or to promote the loyalty of employees generally. For reasons that I have outlined in more detail in the context of the payments by JCM, the difference between the contributions that Alway made (totalling some £490,000) and the amounts that Alway requested the trustee to distribute to employees (£7,620) was simply too large for this to be credible. I do not accept that its object in making large payments totalling £490,000 was to obtain a nebulous benefit in the form of possible increased employee loyalty consequent on employees' knowledge that sums held within the Alway EBT might be applied for their benefit or the benefit of their families. In addition, Alway would have known at the time it made each contribution to the Alway EBT that 90% of the amount it paid would be held on the terms of the Alway Subtrusts with the result that those funds could only benefit certain relatives and descendants of Mr Mee and Mr Larke (and then only after Mr Mee's and Mr Larke's deaths). Therefore, 90% of the amounts it paid to the Alway EBT could not, on any view, have incentivised employees generally. I do not, therefore, accept that the statements of Alway's object set out at [138] and [139] are accurate.

141. Nor, for reasons similar to those outlined at [130], do I consider that Alway's object in making payments to the Alway EBT was simply to remunerate or incentivise Mr Mee or Mr Larke specifically. If that were its object, it would not have made payments to a trust of which both Mr Mee and Mr Larke were prevented from benefiting and would have adopted a much more straightforward method of remunerating or incentivising them. Rather, for reasons similar to those applicable to JCM, I consider that Alway's object was more complicated than this and was similar to that of JCM. That object was (i) to provide the Alway EBT with funds that could be put at the disposal of Mr Mee and Mr Larke in such a way as to defer (perhaps indefinitely) the PAYE and NIC costs that would arise on a "straightforward" payment of a cash bonus while at the same time obtaining a corporation tax deduction for the payment and (ii) to provide the Alway EBT with a fund from which (small) outright payments could be made to Alway's other employees.

The deductibility of the payments made by Alway

142. I have concluded that HMRC have the burden of proving that the assessment made on Alway should be increased. I therefore need to consider whether HMRC have satisfied me that the payments Alway made to the Alway EBT are not deductible.

143. As with the payments that JCM made, I have concluded that Alway's objects included obtaining a corporation tax deduction and a PAYE and NIC benefit. Those do not obviously relate to Alway's trade. While HMRC have the burden of proof, I consider that Alway has an evidential burden of putting forward some explanation as to why these objects bear some relation to its trade. Since it has not done so (and focused its efforts on arguments to the effect that obtaining the tax benefits was not among its objects), I have inferred that the tax benefits had no connection to Alway's trade. Therefore, there was a duality of purpose in incurring the expenditure that, on the face of it, prevents any of that expenditure from being deductible.

144. However, the additional reason for concluding that JCM's payments were not deductible set out at [133] and [134] above are not applicable in Alway's case. If I had concluded that Alway's object in making the payments was solely to place funds at the disposal of Mr Mee and Mr Larke, I would have concluded that HMRC had not discharged their burden of proof. Payments to directors have at least the hallmark of deductibility and HMRC would have needed to adduce further evidence if they wished to establish that outright payments to Mr Mee and Mr Larke would not have been deductible.

145. Nevertheless, the conclusion at [143] means HMRC have discharged their burden of proving that the contributions were not made wholly and exclusively for the purposes of Alway's trade. I will, however, allow Alway a deduction for £7,315 (the amount of the contributions that the Alway Trustee used to make outright payments to employees less the contribution to the staff Christmas party which seems to me to be non-deductible entertainment expenditure). I will leave HMRC and Alway to agree, if they can, the periods to which this deduction should be allocated.

The payments by Praze

146. I do not consider that Praze's object in making payments to the Praze EBT was to incentivise employees of Praze, or its consultants, generally. I regard the statement to this effect in Baxendale Walker's memorandum referred to at [64] as either mistaken or self-serving. Praze cannot have had the object of remunerating or incentivising employees and consultants generally as, if it had, it would have requested the trustee of the Praze EBT to make greater distributions to employees or consultants. I have not accepted that Praze's object in making the payments was to "incentivise" employees and consultants, without rewarding them, as I do not consider that Praze would have paid over £2.6m to the Praze EBT for a benefit as nebulous as increased "loyalty" of employees or consultants. Moreover, Praze would have been aware when it was making its contributions to the Praze EBT of the subtrust arrangements which had the effect that 100% of the trust property was earmarked to be for the benefit of the families and descendants of Dr Hallwood and Mr Kettleborough and thus was ostensibly not available to provide benefits to employees, consultants or their families generally. I do not see how it could have had the object of incentivising employees or consultants generally when it knew that its payments could not benefit employees, consultants or their families generally.

147. Nor, for reasons that I have set out in relation to JCM and Alway could Praze's object simply have been to remunerate Dr Hallwood and Mr Kettleborough specifically. There were more straightforward ways of achieving that object which would not have involved a complicated structure or the payment to a trust whose terms, to Praze's knowledge, specifically excluded Dr Hallwood and Mr Kettleborough from being beneficiaries. Rather, for reasons that are similar to those that I have given in relation to JCM and Alway, I have concluded that Praze's object in making contributions to the Praze EBT were (i) to provide the Praze EBT with sums that could be placed at the disposal of Dr Hallwood and Mr Kettleborough in such a way as to defer (perhaps indefinitely) the PAYE and NIC costs that would arise on a "straightforward" cash bonus while at the same time obtaining a

corporation tax deduction; and (ii) to provide the Praze EBT with a smaller fund that could be used to make outright payments to employees and consultants.

148. I recognise that Dr Hallwood has not actually received any loans from the Praze EBT. However, having explained to JCM and Alway that directors could obtain loans from the EBT, I consider that Baxendale Walker would have explained this possibility to Praze, Dr Hallwood and Mr Kettleborough as well. More generally, there was ample evidence of Dr Hallwood deriving a personal benefit from funds held by the Praze EBT: for example, some funds were used to buy a property in Barbados which Dr Hallwood was free to use without charge. Given that Baxendale Walker took evident care to document their tax advice, as demonstrated by the memorandum they prepared, I consider that they would have informed Praze, Dr Hallwood and Mr Kettleborough of the scope for Dr Hallwood and Mr Kettleborough to derive a benefit from assets of the EBT (and subtrusts) even though they could not be "Beneficiaries" as defined. Dr Hallwood showed an awareness in his evidence that, by writing letters of wishes to the Praze EBT, he might be able to obtain access to cash within the Praze EBT. It was therefore an object of Praze's payments to pay sums to the EBT that could be made available, in some form, to Dr Hallwood and Mr Kettleborough. However, that was not the sole object: for reasons similar to those set out in relation to JCM and Alway, Praze's objects included the obtaining of a corporation tax deduction and the absence of a PAYE or NIC obligation on the sums that were available for Dr Hallwood and Mr Kettleborough to benefit from.

149. Having reached that conclusion as to Praze's objects, I consider (for reasons that are essentially the same as those relating to JCM) that the payments were not incurred wholly and exclusively for the purposes of Praze's trade and so are not deductible in their entirety. I have, however, concluded that £76,700 (the amount of the contributions to the Praze EBT that were actually used to make outright payments to employees and consultants) was in principle deductible since I did not understand Ms Nathan to be objecting to that element of the payments that Praze made.

ISSUE 4 – WHETHER THE DEEDS OF AMENDMENT AND RECTIFICATION TOOK EFFECT RETROSPECTIVELY

150. The essence of Mr Howard's argument on this issue was that all of the relevant trust deeds had been validly amended pursuant to the power to amend contained within them, and the amendments had been stated to take effect retrospectively, they should be given retrospective effect. He relied on the decision of the Privy Council in *Bank of New Zealand v Board of Management of the Bank of New Zealand Officers' Provident Association* [2003] UKPC 58. Both parties were agreed that this decision is not binding on the Tribunal but was of persuasive authority.

151. Ms Nathan did not accept that the amendments made in the Deeds of Amendment and Rectification took effect retrospectively. She relied on statements made by Rowlatt J in *Waddington v O'Callaghan* 18 TC 187 to the effect that the execution of a deed could not "alter the past".

152. I prefer Ms Nathan's submissions as I do not consider that the *Bank of New Zealand* case supports the proposition that a deed can be amended so that the amendments take effect from the date the deed was originally executed. Rather, the Bank of New Zealand authority was concerned with a different kind of "retrospective" amendment. The Bank of New Zealand concerned amendments to the rules of an unincorporated association which had a surplus of assets. The proposed amendments would have resulted in persons who were not, prior to the amendments, entitled to benefit from any of the surplus receiving some payments. It followed that the entitlements of members who were, prior to the amendments, entitled to share in the surplus, would be reduced. Those amendments were "retrospective" in the sense that persons who had been proceeding on the basis that they had no right to share in the surplus would be given a share in the surplus after all and persons who thought they had a particular interest in the surplus would find that interest to be reduced. Therefore, the amendments had the effect of altering entitlements to share in a surplus from what had been supposed. However, the amendments did not seek to "re-write history": they were not, for example, expressed to be backdated to a date before the amendments were made.

153. It follows that I consider that the law is as stated in *Waddington v O'Callaghan* and I have concluded that the amendments made in the Deeds of Amendment and Rectification did not take effect from the date of execution of the original trust deeds.

ISSUE 5 – EFFECT OF THE DECISION IN *MURRAY GROUP HOLDINGS*

154. Mr Howard raised this issue in a supplemental skeleton argument that was served shortly before the hearing. However, despite the fact this was a new point, Ms Nathan made no objection to it being considered. One aspect of Mr Howard's argument on Issue 5 related to the question of whether the appellants incurred expenditure wholly and exclusively for the purposes of their respective trades (Issue 3). I have already explained at [123] why I do not consider Issue 5 to be relevant to Issue 3.

155. There was, however, another aspect to Mr Howard's argument. If the amounts that the appellants contributed to the EBTs were actually emoluments when they were paid and (contrary to my conclusion on Issue 3), those sums were prima facie deductible for corporation tax purposes, neither Section 43 nor Schedule 24 could prevent that deduction from being available.

156. Lord Drummond Young summarised the principle at [56] of the decision in *Murray Group Holdings* as follows:

> The fundamental principle that emerges from these cases appears to us to be clear: if income is derived from an employee's services qua employee, it is an emolument or earnings and thus assessable to income tax even if the employee requests or agrees that it be redirected to a third party.

157. I am not satisfied that the sums paid to the JCM EBT or the Praze EBT were necessarily "derived from an employee's services qua employee". Mr Howard submitted that since Mr McCahill and Dr Hallwood were both directors of JCM and

Praze respectively, the payments could scarcely be made otherwise than in return for them acting as directors or employees and relied on *Hochstrasser v Mayes* [1959] 3 All ER 817. However, this submission overlooks the fact that both Mr McCahill and Dr Hallwood were founding shareholders in the respective appellants. It was at least possible that the payments derived from their shareholdings, rather than from their status as employee or director. In order to establish that the "redirection of earnings" principle could apply, JCM and Praze would have had to lead evidence to establish that the source of each payment was the directorship, and not the shareholding. Mr McCahill would also have needed to give a more detailed account of the "Kintara" trust under which a large proportion of the shares in JCM are held. I therefore agree with submissions that Ms Nathan made to the effect that neither JCM nor Praze had led sufficient evidence to demonstrate that the redirection of earnings principle actually applied to the JCM EBT and the Praze EBT.

158. Alway's situation is somewhat different. As I have concluded, HMRC have the burden of proving that the assessments should be increased under s50(7) of TMA 1970. I consider that there is force in Mr Howard's argument that neither Section 43 nor Schedule 24 could apply if Alway's payments to the Alway EBT were actually emoluments when paid to the Alway EBT. I therefore consider that, to the extent that the increased assessment which HMRC are seeking depends on contributions to the Alway EBT not being emoluments, HMRC have the burden of proving that. Mr Mee and Mr Larke were highly important directors of Alway. Alway made payments to the Alway EBT which it knew Mr Mee and Mr Larke could access (albeit by way of loan). That is evidence that the payments "derived from" their status as directors. If HMRC wanted to prove that the payments derived from some other source (for example their status as shareholder) they needed evidence pointing in the other direction and I have not been referred to any evidence of sufficient weight in this regard.

159. However, there is a further condition that must be met before the "redirection of earnings" principle applies. The employee or director concerned must "request or agree" that payments be redirected rather than paid as ordinary earnings. No appellant referred me to any detailed evidence on this issue. Indeed, all of the directors who gave evidence emphasised their lack of understanding of the arrangements and their lack of involvement in them. As noted, HMRC have the burden of proof in relation to the increased assessment they are requesting on Alway. However, that does not mean that they have to prove that there was no request or agreement. It would be quite impossible for HMRC to prove a negative such as this. Rather, Alway should have pointed to some evidence consistent with the requisite request or agreement and HMRC would then have the burden of proving that the evidence was not sufficient to establish that the employee did indeed request or agree to the redirection of earnings. Since the evidence that Alway has put forward was that Mr Mee and Mr Larke had little knowledge of the arrangements, it follows that I have concluded that there was no request or agreement to a redirection of earnings in Alway's appeal either.

160. I therefore do not consider that the "redirection of earnings" issue is relevant to the deductibility of payments to the EBT (Issue 3). Even though that principle is potentially relevant to Issue 6, I am not satisfied on the evidence in front of me that

the principle would apply in these appeals. I do not, therefore, consider that the payments made by any appellant to its relevant EBT were emoluments for tax purposes.

ISSUE 6 – SECTION 43 OF FINANCE ACT 1989 AND SCHEDULE 24 OF FINANCE ACT 2004

Background and outline of parties' positions on this issue

161. Section 43 and Schedule 24 both apply to payments that would otherwise be deductible in computing trading profits. Very broadly, the effect of those provisions is to deny (or defer) a deduction until the point at which there is a corresponding taxable receipt of emoluments. Since I have already concluded that the payments made to the EBTs were not deductible for corporation tax purposes (see Issue 3 above), it is strictly not necessary for me to consider these provisions. However, I will do so, relatively briefly, since the issue was fully argued in front of me.

162. The parties were agreed that Section 43 was of potential relevance to all three appellants. However, Schedule 24 is of relevance only to JCM, and then only in relation to the contribution of £1,250,000 to the JCM EBT that JCM made in its accounting period ended 31 December 2002.

163. Mr Howard's arguments on Section 43 and Schedule 24 were as follows:

(1) His primary argument was that the amendments made by the Deeds of Amendment and Rectification took effect retrospectively. Since those amendments excluded employees altogether from being among the discretionary beneficiaries of the trusts, the conditions of neither Section 43 nor Schedule 24 were satisfied in relation to any appellant. Since I have concluded (as Issue 4) that the amendments did not take effect retrospectively, I will not consider that argument any further in this section.

(2) His secondary argument was that since, applying the "redirection of earnings" principle set out in *Murray Group Holdings,* all appellants were paying emoluments when they contributed sums to the EBTs, there was no mismatch between the point at which the appellants became entitled to a corporation tax deduction and the point at which there would be a tax charge (for the employees and directors) on the emoluments paid. This meant that, in his submission, the primary conditions of Section 43 and Schedule 24 were not met for any appellant. Since I have concluded (see Issue 5) that the contributions to the EBTs were not emoluments applying the "redirection of earnings" principle, I will say no more on this argument.

(3) If Mr Howard's first two arguments failed (which they have), he conceded in his written skeleton argument, that there was nothing to prevent Section 43 applying to JCM. However, he submitted that Schedule 24 did not apply to JCM's contribution of £1,250,000 since that sum had been used to provide "qualifying benefits" within the requisite time limit.

(4) Mr Howard did, however, argue that the subtrust arrangements (present in the appeals of Praze and Alway) would prevent Section 43 from applying.

164. Therefore, in this section, I will consider Mr Howard's arguments referred to at [163(3)] and [163(4)] above and I will refer to Ms Nathan's submissions when doing so.

Relevant statutory provisions

165. As in force at material times, Section 43 provided, so far as relevant, as follows:

> **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 5th April 1989,
>
> (b) relevant emoluments would (apart from that subsection) be deducted in 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 mentioned 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 5th 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.

166. Section 43 was rewritten as part of the overhaul of the taxation of employee benefit contributions in Finance Act 2003. The rewritten provisions were contained in Schedule 24 and are relevant only to the contributions of £1,250,000 paid by JCM in its accounting period ended 31 December 2002.

167. Paragraph 1 of Schedule 24 provided as follows:

1 Restriction of deductions

(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.

…

(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.

(4) An amount disallowed under sub-paragraph (3) is allowed as a deduction for a subsequent period to the extent that—

(a) qualifying benefits are provided out of the employee benefit contributions in question before the end of that subsequent period, or

(b) where the making of the contributions is itself the provision of qualifying benefits, the contributions are made before the end of that subsequent period.

168. Paragraph 2 of Schedule 24 defines the key concept of "qualifying benefits" as follows:

2 "Provision of qualifying benefits"

(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.

Effect of the subtrusts in relation to Section 43 (Alway and Praze)

169. Section 43 applies to "relevant emoluments" and "potential emoluments". Ms Nathan's primary argument was that the sums that Alway and Praze paid were of "relevant emoluments". I do not, however, agree. In order to be "relevant emoluments", s43(10) requires that the payments must be "allocated" either in respect of particular offices or employments or generally in respect of offices or employments. Paragraph 6 of Lord Hoffmann's speech in *Dextra* indicates that the payments in question must be "allocated" in relevant accounts and it was common ground that all three appellants' accounts referred to the payments as variously contributions to an "employee trust" (in the case of Alway), as "employee costs: remuneration trust" (in the case of Praze) and as "contributions to employee benefit scheme" (in the case of JCM). However, that demonstrates only that "allocation" needs to be reflected in accounts: Lord Hoffmann was not setting out a necessary and sufficient test of what it means for payments to be "allocated" in a particular way. Alway and Praze knew, when they were making their payments, that the sums they paid would be held on discretionary trusts for a class of beneficiaries that included employees but also included persons other than employees. In Praze's case, the effect of the subtrust arrangement was that that employees could not, on the face of matters, benefit at all from the funds. In Alway's case, only 10% of the funds contributed was available to a class of discretionary beneficiary that included employees and even in that case, the Alway Trustee could exercise discretion not to make payments to employees at all (and choose, instead, to favour non-employee beneficiaries). I do not consider that, in these circumstances, payments were "allocated" in respect of particular or general offices or employment. The payments were not, therefore, "relevant emoluments".

170. However, Section 43 applies also to "potential emoluments" defined in s43(11). It was common ground that the Alway Trustee and the Praze Trustee were "intermediaries" for the purposes of s43(11) of Finance Act 1989. Therefore, discussion focused on the question of whether, for the purposes of that section, the trustees held the trust property "with a view to their becoming relevant emoluments".

171. The House of Lords considered the meaning of this phrase in *Dextra.* The essence of the House of Lords' conclusion can be found in the following extract from Lord Hoffmann's speech:

> 17. The Court of Appeal therefore decided that 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.
>
> 18. I agree with the Court of Appeal, largely for the reasons given by Jonathan Parker LJ. In the ordinary use of language, the whole of the funds were potential emoluments. They could be used to pay emoluments. It is true that, as Charles J pointed out, "potential emoluments" is a defined expression and a definition may give the words a meaning different from their ordinary meaning. But that does not mean that the choice of words adopted by Parliament must be

> wholly ignored. If the terms of the definition are ambiguous, the choice of the term to be defined may throw some light on what they mean.

172. Moreover, since the House of Lords agreed with the decision of the Court of Appeal, I consider that they also endorsed comments that Jonathan Parker LJ had made to the effect that where a discretionary trust was involved, the question should not be answered by seeking to anticipate how the trustees might exercise their discretion; rather, it should be determined solely by reference to the terms of the relevant trust deeds considered in the light of any relevant background. For this purpose, since the trust deeds formed part of a composite arrangement that embraced the creation of the subtrusts and, as I have found, both Alway and Praze were aware that this was the case, I consider that the question needs to be addressed by considering the trust deeds and the subtrusts together.

173. Approached in that light, I consider that the Alway Trustee, at all material times, held 90% of the trust property on trusts that could not benefit anyone at all until after the deaths of Mr Mee and Mr Larke (and in particular could not benefit employees) and 10% of trust property on trust for discretionary beneficiaries that included employees. If the matter ended there, that would suggest that 10% of the trust fund was "potential emoluments", but 90% was not.

174. Ms Nathan pointed out that Clause 4.1.1 of both the Larke Subtrust and the Mee Subtrust permitted the Alway Trustee to transfer trust property to other settlements. The Alway Trustee could, therefore, potentially have transferred property held by the subtrusts back into the "main fund" although there was no evidence that this had in fact happened. She submitted therefore, that despite the terms of the subtrusts, trust property could have been distributed to employees in such a way as to constitute emoluments. However, I do not consider that this is enough to constitute the "realistic possibility" to which the House of Lords have referred particularly since the question has to be determined primarily by reference to the trust deeds involved. The power in Clause 4.1.1 could have been used to transfer trust property to settlements with no employees as beneficiaries. I do not consider that an examination of the trust deeds should result in a conclusion that there was a "realistic possibility" that the power in Clause 4.1.1 would be used to make transfers to trusts whose beneficiaries included employees. Therefore, I have concluded that Section 43 would not (to the extent those payments were otherwise deductible) apply to 90% of contributions that Alway made to the Alway EBT.

175. The Praze Trustee ostensibly held 100% of the relevant trust fund pursuant to the terms of the Hallwood Subtrust and the Kettleborough Subtrust which similarly could not benefit employees. However, as I have noted at [73], the Praze Trustee did in fact transfer property from the subtrusts back to the main fund. Since that happened in practice, I have concluded that it was a "realistic possibility". It follows that all of the contributions to the Praze EBT were of "potential emoluments" and Section 43 would, to the extent those payments were otherwise deductible, apply to all payments to the Praze EBT.

Schedule 24 – applicability to JCM

176. Mr Howard's argument was that "qualifying benefits" were paid out of the £1,250,000 that JCM contributed to the JCM EBT in its accounting period ended on 31 December 2002 and those qualifying benefits were paid within 9 months of the end of the accounting period. He therefore submitted that the condition set out in paragraph 1(3) of Schedule 24 was met with the result that no restriction on deductibility applied. In support of that argument, he relied on a note to JCM's audited financial statements for the accounting period ended 31 December 2002. Those financial statements were prepared on 18 November 2003. In Note 10 to those accounts (which contained details of the contingent liability that arose as a consequence of HMRC's challenge to the deductibility of payments to the JCM EBT) the following paragraph appeared:

> The directors understand that all of the Trust assets, prior to the latest contribution referred to in Note 3 were vested in eligible beneficiaries during the year.

Note 3 to those accounts referred to the final contribution of £1,250,000 to the JCM EBT. Note 3 also contained the following paragraph:

> On 27 November 2002, the company made a further cash contribution of £1,250,000 to a Pre-Retirement Employee Benefits Trust.
>
> The Trust was originally established for the benefit of the present, past and future employees of the company and their families. However, with effect from 26 November 2002, the Trust Deed was amended so as to exclude from benefit any person who, at that date or at any future time, fell within the definition of an employee for the purpose of what is no Section 143 of, and Schedule 24 to, the Finance Act 2003.

177. That note is not explicit: it seems to refer only to payments made out of contributions made prior to the £1,250,000 contribution. It may, therefore, not be saying anything at all about how the contribution of £1,250,000 was used. That note expresses only the directors' "understanding" and that understanding may have been faulty particularly given that the JCM Trustee (and not the directors) had the ultimate control over how to spend trust property. Mr McCahill, in his evidence, was unable even to explain what Note 10 was referring to, still less could he give a detailed account of how assets held by the JCM Trustee were used. No other evidence was put forward as to what the JCM Trustee did with the £1,250,000 contribution.

178. Note 3 also begs a number of questions. In particular, it refers to an amendment to the JCM Trust Deed made on 26 November 2002 and seems to hint that it is significant that the contribution of £1,250,000 was made after that amendment. Yet, during the hearing, I was not referred to any amendment to the JCM Trust Deed made on that date.

179. I have not, therefore, accepted Mr Howard's submissions and I conclude that, if the payment of £1,250,000 made to the JCM EBT was deductible, Schedule 24 would have applied so as to deny JCM a deduction.

Conclusion

180. My conclusions are as follows:

(1) On Issue 1 – I reject the appellants' submissions. I will not set aside the assessments (or make directions barring HMRC from defending the appeal) on the procedural grounds requested.

(2) On Issue 2 – I reject Alway's submissions. There was a valid assessment for £2,100 and the Tribunal will consider increasing the assessment to £126,492.21 as Ms Nathan requests. However, HMRC bear the burden of proving that the assessment should be increased.

(3) On Issue 3 – I agree with HMRC that the payments are not, for the most part deductible. However, £7,315 of Alway's contributions, £76,700 of Praze's contributions and £30,000 of JCM's contributions (representing, in each case, the amounts paid with the object of setting aside a small fund from which outright payments of bonuses to employees could be made) were incurred wholly and exclusively for the purposes of their respective trades.

(4) On Issue 4 – The amendments effected by the Deeds of Amendment and Rectification did not take effect retrospectively.

(5) On Issue 5 – The payments to the EBTs were not "indirect remuneration" of the kind set out in *Murray Group Holdings*.

(6) On Issue 6 – Schedule 24 applied to JCM's final contribution of £1,250,000 to the JCM EBT. Section 43 also applied to JCM's other contributions to the JCM EBT. Section 43 applied to the entirety of Praze's contributions to the Praze EBT. However, it did not apply to 90% of Alway's contributions to the Alway EBT.

181. I am not able to set out final figures for the appellants' tax liabilities at issue in this appeal and therefore the decisions above are decisions in principle. Within 56 days, the parties should seek to reach agreement on final figures. In doing so, they will need to determine how much of the deductions that are in principle allowable as set out at [180(3)] should be allocated to which periods. They will also need to work out how Section 43 and/or Schedule 24 apply to those payments in the light of my decision at [180(6)]. If they cannot reach agreement on these issues within this period, any party may apply to the Tribunal for a determination.

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

JONATHAN RICHARDS
TRIBUNAL JUDGE
RELEASE DATE: 24 FEBRUARY 2017

APPENDIX ONE – DETAILS OF ASSESSMENTS MADE

Company	**Accounting period end**	**"Pay and file" or self-assessment**	**Disputed deduction (£)**	**Date of assessment/closure notice**	**Amount of tax in issue for purposes of this appeal (£)**
JCM	31/12/1999	CTSA	165,300	2/5/2014	32,455.26
	31/12/2000	CTSA	436,000	2/5/2014	114,349.63
	31/12/2001	CTSA	nil	2/5/2014	6,844.30
	31/12/2002	CTSA	1,250,000	2/5/2014	360,452.21
Alway	30/4/1998	Pay and File	490,000	6/9/1999	2,100/126,492.21[5]
Praze	31/5/2000	CTSA	1,400,000	2/10/2012	414,480
	31/5/2001	CTSA	1,060,000	2/10/2012	311,850
	31/5/2002	CTSA	200,000	2/10/2012	48,690

[5] HMRC have issued an assessment for £2,100 but are asking the Tribunal to exercise its power, under s50(7) of TMA 1970 to increase the assessment to £126,492.21

APPENDIX TWO – SUMMARY OF CONTRIBUTIONS

Alway Sheet Metal Limited

1. The contributions that Alway made to the Alway EBT are summarised in the following table:

Date of contribution[6]	Amount of contribution (£)
May 1998	100
May 1998	150,000
May 1998	150,000
September 1998	100,000
January 1999	55,750
February 1999	45,000
LESS Establishment and admin costs	(10,850)
Total	**490,000**

2. On 11 March 1999, Bunney Hayes, an executive assistant at Baxendale Walker, wrote to the trustee of the Alway EBT to request the trustee to consider making discretionary awards to certain named employees or their relatives. In response to that request, the trustee made the following awards which were similar, if not identical to the amounts requested:

Date	Amount of distribution
15 March 1999	£250 bonus to each of 8 employees
15 March 1999	£315 bonus to an employee
15 March 1999	£2,000 bonus to "J Larke" (Mr Larke's father)
15 March 1999	£3,000 bonus to an employee
15 March 1999	£305 contribution to staff Christmas party
Total	**£7,620**

Praze Consultants Limited

3. The contributions that Praze made to the Praze EBT are summarised in the following table:

Date of contribution	Amount of contribution (£)
On formation	100
7 December 1999	400,000
16 April 2000	400,000
10 May 2000	400,000
26 May 2000	200,000
30 November 2000	500,000
18 April 2001	420,000

[6] I do not fully understand how these payments (which were all made after 30 April 1998) came to be the subject of an assessment made for the year ended 30 April 1998. No doubt it was because of an aspect of the "pay and file" regime for corporation tax that was not fully explained.

29 May 2001	140,000
25 October 2001	200,000
Total	**2,660,100**

4. The trustee of the Praze EBT has made the following distributions to employees, consultants or their relatives. Each of those distributions was made after Praze sent a written request to the trustee of the Praze EBT recommending that certain named individuals should receive a year-end bonus of a specified amount and the amount distributed was at or around the amount that Praze requested.

Date	**Amount of distribution (£)**
6 June 2000	18,500
6 May 2001	20,500
7 May 2002	37,700
Total	**76,700**

J C McCahill Limited

5. The contributions that JCM made to the JCM EBT are summarised in the following table:

Date of contribution	**Amount of contribution**
Some time in 1997	£40,000
Between 1 May 1998 and 28 December 1998	6 contributions totalling £196,250
Between 10 March 1999 and 20 December 1999	6 contributions totalling £165,300
Between 6 June 2000 and 22 December 2000	5 contributions totalling £436,000
27 November 2002	£1,250,000
Total	**£2,087,550**

6. The trustee of the JCM EBT has made the following distributions to employees or their relatives. All payments were made after JCM made a request to the JCM Trustee and all payments were at or around the amount requested.

Date	**Amount of distribution (£)**
January 1998	5,000
November 1998	5,000
November 1999	5,000
June 2000	5,000
October 2000	10,000
Total	**30,000**

7. All of the above payments were described as bonuses paid to Mr Neil Cosford who was, at the relevant times, an employee of JCM. Mr McCahill said in cross-examination that he thought that the JCM EBT had also paid bonuses to a Ms Halfyard, who was a secretary employed by JCM. However, since we were not shown any documentary evidence of any such payments, and since Mr McCahill himself noted that his recollection of events from over 17 years ago was far from clear, I have concluded that he was mistaken and the amounts described in the table above were the only distributions to employees or their relatives made by the JCM EBT.