**[2015] UKUT 0472 (TCC)**

**Appeal number: FTC/76/2013**

***Construction Industry Scheme – notices of determination – whether UK contractor obliged to make deductions under the scheme in respect of payments made to its Isle of Man parent company – FA 2004 Sections 57 to 67 – Income Tax (Construction Industry Scheme) Regulations 2005 - appeals dismissed***

**UPPER TRIBUNAL**
**TAX AND CHANCERY CHAMBER**

**ISLAND CONTRACT MANAGEMENT (UK) LTD** **Appellant**

**- and -**

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

**TRIBUNAL: Mrs Justice Rose, President of the Upper Tribunal Tax and Chancery Chamber**

**Sitting in public at The Rolls Building, Fetter Lane, London EC4A 1NL on 22, 23 and 24 June 2015**

**David Ewart QC and Adam Rushworth for the Appellant**

**Akash Nawbatt and Georgia Hicks instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

## DECISION

1. This is an appeal against the decision of the First-tier Tribunal (Judge Herrington and Charles Baker FCA) released on 2 April 2013 ([2013] UKFTT 207 (TC) ('The Decision'). The Tribunal rejected the Appellant's challenge to decisions of the Respondents ('HMRC') by which HMRC had -

> (1) issued notices of determination under cover of a letter dated 28 February 2008 relating to five tax periods from 2002/2003 to 2006/2007 requiring payment of a total of £8,440,689.60;
>
> (2) issued further notices of determination under cover of a letter dated 8 March 2010 in respect of a further two tax years 2007/2008 and 2008/2008 plus the period May 2009 to February 2010 requiring payment of a total of £34,313,619.14;
>
> (3) by a decision of 16 February 2009 withdrawn the Appellant's certificate entitling it to receive payments without deduction by the payer of amounts which would otherwise fall to be deducted under section 61 of the Finance Act 2004.

### Background: the Construction Industry Scheme

2. The Construction Industry Scheme ('CIS') is a statutory scheme which is now contained in the Finance Act 2004. Its aim is to encourage tax recovery for businesses operating in the construction industry. As the Tribunal noted at [6] of the Decision, the construction industry historically attracted a large itinerant workforce who were not employees and so not subject to the PAYE scheme, who were paid cash in hand and who did not fully account for their income for tax and National Insurance purposes. To reduce non-compliance there has since 1972 been a dedicated compliance scheme in place which, very broadly, places an obligation on those who pay self-employed workers for construction work to make a deduction from that pay and to account to HMRC for that deduction. The money is then treated as tax paid by the construction worker.

3. The relevant provisions were set out in the Income and Corporation Taxes Act 1988 ('ICTA') until 5 April 2007: see sections 559 onwards. Those provisions were replaced as from that date by provisions in the Finance Act 2004 ('FA 2004'). There is no material difference for our purposes between the provisions in ICTA and the provisions in the FA 2004 so although the period covered by the determinations in dispute spans from tax years 2002/2003 to 2009/2010 I will refer only to the FA 2004 provisions. All references to sections in the following paragraph are therefore references to the FA 2004. Further details about the operation of the CIS are set out in the Income Tax (Construction Industry Scheme) Regulations 2005 (S.I. 2005/2045) ('the 2005 Regulations').

4. The key operative provision of the CIS is section 61 which provides:

**"61 Deductions on account of tax from contract payments**

(1) On making a contract payment the contractor (see section 57(3)) must deduct from it a sum equal to the relevant percentage of so much of the payment as is not shown to represent the direct cost to any other person of materials used or to be used in carrying out the construction operations to which the contract under which the payment is to be made relates."

5. It was common ground in this appeal that none of the payments made under the arrangements represented a direct cost of materials – all the payments were for labour only.

6. To understand the scope of the scheme one must consider the definitions of the various terms used in section 61(1). In the following explanation of the provisions, I focus on those parts which are relevant to the present case. The full text of the provisions is set out in Appendix 1 to this judgment.

7. A 'contract payment' is defined in section 60(1) as being any payment which is made under a construction contract and is so made by the contractor to the sub-contractor or to a person nominated by the sub-contractor or the contractor. A payment is not a contract payment if it is treated as earnings from an employment. A 'contractor' according to section 59(1) includes any person carrying on a business which includes construction operations. 'Construction operations' are defined in section 74 as including the construction, alteration, repair, extension, demolition or dismantling of buildings or structures (whether permanent or not), including offshore installations. However construction operations are not covered by the CIS if they are operations 'carried out or to be carried out otherwise than in the United Kingdom': see section 74(1)(b).

8. As regards who is a 'sub-contractor', section 58 provides as follows:

"**58 Sub-contractors**

(1) For the purposes of this Chapter a party to a contract relating to construction operations is a sub-contractor if, under the contract—

(a) he is under a duty to the contractor to carry out the operations, or to furnish his own labour (in the case of a company, the labour of employees or officers of the company) or the labour of others in the carrying out of the operations or to arrange for the labour of others to be furnished in the carrying out of the operations; or

(b) he is answerable to the contractor for the carrying out of the operations by others, whether under a contract or under other arrangements made or to be made by him."

9. A 'construction contract' is defined in section 57(2) as a contract relating to construction operations which is not a contract of employment but where one party to the contract is a sub-contractor and another party to the contract is either a sub-

contractor under another such contract relating to all or any of the construction operations, or a contractor for the purposes of section 59.

10. The obligation imposed by section 61 therefore requires the contractor, when making a contract payment to the sub-contractor, to make a deduction of the relevant percentage – that is a percentage set in an order made by HM Treasury. During the period covered by the assessments made by HMRC for the Appellant, the relevant percentage was 18 per cent for the tax years 2002/03 to 2006/07 and 30 per cent for the tax years 2007/08 to 2009/10. Section 62 provides that the contractor must pay the sums deducted to HMRC and that the contract payment is, broadly speaking, treated in the hands of the sub-contractor as being the gross amount as if paid without deduction. Also very broadly, the deduction is then treated as if it were tax or national insurance paid by the sub-contractor on the payment it receives.

11. Section 63 provides for individuals and companies to be registered either for gross payment or for payment under deduction. The procedure for registration of sub-contractors is set out in Part 5 of the 2005 Regulations and requires the applicant to provide evidence of his identity.

12. If a person is registered for gross payment, this means that the contractor making contract payments to him does not need to make and account for deductions from those payments in accordance with the Scheme. The provisions relating to gross payment are set out in section 63. That provides that HMRC must register a person for gross payment if the person satisfies various criteria. Where the application for registration for gross payment is made by a company, the company must satisfy the conditions in Part 3 of Schedule 11 to the Act: see section 64(4).

13. Part 3 to Schedule 11 sets out a threefold test - a business test, a turnover test and a compliance test. The business test is set out in paragraph 10 which provides as follows:

> "*The business test*
>
> 10. The company must satisfy the Inland Revenue, by such evidence as may be prescribed in regulations made by the Board of Inland Revenue, that—
>
> (a) it is carrying on (whether or not in partnership) a business in the United Kingdom, and
>
> (b) that business satisfies the conditions mentioned in paragraph 2(a) and (b)."

14. The conditions mentioned in paragraph 2(a) and (b) referred to there are that the company is carrying on a business in the United Kingdom which consists of or includes the carrying out of construction operations or the furnishing or arranging for the furnishing of labour in carrying out construction operations, and that the business is, to a substantial extent, carried on by means of an account with a bank.

15. The turnover test is that the company must satisfy HMRC that either it has the minimum turnover calculated in accordance with paragraph 11 of the Schedule or that all the shareholders in the company are themselves companies which are registered for gross payment.

16. The compliance test is that the company must have complied with a whole raft of statutory requirements, including its tax and national insurance obligations or at least that any failures to comply are of the kind specified in paragraph 12 of the Schedule as not disqualifying the company under this head. More details about the kinds of evidence that the contractor can provide in order to show that he fulfils these criteria are set out in Part 6 of the 2005 Regulations.

17. Section 66 provides that HMRC may at any time make a determination cancelling a person's registration for gross payment if it appears to them that -

> (a) if an application to register the person for gross payment were to be made at that time, they would refuse so to register him, or
>
> (b) he has made an incorrect return or provided incorrect information (whether as a contractor or as a sub-contractor), or
>
> (c) he has failed to comply (whether as a contractor or as a sub-contractor) with any specified provision.

18. Section 66(5) provides that on making a determination under this section cancelling a person's registration for gross payment, HMRC must without delay give the person notice stating the reasons for the cancellation.

19. The 2005 Regulations provide that the contractor must make monthly returns to HMRC setting out its name and unique taxpayer reference and, in respect of each sub-contractor to whom or to whose nominee it has made payments, details such as the name and national insurance number and whether the sub-contractor is registered for gross payment or for payment under deduction, as described below. Regulation 6 of the 2005 Regulations provides that a contractor must verify with HMRC whether a person to whom he is proposing to make a contract payment is registered for gross payment or for payment under deduction or is not registered at all. The monthly return that the contractor has to send to HMRC must include a declaration indicating whether he has complied with this obligation to verify the registration status of each person to whom he has made a payment.

**ICM (UK) and the arrangements in dispute**

20. The Appellant ('ICM (UK)') is a wholly owned subsidiary of a company called Island Contract Management Limited ('Island (Isle of Man)'). Island (Isle of Man) was incorporated in the Isle of Man on 23 June 1999 by Mr David Boothman who is a Chartered Accountant resident in the Isle of Man since November 1984. He has his own practice of accountants called Boothmans (Chartered Accountants) there and the Tribunal found that Mr Boothman effectively controlled Island (Isle of Man). Mr Boothman's evidence before the Tribunal was that Island (Isle of Man) started its business of paying construction workers in 1999 without seeking to participate in any way in the CIS. However it became apparent that the recruitment agencies who have lists of construction workers on their books and make them available to work on construction projects prefer to deal with an intermediary which is registered for gross

payment. This saves them the burden of making deductions from pay and accounting for those deductions to HMRC.

21. Island (Isle of Man) made enquiries of HMRC whether it was possible for it to qualify for registration for gross payment. There was a clash of evidence between Mr Boothman and the witness from HMRC before the Tribunal as what HMRC's response to those enquiries had been. The Tribunal found that it was more likely than not that Mr Boothman had been given the information in HMRC's guidance as to the application of the gross payment certificate provisions to entities based outside the UK. That guidance was in effect that an overseas company could qualify. In considering any such application, the threefold test in Part 3 of Schedule 11 to the FA 2004 would be modified to apply to such a company, for example by determining that the compliance test was satisfied if the applicant could present to HMRC a letter from its own Revenue authorities stating that the company had no adverse compliance history.

22. Mr Boothman did not pursue an application for gross payment certificate on behalf of Island (Isle of Man). Instead, he incorporated ICM (UK) as a wholly-owned subsidiary of Island (Isle of Man) on 10 May 2001. Mr Boothman accepted in his evidence before the Tribunal that ICM (UK) was set up to satisfy potential customers who required a sub-contractor to whom they could make payments gross in respect of construction workers they provided work for. Soon after incorporation, ICM (UK) applied to HMRC for registration under the CIS and for the issue of a gross payment certificate. That application was successful and a gross payment certificate was issued to ICM (UK) in the autumn of 2001.

23. Island (Isle of Man) and ICM (UK) then operated a system whereby contractors would make payments to ICM (UK) in respect of work carried out by construction workers. The contractors who made payments to ICM (UK) could be of two kinds. They could be construction companies who were actually engaged by a site owner to carry out building work at the site where the construction workers would ultimately provide their services, or they could be recruitment agencies such as FastTrack Management Services Ltd ('FastTrack') which was an agency procuring contract technical staff for construction companies. I will refer to the entities of either kind at the top of the contractual chain as the Client. The Clients made payments to ICM (UK) without making any deduction from them because ICM (UK) was registered for gross payment under the CIS.

24. ICM (UK) would pay the money it received from the Clients also without deduction to Island (Isle of Man). There was no written contract between ICM (UK) and Island (Isle of Man) explaining the basis for this payment. The Tribunal referred to a contract that came into existence between Island (Isle of Man) and ICM (UK) later, but the Tribunal held that this has not in fact altered the nature of the relationship between the parties: see paragraph [83].

25. At the other end of the chain were the construction workers themselves. In order to be sub-contractors for the purposes of the CIS they must be self-employed rather than employees. They ought also to have registration cards because construction

workers have to be registered either for gross payment or for payment under deduction. It is possible for a construction worker to be registered for gross payment himself but there is no evidence to suggest that any of those who were paid under these arrangements were so registered. Island (Isle of Man) then made payments to the construction workers without making any deduction for the purposes of the CIS.

26. The main question for the Tribunal and the main question in this appeal is whether ICM (UK) ought, in order to comply with the CIS, to have made deductions from the payments that it received from the Clients and transferred over to Island (Isle of Man).

27. In analysing the contractual arrangements it is necessary to consider three separate elements. First there are the findings of fact as to the terms of the contracts and what actually happened when the arrangements were operated by Island (Isle of Man) and ICM (UK). Secondly, there is the legal characterisation of the contracts entered into at various points in the chain. Thirdly there is the issue of how the CIS applies to those contracts. These elements may overlap since the legal characterisation of the contracts takes account of the fact that the parties to the contracts were trying to achieve a particular result under the CIS. But it is important to distinguish between matters that are really findings of primary fact by the Tribunal and matters which are the Tribunal's conclusions as to the legal characterisation of those facts or the application of the legislation to them. The findings of primary fact such as the content of the contractual terms or the way the arrangements operated in practice cannot be disturbed on appeal other than on the well-known grounds set out in *Edwards v Bairstow*. No such challenges to factual findings were made by ICM (UK). As regards the Tribunal's conclusions as to the legal characterisation of the contractual relationships between the entities and as to the application of the CIS, those are matters of law which I must investigate in order to decide whether the Tribunal erred in law in upholding HMRC's decisions.

**The contractual documents**

28. The contractual documentation provided by ICM (UK) to HMRC comprises:

> (1) a framework agreement setting out the terms on which ICM (UK) contracts with the Client and providing in effect a template for future agreements between them; and
>
> (2) a package of documents setting out the terms on which Island (Isle of Man) contracts with the construction workers.

29. In construing these contracts I have borne in mind the judgments of the Supreme Court in *HMRC v Secret Hotels2 Ltd (formerly Med Hotels Ltd)* [2014] UKSC 16 ('*Secret Hotels2*'), decided in March 2014, after the Tribunal's ruling in this case. *Secret Hotels2* concerned the appropriate characterisation of the relationship between the company, the operators of the hotels, and the holiday-makers or their travel agents. It was important to determine whether the travel agents dealt with their customers as principals or whether they acted only as intermediaries for the travel companies. Lord Neuberger, with whom the other Supreme Court Justices agreed, described the approach the court should take as follows:

" 31. Where parties have entered into a written agreement which appears on its face to be intended to govern the relationship between them, then, in order to determine the legal and commercial nature of that relationship, it is necessary to interpret the agreement in order to identify the parties' respective rights and obligations, unless it is established that it constitutes a sham.

32. When interpreting an agreement, the court must have regard to the words used, to the provisions of the agreement as whole, to the surrounding circumstances in so far as they were known to both parties, and to commercial common sense. When deciding on the categorisation of a relationship governed by a written agreement, the label or labels which the parties have used to describe their relationship cannot be conclusive, and may often be of little weight. …"

30. Lord Neuberger then referred to the rules that apply when the court construes a contract governed by English law, noting that it is not generally permissible to take into account the subsequent behaviour or statements of the parties as an aid to interpreting their written agreement. The right starting point was to characterise the nature of the relationship between the counterparties in the light of the contractual documentation. One must next consider whether that characterisation can be said to represent the economic reality of the relationship in the light of any relevant facts. The final issue was the result of that characterisation so far as the relevant provisions in the legislation were concerned.

*The contract for services between ICM (UK) and the Client*

31. The parties to the contract for services are ICM (UK) and the Client. The framework agreement recites that ICM (UK) is -

'… in business as a commercial sub-contractor undertaking construction operations and has skills and abilities and can undertake services that may be of use to the Client from time to time."

32. ICM also warrants that it is qualified to perform the services: clause 16.

33. The parties to the contract agree that if and when ICM (UK) supplies services to the Client it will do so in accordance with the terms of this contract. Thus the contract does not itself impose any obligations on ICM (UK) to provide services or on the Client to pay: see clause 21. Rather, the contract envisages that there will be a particular project in respect of which the parties will enter into contracts on these terms for the provision of services at a particular location. Once a project has been offered and accepted, the only obligation is to complete that project: see clause 21. The contract can also be terminated by either side at any time and without notice. The contract provides that both parties agree and intend that:

"… this legal relationship is one of contracting for independent specialist services and specifically is not a relationship of master and servant or employer and employee"

34. As to how it will work on a day to day basis, the contract provides that -

> (1) The contract price for the services will be negotiated and agreed as between the Client and ICM (UK) from time to time and will be detailed in a Schedule to the contract. Payment will be made against presentation of an invoice: clauses 10 and 11.
>
> (2) The Client cannot require ICM (UK) to undertake the services at a different site or location from that verbally agreed at the outset of the contract – ICM (UK) may agree to change the location but is not obliged to do so: clause 12.
>
> (3) ICM (UK) may at its own discretion use its own equipment to undertake the provision of services: clause 13.
>
> (4) ICM (UK) also undertakes to maintain insurance policies as it deems necessary for the performance of the services, including public liability insurance of at least £1 million: clause 24.
>
> (5) ICM (UK) will prepare invoices for all services undertaken at a frequency set out in a schedule to the contract, which is in fact weekly: clause 33.

35. Clause 9 provides that the whole or part of the contract can be assigned or subcontracted to any third party providing that the sub-contractor is suitably experienced and qualified. If such assignment or subcontracting takes place, the third party will be bound by the terms set out in the contract.

36. In paragraph 183(2) – (5) of the Decision, the Tribunal described the chain of contracts that might come into existence in the upper part of the chain, that is as between the company actually wanting the construction work done on its site and either Island (Isle of Man) or ICM (UK). Each of those contracts would be between a contractor and a sub-contractor. In an important passage the Tribunal held (the Tribunal referred to Island (Isle of Man) as 'ICM'):

> "202. This analysis therefore begs the question as to whether ICM (UK) can properly be regarded as a sub-contractor (in relation to the payments it receives) and a contractor (in relation to the payments it passes on to ICM) within the scope of the CIS.
>
> 203. One possible analysis is that ICM (UK) is, like ICM, purely a paying agent, the true contractor/sub-contractor relationship being that between the construction worker and the contractor firm concerned for whom the individual sub-contractor performs construction operations. We believe that such analysis reflects the commercial reality of the situation.
>
> 204. Nevertheless in relation to the operation of the CIS in our view it is clear that ICM (UK) should be regarded as being a sub-contractor in relation to its relationship with the recruitment agency or construction firm that finds work for the construction worker with such agency or firm being regarded as the contractor. The reasons for this are as follows.

205. As we have found, there was a pro forma contract between ICM (UK) and its client, the construction firm or recruitment agency sourcing the labour. This contract recites that ICM (UK) is a commercial sub-contractor undertaking construction operations and will provide such services to the client. Pursuant to this contract, invoices were issued by ICM (UK) some of which we were shown relating to the services provided pursuant to this contract.

206. As we have observed, section 58(a) provides that a party to a contract relating to construction operations is a sub-contractor if, inter alia, he is under a duty to the contractor to furnish the labour of others in the carrying out of the operations. We know that ICM (UK) had no construction expertise of its own. The only way it could fulfil its obligations under its contract with the client would be to procure labour for that purpose. In reality the contract was therefore performed by the construction workers who were found work by the recruitment agency or construction firm involved. These construction workers were introduced to ICM as a sub-contractors who wished to be paid through ICM's payment structure, and these construction workers then became sub-contractors to ICM (UK), with invoices being issued by ICM (UK) to the firm or agency to whom ICM (UK) became contractually obliged to procure their services. The contact details given to the construction workers were for Boothman's office so it would not be clear to the construction worker whether he was being introduced to ICM, ICM (UK) or both.

207. This arrangement therefore provides a legal basis for ICM (UK) to receive payments for these services gross under the terms of the CIS. ICM (UK) has held itself out as providing the services of construction workers to perform construction operations, such individuals having been introduced to it for that purpose."

37. The Tribunal therefore concluded at paragraph 210(1) that:

"ICM (UK) entered into arrangements with clients which amounted to construction contracts within the meaning of Section 57 under which the client was the contractor and ICM (UK) the sub-contractor. This contract was a construction contract by virtue of Section 58(a), there being a duty on ICM (UK) to furnish labour which was performed by ICM (UK) making available the labour of the construction workers."

38. The passage in paragraphs 203 and 204 were criticised by Mr Ewart QC as adopting an impermissible approach to construing the contract. I do not accept that criticism. The Tribunal was considering whether the fact that ICM (UK) did not in fact have access to a pool of construction workers and really had no expertise in construction work overrode the intention of the Client and ICM (UK) that the contracts between them should be construction contracts for the purposes of the CIS. That intention is evinced not only from the wording of the contract itself but from the surrounding circumstances known to the parties at the time and from commercial common sense. Those surrounding circumstances are the way that the CIS operates,

the fact that ICM (UK) was registered for gross payment and the fact that some, if not all, of its Clients contracted with it precisely because they wanted to pay for labour gross without having the burden themselves of making and accounting for deductions.

39. I agree with the Tribunal's conclusion on this point. Viewed objectively, ICM (UK) and the Client intended when they entered into contracts in relation to a particular construction project to enter into construction contracts as contractor and sub-contractor. There is no reason to doubt that they succeeded in doing so. The contract allows ICM (UK) to make whatever arrangements for finding labour it wishes. But it was under an obligation to provide that labour once it had entered into a contract to do so. In this case there is a circular element to what happened if the Client was a recruitment agency like FastTrack. In such a case FastTrack was not only the Client under the contract, but also the entity which in fact identified the individual construction workers whom it wanted ICM (UK) to provide to in fulfilment by ICM (UK) of its contractual obligations. It seems that that is how FastTrack operates: see paragraphs 57 to 59 of the Decision.

40. I therefore uphold the Tribunal's finding that the relationship between ICM (UK) and the Client in this chain was one of contractor and sub-contractor for the purposes of the CIS.

*The contract between Island (Isle of Man) and the construction worker*

41. The Tribunal noted that in 2007, after HMRC had opened its investigation into the arrangements, the contractual terms between Island (Isle of Man) and the construction workers purported to record a contractor/sub-contractor relationship. However, the Tribunal found at paragraph 175(12) of the Decision that the arrangements between them operated in the same way throughout the period covered by the appeal. The terms which the Tribunal considered were contained in a pack of documents sent to a construction worker who was usually put in touch with Island (Isle of Man) by the recruitment agency to which he had signed up. These comprised the following documents.

42. First there was a **covering letter** sent from Island (Isle of Man) to the construction worker. It refers to the construction worker's enquiry regarding 'the Contract Management and Settlement services' which Island (Isle of Man) can provide and reminded the worker that the company 'act specifically in the management of contracts which you enter into' and that responsibility for accounting for tax and national insurance remained with the worker. The letter invited the worker to complete and return the application form so that Island (Isle of Man) could 'begin acting on [his] behalf'. The contract provided for the payment of the fees 'after receipt of funds from [his] client'. The fee payable is described as 5 per cent of 'the Amounts that we collect on your behalf'.

43. Secondly there was an **application form** which was a single page seeking the construction worker's contact details and bank account details.

44. Thirdly there was an **agreement** signed by the construction worker who was referred to in the agreement as the 'Consultant' and by Island (Isle of Man) referred to as 'Island'. I have set out the relevant terms in full in Appendix 2 to this judgment. The pre-amble of the agreement said:

> "This agreement sets out the terms and conditions under which the Consultant will provide the services of himself to Island and the services which Island will provide to the Consultant."

45. The first three clauses of the agreement emphasise that no employment relationship is created between Island (Isle of Man) and the construction worker. Island (Isle of Man) takes no responsibility for directing the worker's activities or insuring him against any loss or injury suffered in the course of his work.

46. The terms of the contract are inconsistent as to whether the client for whom the worker provides his labour is Island (Isle of Man)'s client or the worker's. Thus clause 5 provides (emphasis added) "The Consultant will observe the terms of <u>any agreements entered into by Island with any agency or clients entered into on the Consultant's behalf and with the Consultant's permission</u>" and clause 13 provides "It is expressly acknowledged and agreed that Island is not a party to any contract conditions entered into <u>between the Consultant and his client</u> and that for the purpose of this clause, a <u>client of the Consultant</u> will include any labour agency …." Further, clause 8 refers to invoicing 'the Consultant's client' on receipt of the time sheets sent in by the worker. By contrast there are several references to 'Island's client' in the contract. Thus, clause 6 obliges the worker to ensure that his work sheet is signed by an authorised representative of 'Island's client' and clause 7 also refers to representatives of 'Island's contractor client' or 'Island's client'.

47. So far as the payment of monies is concerned, the agreement makes clear that Island (Isle of Man) is only liable to pay the construction worker the monies which it receives itself on his behalf. Clause 10 provides that -

> "In the event that the amount collected for work undertaken by the Consultant is less than the amount set out on the Consultant's invoice then Island will remit such lesser amount and it is agreed that both the Consultant and Island will use their best endeavours to resolve all and any such differences, but that no further payment will be remitted to the Consultant until further payments are received."

48. Fourthly, the pack sent to the construction worker also included a document called 'Most Often Asked Questions' ('the MOAQs'). The first question which Island (Isle of Man) anticipates the worker raising is the following:

> "**Why Can Island Pay Subcontractors on a Gross Basis?**
>
> 1. Island is registered in the Isle of Man and is not subject to UK Tax law.
> 2. Island is not subject to the Construction Industry Scheme (CIS) because the Inland Revenue has no jurisdiction in the Isle of Man.

3. There is a management contract between the subcontractor and Island that specifically excludes any Employer/Employee relationships, therefore Income Tax and National Insurance cannot apply.
4. There is a contract between Island's UK CIS registered subsidiary and the agency or main contractor. They are separate limited companies and National Insurance does not contractually apply between them.
5. The agency or main contractor pays Island UK on a gross basis because of its CIS status. Being outside of UK tax law, Island had no right to deduct Income Tax or National Insurance because these deductions for work done in the UK do not directly apply in the Isle of Man."

49. Other questions posed and answered relate to Island (Isle of Man)'s charges described as a flat fee of up to 5% of gross pay and how money is transferred. Another question is 'Am I Still Responsible for Income Tax and National Insurance?' to which the answer is 'yes'. However the answer goes on to say: (emphasis added)

> "3. The benefit of working <u>via us</u> is that you are paid gross, our charges are tax deductible and you are in control of your earnings because <u>you will not be stopped any tax or NI deductions at source</u>'.

50. The MOAQs also explain what other services Island (Isle of Man) can provide for the worker including record keeping and efficiency in money collection. There is also the following question and answer:

> "Do I need a CIS Card?
>
> No, your arrangements are outside of the UK tax system. Indeed, this may be the only way you can be paid if you do not get, or do not want to hold a CIS card."

51. Further the MOAQs document stresses that Island (Isle of Man) does not find work for the construction worker: "We are a specialist contract management company and are expert in arranging prompt settlement. It is up to you to find suitable work, but tell us whom you work for and we obtain payment."

52. The way the arrangement worked in practice was that the construction worker would present his time sheet to be signed by someone in charge on the construction site where he carried out his work. He would then pass the time sheet to Island (Isle of Man) which would in turn pass it to ICM (UK). ICM (UK) would then raise an invoice to be sent to the Client. The Client would pay the invoice to ICM (UK) and the money would then be passed to Island (Isle of Man) without deduction. It was common ground that Island (Isle of Man) did not then make deductions, other than its own fee, from the sums it received from ICM (UK) when transmitting those sums to the relevant construction worker.

53. The Tribunal set out the submissions made by Mr Boddington, representing ICM (UK), to the effect that the agreement between Island (Isle of Man) and the construction worker was a construction contract between Island (Isle of Man) as

contractor and the construction worker as sub-contractor. The Tribunal rejected this analysis:

> "193. We reject Mr Boddington's submissions on the nature of the arrangements. In our view it is necessary to look at all the surrounding circumstances in construing the effect of the contractual arrangements.
>
> 194. When the terms of the original contract are read in conjunction with the explanatory material issued at the time, the way the relationship between ICM and the construction worker was established, and what was said to HMRC at the meeting held on 3 April 2007, in our view it is clear that the role of ICM was to act as a paying agent so as to act as the construction worker's agent in remitting payments in respect of arrangements entered into by the construction worker for the provision of his services to third parties."

54. The Tribunal then set out eight circumstances that led them to this conclusion. Most of these relied on the wording of the agreement itself. Others referred to how Island (Isle of Man) had presented itself in its discussions with HMRC in 2007 and in the covering letter sent to the construction worker with the pack of documents.

55. I have based my analysis entirely on the wording of the agreement signed by Island (Isle of Man) and the construction worker. I find that the relationship established between Island (Isle of Man) and the construction worker is not one of contractor and sub-contractor but one of principal and agent whereby the company agrees to act for the worker by concluding agreements on his behalf for the supply of his labour and processing the payments that are made in return for that labour. The wording appears to me to establish that the parties' intention, objectively ascertained, was that the construction worker agreed with Island (Isle of Man) that the company would act on his behalf in bringing the construction worker together with the clients who would engage him to provide his labour. The client would then channel the payment through Island (Isle of Man) to the worker in the way described.

56. The factors which lead me to that conclusion are not entirely the same as the list in paragraph [195] of the Decision though there are some in common. I agree with the Tribunal that it is significant that there is no operative provision under which the construction worker provides his services to Island (Isle of Man); that the company agrees to pay the worker only the monies it receives from the Client (even though it may assist the worker to resolve any difficulties with payment); and that the payment of a percentage fee is more consistent with a paying agency relationship than with a contractor/sub-contractor relationship. I regard clauses 5 and 13 of the contract as the key clauses of the agreement:

> "5. The Consultant will observe the terms of any agreements entered into by Island with any agency or clients entered into on the Consultant's behalf and with the Consultant's permission.
>
> 13. It is expressly acknowledged and agreed that Island is not a party to any contract conditions entered into between the Consultant and his client and that

> for the purpose of this clause, a client of the Consultant will include any labour agency and that the Consultant hereby indemnifies Island from any loss including but not limited to consequential loss as a result of any action of the Consultant."

57. The references in the contract to the client being Island (Isle of Man)'s rather than Consultant's client are mainly limited to those clauses which deal with the mechanics of payment rather than the clauses which spell out the nature of the contractual relationship.

58. I therefore uphold the Tribunal's finding that the nature of the contract between Island (Isle of Man) and the construction worker is not one of contractor and sub-contractor but rather one under which the construction worker instructs Island (Isle of Man) to act as his agent in concluding contracts between him as sub-contractor and another entity as contractor. This analysis is consistent with what the construction worker was told about the service that was being provided to him in the MOAQs. The passage quoted above which poses and answers the question 'Why can Island Pay Sub-Contractors on a Gross Basis?' refers to the contract between the worker and Island (Isle of Man) as a 'management contract' and refers also to the contract between ICM (UK) and the ultimate Client. It informs the worker that that ultimate Client pays ICM (UK) on a gross basis because it is registered for gross payment. The overall effect of the contract is therefore that the construction worker is paying Island (Isle of Man) to act on his behalf by concluding agreements under which he provides his labour to others rather than to Island (Isle of Man).

*The missing link*

59. The next issue is then to define the relationship between the construction worker, ICM (UK) and Island (Isle of Man). If Island (Isle of Man) is acting as agent for the construction worker in concluding contracts between him as sub-contractor and another entity as contractor, who is that other entity? There are two possible options: either the construction worker enters into a construction contract, via the agency of Island (Isle of Man), directly with the Client or he enters into a construction contract, via the agency of Island (Isle of Man), with ICM (UK).

60. In my judgment the Tribunal was right that the second option is the correct analysis. To hold that the construction worker entered into a direct contract with the Client would be contrary to any objective assessment of what the parties thought they were doing. The Client certainly did not want to enter into a contract with the construction worker. On the contrary, it clearly intended to contract with ICM (UK) as an entity registered for gross payment so that it could avoid having to make deductions from the contract payments itself. The construction worker also had no intention of entering into a contract with the Client because he wanted to be paid gross rather than under deduction. He was told that this arrangement achieved that goal. It is true that the wording of his contract with Island (Isle of Man) envisages that there will be many different clients for the construction worker or Island (Isle of Man) whereas, on the Tribunal's analysis, there was in fact only one – ICM (UK). But that does not undermine this analysis because the construction worker's primary

concern in this regard is that the entity with which he contracts, through the agency of Island (Isle of Man), is one which is entitled to be paid gross and will be prepared to pay him gross.

61. It must be right, therefore, that the correct analysis of this link in the chain is that the construction worker is in a direct contractual relationship, concluded via the agency of Island (Isle of Man), with ICM (UK).

62. The Tribunal expressed its conclusion on this point in paragraph 208:

> "208. It is true that there is no written contract between ICM (UK) and the construction worker under which he agrees to provide his services to ICM (UK). Nevertheless, in our view such a contract is to be implied. As we have found, the "most often asked questions" document refers to the fact that there is a contract between ICM (UK) and the agency or the main contractor, and that ICM receives payment under that contract gross. The document then goes on to say that ICM pays the monies without deduction because it is "outside of UK tax law". It is clear therefore that to benefit from this arrangement the construction worker needs to have a relationship with ICM (UK), who receives the monies under a contract relating to construction operations, which as we have analysed above, in this case takes the form of ICM (UK) providing the services of the construction worker. The construction worker impliedly agrees to such an arrangement, in addition to contracting with ICM, so as to receive the benefits of the work he has provided to the construction firm under the umbrella of the arrangements that ICM (UK) has entered into with that firm or the recruitment agency, subject to the deduction of ICM's fee. On our analysis of the service that ICM provides, its role is to manage the payments under the contract between ICM (UK) and the construction worker. Indeed, as ICM's marketing material makes clear participating in the arrangements in this way may be the only way that the construction worker can be paid gross and as we have found, ICM takes no responsibility for finding work for the construction worker."

63. Mr Ewart's attack on this passage formed one of the main grounds of ICM (UK)'s challenge to the Decision. He argued that the Tribunal held there that there was an implied contract without considering the case law on implied contracts – such as *Modahl v British Athletic Association* [2001] EWCA Civ 1447 – and identifying the conduct which comprises the offer and acceptance of the parties. I consider that that criticism misses the mark because the Tribunal was not considering an implied contract in that sense. Having concluded that (a) the relationship between ICM (UK) and the Client was one of contractor/sub-contractor and (b) the relationship between Island (Isle of Man) and the construction worker was one of principal and agent, the Tribunal was explaining in that paragraph that the counterparty to the construction contract which Island (Isle of Man) concludes as agent on behalf of the construction worker is in fact ICM (UK). The contract is formed not by an offer from the construction worker and an acceptance from ICM (UK) but from the agency relationship between the construction worker and Island (Isle of Man) and the relationship between Island (Isle of Man) and ICM (UK) evidenced by the payment of

the sums earned by the construction worker from ICM (UK) to Island (Isle of Man). Strictly there was no need to refer to an 'implied' contract. The Tribunal's conclusions were perhaps more clearly expressed in paragraph 201 where they summarised their conclusions as:

> (1) ICM (UK) entered into construction contracts with the Client;
>
> (2) The construction worker agreed to make his services available to ICM (UK) so that ICM (UK) could perform its obligations to the client;
>
> (3) ICM (UK) had an obligation as principal to pay the construction workers for the services they provided. Those sums were received gross by ICM (UK) because it was registered for gross payment under the CIS;
>
> (4) The construction worker agreed with Island (Isle of Man) that the company would collect the payments from ICM (UK) gross and pass them to him, subject to a deduction of the 5 per cent fee. This agreement was not a construction contract but a paying agency agreement under which Island (Isle of Man) agreed to manage the payments due from ICM (UK) to the construction worker.
>
> (5) The agreement between Island (Isle of Man) and ICM (UK) was not a construction contract. Rather payments from ICM (UK) to the construction worker passed through Island (Isle of Man) with the consent of the construction worker and satisfied ICM (UK)'s obligation to pay the construction worker under the contract between ICM (UK) and that worker.

64. I agree with those conclusions. Any other analysis of the contractual chain would be inconsistent with the wording of the contractual documents which exist and also inconsistent with what the parties must be taken to have intended, given those documents and given the background of the CIS in which they knew they were operating.

65. The Tribunal then turned to consider the application of the CIS provisions to the contractual relationships it had found existed. The key question was whether ICM (UK) was right to think that by routing the payments it made to the construction workers through Island (Isle of Man), it could legitimately avoid making those payments under deduction. The Tribunal held that that was not right. Section 60(1) of the FA 2004 defines a contract payment which must be made under deduction as a payment made under a construction contract by the contractor to either the sub-contractor or to a person nominated by the sub-contractor or the contractor. The Tribunal held:

> "…. the payments were made to a person nominated by the sub-contractor to receive payment, that person being [Island (Isle of Man)]. This arose as a result of [Island (Isle of Man)] being appointed by the construction worker to collect payments in respect of sums owed to him by ICM (UK) on his behalf and pass them on subject to the agreed deduction for [Island (Isle of Man)'s] fees. On that basis, the construction worker authorised [Island (Isle of Man)] to collect these monies from ICM (UK) and thus ICM (UK) made payments to a person

nominated by the sub-contractor to receive payment within the meaning of Section 60(1) (b)."

214. Consequently ICM (UK) was obliged to make appropriate deductions pursuant to Section 61 FA 2004 unless, as provided for by section 60(4) FA 2004, the construction worker was registered for gross payment. We have had no evidence that any of the construction workers were so registered."

66. The Tribunal then went on briefly in paragraph 215 to hold that the fact that the payment nominee, Island (Isle of Man), was based outside the UK did not absolve ICM (UK) of the obligation to make deductions. I consider this point further when dealing with territorial scope below. For the present, I hold that the Tribunal was right to analyse the payments made by ICM (UK) to Island (Isle of Man) as contract payments made by ICM (UK) as contractor to a nominee of the construction worker as sub-contractor for the purposes of section 60.

*The Ramsey principle*

67. The Tribunal went on to consider the application to the case of the *Ramsey* principle, citing several authorities in which the principle has been explained and applied. The essence of the principle, deriving from the decision of the House of Lords in *W T Ramsey Ltd v Inland Revenue Commissions* [1982] AC 300 has been described as requiring the courts to give a purposive construction to legislation in order to determine the nature of the transaction to which it was intended to apply and then to decide whether the actual transaction in issue answered to the statutory description. That description of the principle is taken from the speech of Lord Nicholls of Birkenhead in *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2004] UKHL 51 paragraph 32. Lord Nicholls noted that the principle did not require the court to put its reasoning into the straitjacket of first construing the statute in the abstract and then looking at the facts. It might be more convenient to analyse the facts and then ask whether they satisfy the requirements of the statute.

68. The Tribunal also referred to *DTE Financial Services Ltd v Wilson* (2001) 74 TC where the Court of Appeal held that it was legitimate to apply the *Ramsey* principle to what was a mechanism to collect tax rather than to a taxing provision in its own right.

69. I consider that this case is one of those referred to by Lord Nicholls where it is better to focus on the facts and then apply the law to the facts found. The issues in this case arise not from the difficulty of construing the legislation but from working out the nature of the contractual relationship between the various parties in the chain. Once the nature of the contracts is established, the application of the CIS provisions does not raise any particularly difficult issues of construction, other than the issue relating to territorial scope discussed below. There is no need to rely on the *Ramsey* principle in this case.

*The territorial scope of the CIS*

70. ICM (UK), Island (Isle of Man) and the construction workers involved in the arrangements operated on the basis that ICM (UK) could legitimately make the contract payments to Island (Isle of Man) without deduction because Island (Isle of Man) is outside the United Kingdom. As Island (Isle of Man) expressed it in the MOAQs when encouraging construction workers to sign up for its services, Island (Isle of Man) is not subject to UK tax law and HMRC has no jurisdiction in the Isle of Man.

71. Mr Ewart submitted that the purpose of subjecting contract payments under the CIS to deductions was to make sure that the person to whom the payments were made paid the taxes they were liable to pay to HMRC; the deductions are ultimately offset against the recipient's own tax liabilities. If the recipient of the payment is outside the UK tax system and is not therefore liable to pay any taxes to HMRC, there is no point in making any deductions.

72. ICM (UK) also argued before the Tribunal that it should be relieved of the obligation to pay the deductions which it ought to have paid pursuant to regulation 9 of the 2005 Regulations. Regulation 9 provides that where it appears to HMRC that a contractor has not deducted all the sums it should have deducted, they may direct that it is not liable to pay the shortfall if one of two conditions is met. The second condition is satisfied where, amongst other things, HMRC is satisfied that the person to whom the contractor made the contract payments was not chargeable to income tax or corporation tax in respect of those payments.

73. The Tribunal dealt briefly with the territorial scope of the FA 2004 in paragraph 215 as I have already mentioned and also in paragraph 261 of the Decision. In the latter paragraph, the Tribunal said that there was 'no obvious basis' in the legislation governing the CIS for the assumption that payments to non-UK sub-contractors are outside the scope of the CIS.

74. On this issue both parties referred me to the decision of the House of Lords in *Clark (H.M. Inspector of Taxes) v Oceanic Contractors Incorporated* [1983] 2 WLR 94, (1982) 56 TC 183 ('*Oceanic*'). That case concerned the application of the obligation to make PAYE deductions from wages paid to workers by a company resident outside the UK in respect of work performed on the UK continental shelf. The employees were paid in US dollars by cheques drawn in Brussels on a New York bank account. The leading speech was that of Lord Scarman who posed the question whether Oceanic was required to operate the PAYE system merely because the employees were themselves assessable to British income tax on their emoluments. The Crown submitted that that was a sufficient link but argued in the alternative that Oceanic had a sufficient 'tax presence' in the jurisdiction to bring it within the scheme, even though it was not tax resident here. Oceanic argued that the anomalies and enforcement problems arising from an attempt to impose the PAYE obligation on Oceanic were such that Parliament cannot have intended to impose on the employer those duties: the section imposing the duty must be subject to an implied territorial limitation which would exclude its operation in such circumstances.

75. Lord Scarman described the general principle as regards the territorial scope of legislation as follows: (page 221)

> "… unless the contrary is expressly enacted or so plainly implied that the Courts must give effect to it, United Kingdom legislation is applicable only to British subjects or to foreigners who by coming into the United Kingdom, whether for a short or a long time, have made themselves subject to British jurisdiction. Two points would seem to be clear: first, that the principle is a rule of construction only, and secondly, that it contemplates mere presence within the jurisdiction as sufficient to attract the application of British legislation. Certainly, there is no general principle that the legislation of the United Kingdom is applicable only to British subjects or persons resident here."

76. He went on to note that Parliament recognises the almost universally accepted principle that fiscal legislation is not enforceable outside the limits of the territorial sovereignty of the kingdom:

> 'Fiscal legislation is, no doubt, drafted in the knowledge that it is the practice of nations not to enforce the fiscal legislation of other nations. But, in the absence of any clear indications to the contrary, it does not necessarily follow that Parliament has in its fiscal legislation intended any territorial limitation other than that imposed by such enforceability: …" (page 221 – 222)

77. Lord Scarman went on to consider the factors relevant to the interpretation of the statutory provisions. He said that it was necessary, in seeking the territorial limits of the PAYE scheme to consider the section in its Schedule E context. The machinery of collection was tied to the Schedule and Schedule E had its own express territorial limitations. It was however, possible that the relevant provision had to be read subject to further limitation. The Crown argued that the fact that the employer was paying emoluments to employees who were themselves subject to Schedule E was not enough to impose the PAYE scheme on that employer. He rejected that submission:

> "The persuasiveness of the Crown's submission lies in the attractive robe of logicality which it wears. How can it be necessary to write into the section any territorial limitation other than the two specified in the two Schedule E cases to which s 204 by its language plainly applies? To this question the Respondent makes answer that it is inconceivable that Parliament should have intended the PAYE obligation to be imposed on a foreign employer in respect of the emoluments paid outside the United Kingdom in a foreign currency to a person engaged in duties wholly performed outside the United Kingdom. Yet, if the Crown is right, the garb of logicality which it claims for its submission conceals extraordinarily far-reaching and anomalous consequences. How can the PAYE duties be enforced? How can the system be made to work? How can it be supervised? How can the necessary documents be obtained for inspection by the Revenue, unless the foreign corporation is compliant? It all adds up to a practical impossibility of enforcing or monitoring the system against an uncooperative employer outside the United Kingdom making payments outside the United Kingdom.

> The difficulties are such that I have reached the conclusion that the Judge and the Court of Appeal were right to hold that some limitation other than those specified in Schedule E must be implied into s 204. It is perfectly true, as Mr. Potter Q.C. for the Crown urged, that there are situations where our tax laws recognise the existence of a tax liability even though the tax is not collectable and the tax obligation is unenforceable. But, in my view, the problems of construing s 204 so as to extend the duty it imposes to all income assessable under Cases I and II of Schedule E and the anomaly of the theoretical subjection of non co-operative foreigners outside the United Kingdom to the penalties of non-compliance compel the conclusion that there must be some further limitation implied."

78. He went on to consider the consequences for the scheme if the tax payer was right that the non-residence of the employer in the UK took the employer outside the scope of the PAYE mechanism. He commented that such a limitation would mean that a non-resident employer of persons working in the UK and paid in this country could escape the PAYE obligation. This would mean that tax charged could not be collected by PAYE, "even though there would in such circumstances be no practical difficulty in operating the system". He stressed that the provision under scrutiny was not a charge to tax but simply a method of tax collection: "The only critical factor, so far as collection is concerned, is whether in the circumstances it can be made effective." A trading presence in the UK would be sufficient to make the collection method effective since there would then be no practical difficulties in operating PAYE.

79. Lord Wilberforce expressed the question to be asked when considering the territorial scope of legislation as "who … is within the legislative grasp, or intendment, of the statute under consideration?". He also considered the enforceability of the provision in the circumstances of the case. Lord Roskill agreed with both speeches.

80. Applying that approach to the present case I ask myself whether it can have been the intention of Parliament that when construction workers carry out work in the United Kingdom and contract payments are made by the Client in respect of that work to a sub-contractor which is incorporated here and registered for gross payment under the CIS, the sub-contractor does not need to make deductions from the onward payments if the recipient is an Isle of Man company. The answer in my judgment is clearly no, it cannot have so intended. There is no difficulty in enforcement here – ICM (UK) is subject to the CIS and can be required to make the payment. There are no "non-cooperative foreigners" to use Lord Scarman's phrase to cause a problem for enforcement of the deductions. Further, if the answer to the question were yes, then the door would be open for wide scale tax avoidance of precisely the kind that the CIS was set up to prevent: every construction worker would sign up to be paid via an Isle of Man company and receive his pay without deduction even if he were not himself registered for gross payment. It may be, as with PAYE and the *Oceanic* case that the fact that the construction workers provide their services on UK construction sites is not of itself enough to bring everyone above them in the chain into the scheme, even

if they have no tax presence at all in the UK. But the legislation contemplates a chain of contracts between the top contractor tasked by the site owner with carrying out the work at a site in the UK and the construction worker providing his services in the UK. The payments have to be deducted all along the chain unless there is interposed an entity entitled to be paid gross. The fact that below that entity in the chain there is a person operating outside the UK does not take the whole chain out of the territorial scope of the legislation.

81. Further, in my judgment, ICM (UK) would not be absolved from the obligation to make deductions even if there were, as ICM (UK) argued before the Tribunal, a construction contract between the worker and Island (Isle of Man) and another construction contract between Island (Isle of Man) and ICM (UK) rather than, as I have found, a construction contract between the construction worker and ICM (UK) with Island (Isle of Man) acting as paying agent. Parliament could not have intended that where the ultimate sub-contractor (that is the construction worker) is carrying out constructions operations in the United Kingdom and contract payments are made higher up the chain are made by a contractor registered for gross payment under the CIS, that the contractor does not need to make deductions if his immediate sub-contractor is outside the jurisdiction. Again, applying the principles set out in *Oceanic* would apply: there is no difficulty in enforcing the payment mechanism in respect of the contractor and to construe the legislation as ICM (UK) proposes would lead to easy evasion of the scheme.

82. I therefore uphold the Tribunal's decision that ICM (UK) was obliged to make deductions pursuant to section 61 when making payments to Island (Isle of Man) and that HMRC's determinations were valid.

**The revocation of ICM (UK)'s gross payment entitlement**

83. HMRC revoked ICM (UK)'s gross payment status on the ground that it failed to make deductions for the years 2007/08 and 2008/09. I have held that HMRC was right to conclude that ICM (UK) had so failed.

84. The Tribunal rejected the submission that it had a reasonable excuse for that failure within the meaning of paragraph 12(3) of Schedule 11 to the FA 2004. That provides (broadly) that a company that has failed to comply with its obligation is to be treated as satisfying the compliance test if HMRC are of the opinion that the company had a reasonable excuse for the failure to comply. ICM (UK) contended that it reasonably believed that the true relationship between ICM (UK) and Island (Isle of Man) was that of contractor and sub-contractor and that as Island (Isle of Man) was outside the UK tax system there was no obligation to make the payments. The Tribunal held at paragraph 261 that there was no obvious basis in the legislation governing the CIS for that assumption. The Tribunal noted, further, that ICM (UK) chose to make that assumption without taking professional advice and that Island (Isle of Man) had deliberately failed to engage in a discussion of the issue with HMRC by writing a misleading letter prior to ICM (UK)'s application for gross payment status. The Tribunal therefore regarded ICM (UK) as reckless and held that it had failed to establish that it had any reasonable excuse.

85. I entirely agree with this reasoning and conclusion. The criteria applied in the three-fold test for qualifying for payment without deduction show that the status is reserved to those entities who have the financial means and compliance record for HMRC to be confident that the status will not be used as a means of undermining the CIS. ICM (UK) and Island (Isle of Man) used that status to avoid the application of the CIS. There was no reasonable excuse here.

**Disposition**

86. In the light of the reasons set out above, I dismiss the appeal.

**TRIBUNAL JUDGE: MRS JUSTICE ROSE, PRESIDENT OF THE UPPER TRIBUNAL TAX AND CHANCERY CHAMBER**

**RELEASE DATE: 28 August 2015**

## APPENDIX 1

## RELEVANT PROVISIONS OF FA 2004

1. Section 57, so far as relevant, sets out the scope of the CIS as follows:

"**57 Introduction**

(1) This Chapter provides for certain payments (see section 60) under construction contracts to be made under deduction of sums on account of tax (see sections 61 and 62).

(2) In this Chapter "construction contract" means a contract relating to construction operations (see section 74) which is not a contract of employment but where—

(a) one party to the contract is a sub-contractor (see section 58); and

(b) another party to the contract ("the contractor") either—

(i) is a sub-contractor under another such contract relating to all or any of the construction operations, or

(ii) is a person to whom section 59 applies.

(3) In sections 60 and 61 "the contractor" has the meaning given by this section.

(4) In this Chapter—

(a) references to registration for gross payment are to registration under section 63(2),

(b) references to registration for payment under deduction are to registration under section 63(3), and

(c) references to registration under section 63 are to registration for gross payment or registration for payment under deduction."

2. Section 58 contains the definition of sub-contractor as follows:

"**58. Sub-contractors**

For the purposes of this Chapter a party to a contract relating to construction operations is a sub-contractor if, under the contract—

(a) he is under a duty to the contractor to carry out the operations, or to furnish his own labour (in the case of a company, the labour of employees or officers of the company) or the labour of others in the carrying out of the operations or to arrange for the labour of others to be furnished in the carrying out of the operations; or

(b) he is answerable to the contractor for the carrying out of the operations by others, whether under a contract or under other arrangements made or to be made by him."

3. Section 59(1) includes in the scope of persons who are contractors any person carrying on a business which includes construction operations.

4. Section 60 sets out the class of payments which are made subject to the obligation to deduct sums in respect of income tax and national insurance. This section, so far as relevant, provides:

"**60 Contract payments**

(1) In this Chapter "contract payment" means any payment which is made under a construction contract and is so made by the contractor (see section 57(3)) to—

(a) the sub-contractor,

(b) a person nominated by the sub-contractor or the contractor, or

(c) a person nominated by a person who is a sub-contractor under another such contract relating to all or any of the construction operations.

(2) But a payment made under a construction contract is not a contract payment if any of the following exceptions applies in relation to it.

(3) This exception applies if the payment is treated as earnings from an employment by virtue of Chapter 7 of Part 2 of the Income Tax (Earnings and Pensions) Act 2003 (c. 1) (agency workers).

(4) This exception applies if the person to whom the payment is made or, in the case of a payment made to a nominee, each of the following persons—

(a) the nominee,

(b) the person who nominated him, and

(c) the person for whose labour (or, where that person is a company, for whose employees' or officers' labour) the payment is made, is registered for gross payment when the payment is made.

…"

5. Section 61 sets out the obligation to make the deductions and provides:

"**61. Deductions on account of tax from contract payments**

(1) On making a contract payment the contractor (see section 57(3)) must deduct from it a sum equal to the relevant percentage of so much of the payment as is not shown to represent the direct cost to any other person of materials used or to be used in carrying out the construction operations to which the contract under which the payment is to be made relates.

(2) In subsection (1) "the relevant percentage" means such percentage as the Treasury may by order determine.

(3) That percentage must not exceed—

(a) if the person for whose labour (or for whose employees' or officers' labour) the payment in question is made is registered for payment under deduction, the percentage which is the basic rate for the year of assessment in which the payment is made, or

(b) if that person is not so registered, the percentage which is the higher rate for that year of assessment."

6. Section 62 of FA 2007 provides for the treatment of the sums deducted, so far as relevant, provides:

"**62. Treatment of sums deducted**

(1) A sum deducted under section 61 from a payment made by a contractor—

(a) must be paid to the Board of Inland Revenue, and

(b) is to be treated for the purposes of income tax or, as the case may be, corporation tax as not diminishing the amount of the payment.

(2) If the sub-contractor is not a company a sum deducted under section 61 and paid to the Board is to be treated as being income tax paid in respect of the sub-contractor's relevant profits. If the sum is more than sufficient to discharge his liability to income tax in respect of those profits, so much of the excess as is required to discharge any liability of his for Class 4 contributions is to be treated as being Class 4 contributions paid in respect of those profits.

(3) If the sub-contractor is a company—

(a) a sum deducted under section 61 and paid to the Board is to be treated, in accordance with regulations, as paid on account of any relevant liabilities of the sub-contractor;

(b) regulations must provide for the sum to be applied in discharging relevant liabilities of the year of assessment in which the deduction is made;

(c) if the amount is more than sufficient to discharge the subcontractor's relevant liabilities, the excess may be treated, in accordance with the regulations, as being corporation tax paid in respect of the sub-contractor's relevant profits; and

(d) regulations must provide for the repayment to the subcontractor of any amount not required for the purposes mentioned in paragraphs (b) and (c).

(4) For the purposes of subsection (3) the "relevant liabilities" of a subcontractor are any liabilities of the sub-contractor, whether arising before or after the deduction is made, to make a payment to the Inland Revenue in pursuance of an obligation as an employer or contractor.

(5) In this section—

(a) "the sub-contractor" means the person for whose labour (or for whose employees' or officers' labour) the payment is made;

(b) references to the sub-contractor's "relevant profits" are to the profits from the trade, profession or vocation carried on by him in the course of which the payment was received;

(c) "Class 4 contributions" means Class 4 contributions within the meaning of the Social Security Contributions and Benefits Act 1992 (c. 4) or the Social Security Contributions and Benefits (Northern Ireland) Act 1992 (c. 7)."

7. Sections 63 and 64 make provision for registration to enable construction contract payments to be made either gross or net as appropriate as follows:

"**63 Registration for gross payment or for payment under deduction**

(1) If the Board of Inland Revenue are satisfied, on the application of an individual or a company, that the applicant has provided—

(a) such documents, records and information as may be required by or in accordance with regulations made by the Board, and

(b) such additional documents, records and information as may be required by the Inland Revenue in connection with the application, the Board must register the individual or company under this section.

(2) If the Board are satisfied that the requirements of subsection (2), (3) or (4) of section 64 are met, the Board must register—

(a) the individual or company, or

(b) in a case falling within subsection (3) of that section, the individual or company as a partner in the firm in question, for gross payment.

(3) In any other case, the Board must register the individual or company for payment under deduction.

**64 Requirements for registration for gross payment**

(1) This section sets out the requirements (in addition to that in subsection (1) of section 63) for an applicant to be registered for gross payment.

….

(4) Where the application is for the registration for gross payment of a company (otherwise than as a partner in a firm)—

(a) the company must satisfy the conditions in Part 3 of Schedule 11 to this Act, and

(b) if the Board of Inland Revenue have given a direction under subsection (5), each of the persons to whom any of the conditions in Part 1 of that

Schedule applies in accordance with the direction must satisfy the conditions which so apply to him.

(5) Where the applicant is a company, the Board may direct that the conditions in Part 1 of Schedule 11 to this Act or such of them as are specified in the direction shall apply to—

(a) the directors of the company,

(b) if the company is a close company, the persons who are the beneficial owners of shares in the company, or

(c) such of those directors or persons as are so specified, as if each of them were an applicant for registration for gross payment.

…"

8. Part 3 of Schedule 11 includes paragraphs 9 to 13 (supplemented by paragraph 14) sets out the conditions to be satisfied by companies wishing to be registered for gross payment as follows:

"**9.** In the case of an application for a company to be registered for gross payment (whether as a partner in a firm or otherwise), the following conditions must be satisfied by the company.

*The business test*

**10.** The company must satisfy the Inland Revenue, by such evidence as may be prescribed in regulations made by the Board of Inland Revenue, that—

(a) it is carrying on (whether or not in partnership) a business in the United Kingdom, and

(b) that business satisfies the conditions mentioned in paragraph 2(a) and (b)."

*[Paragraph 2(a) and (b) provides:*

*"The applicant must satisfy the Inland Revenue, by such evidence as may be prescribed in regulations made by the Board of Inland Revenue, that he is carrying on a business in the United Kingdom which—*

*(a) consists of or includes the carrying out of construction operations or the furnishing or arranging for the furnishing of labour in carrying out construction operations, and*

*(b) is, to a substantial extent, carried on by means of an account with a bank."]*

*The turnover test*

**11.** (1) The company must either—

(a) satisfy the Inland Revenue, by such evidence as may be prescribed in regulations made by the Board of Inland Revenue, that the carrying on of its business is likely to involve the receipt in the year following the making of the application of an aggregate amount by way of relevant payments which is not less than the amount which is the minimum turnover for the purposes of this sub-paragraph; or

(b) satisfy the Inland Revenue that the only persons with shares in the company are companies which are limited by shares and themselves are registered for gross payment;

and in this sub-paragraph "relevant payments" has the meaning given by paragraph 3(2).

(2) [*Definition of minimum turnover]*

*The compliance test*

**12.** (1) The company must, subject to sub-paragraphs (2) and (3), have complied with—

(a) all obligations imposed on it in the qualifying period (see paragraph 14) by or under the Tax Acts or the Taxes Management Act 1970 (c. 9); and

(b) all requests made in the qualifying period to supply to the Inland Revenue accounts of, or other information about, its business.

(2) A company that has failed to comply with such an obligation or request as—

(a) is referred to in sub-paragraph (1), and

(b) is of a kind prescribed by regulations made by the Board of Inland Revenue,

is, in such circumstances as may be prescribed by the regulations, to be treated as satisfying the condition in that sub-paragraph as regards that obligation or request.

(3) A company that has failed to comply with such an obligation or request as is referred to in sub-paragraph (1) is to be treated as satisfying the condition in that sub-paragraph as regards that obligation or request if the Board of Inland Revenue are of the opinion that—

(a) the company had a reasonable excuse for the failure to comply, and

(b) if the excuse ceased, it complied with the obligation or request without unreasonable delay after the excuse had ceased.

(4)… [*lists of obligations]*

(7) There must be reason to expect that the company will, in respect of periods after the qualifying period, comply with—

(a) all such obligations as are referred to in paragraphs 10 and 11 and sub-paragraphs (1) to (6), and

(b) such requests as are referred to in sub-paragraph (1).

(8) Subject to sub-paragraphs (2) and (3), a company is not to be taken for the purposes of this paragraph to have complied with any such obligation or request as is referred to in sub-paragraphs (1) to (6) if there has been a contravention of a requirement as to—

(a) the time at which, or

(b) the period within which,

the obligation or request was to be complied with.

…

**14.** In this schedule "the qualifying period" means the period of 12 months ending with the date of the application in question."

9. Section 66 gives HMRC power to cancel a registration for gross payment and Section 67 provides for appeals to be made by persons aggrieved by decisions to refuse or cancel registration as follows:

"**66. Cancellation of registration for gross payment**

(1) The Board of Inland Revenue may at any time make a determination cancelling a person's registration for gross payment if it appears to them that—

(a) if an application to register the person for gross payment were to be made at that time, the Board would refuse so to register him,

(b) he has made an incorrect return or provided incorrect information (whether as a contractor or as a sub-contractor) under any provision of this Chapter or of regulations made under it, or

(c) he has failed to comply (whether as a contractor or as a sub contractor) with any such provision.

(2) Where the Board make a determination under subsection (1), the person's registration for gross payment is cancelled with effect from the end of a prescribed period after the making of the determination (but see section 67(5)).

(3) The Board of Inland Revenue may at any time make a determination cancelling a person's registration for gross payment if they have reasonable grounds to suspect that the person—

(a) became registered for gross payment on the basis of information which was false,

(b) has fraudulently made an incorrect return or provided incorrect information (whether as a contractor or as a sub-contractor) under any provision of this Chapter or of regulations made under it, or

(c) has knowingly failed to comply (whether as a contractor or as a sub-contractor) with any such provision.

(4) Where the Board make a determination under subsection (3), the person's registration for gross payment is cancelled with immediate effect.

(5) On making a determination under this section cancelling a person's registration for gross payment, the Board must without delay give the person notice stating the reasons for the cancellation.

(6) Where a person's registration for gross payment is cancelled by virtue of a determination under subsection (1), the person must be registered for payment under deduction.

(7) Where a person's registration for gross payment is cancelled by virtue of a determination under subsection (3), the person may, if the Board thinks fit, be registered for payment under deduction.

(8) A person whose registration for gross payment is cancelled under this section may not, within the period of one year after the cancellation takes effect (see subsections (2) and (4) and section 67(5)), apply for registration for gross payment.

(9) In this section "a prescribed period" means a period prescribed by regulations made by the Board.

**67 Registration for gross payment: appeals**

(1) A person aggrieved by—

(a) the refusal of an application for registration for gross payment, or

(b) the cancellation of his registration for gross payment, may by notice appeal.

(2) The notice must be given to the Board of Inland Revenue within 30 days after the refusal or cancellation.

(3) The notice must state the person's reasons for believing that—

(a) the application should not have been refused, or

(b) his registration for gross payment should not have been cancelled.

(4) The jurisdiction of the tribunal on such an appeal that is notified to the tribunal shall include jurisdiction to review any relevant decision taken by the Board of Inland Revenue in the exercise of their functions under section 63, 64, 65 or 66.

(5) Where a person appeals against the cancellation of his registration for gross payment by virtue of a determination under section 66(1), the cancellation of his registration does not take effect until whichever is the latest of the following—

(a) the abandonment of the appeal,

(b) the determination of the appeal by the tribunal, or

(c) the determination of the appeal by the Upper Tribunal or a court."

10. Section 74 deals with the meaning of "construction operations" and which, so far as relevant, provides:

"**74 Meaning of "construction operations"**

(1) In this Chapter "construction operations" means operations of a description specified in subsection (2), not being operations of a description specified in subsection (3); and references to construction operations—

(a) except where the context otherwise requires, include references to the work of individuals participating in the carrying out of such operations; and

(b) do not include references to operations carried out or to be carried out otherwise than in the United Kingdom (or the territorial sea of the United Kingdom).

(2) The following operations are, subject to subsection (3), construction operations for the purposes of this Chapter—

(a) construction, alteration, repair, extension, demolition or dismantling of buildings or structures (whether permanent or not), including offshore installations;

(b) [*other kinds of construction operations ]*

**RELEVANT PROVISIONS OF THE 2005 REGULATIONS**

11. Regulation 9 of the Regulations deal with the power to grant relief from liability where the correct amounts have not been deducted from contract payments as follows:

" **Recovery from sub-contractor of amount not deducted by contractor**

9 . — (1) This regulation applies if –

(a) it appears to an officer of Revenue and Customs that the deductible amount exceeds the amount actually deducted, and

(b) condition A or B is met.

(2) In this regulation –

"the deductible amount" is the amount which a contractor was liable to deduct on account of tax from a contract payment under section 61 of the Act in a tax period;

"the amount actually deducted" is the amount actually deducted by the contractor on account of tax from a contract payment under section 61 of the Act during that tax period;

"the excess" means the amount by which the deductible amount exceeds the amount actually deducted.

(3) Condition A is that the contract satisfies an officer of the Revenue and Customs –

(a) that he took reasonable care to comply with section 61 of the Act and these Regulations, and

(b) that –

(i) the failure to deduct the excess was due to an error made in good faith, or

(ii) he held a genuine belief that section 61 of the Act did not apply to the payment.

(4) Condition B is that –

(a) an officer of Revenue and Customs is satisfied that the person to whom the contractor made the contract payments to which section 61 of the Act applies either –

(i) was not chargeable to income tax or corporation tax in respect of those payments, or

(ii) has made a return of his income or profits in accordance with section 8 of TMA (personal return) or paragraph 3 of Schedule 18 to the Finance Act 1998 (company tax return) in which those payments were taken into account, and paid the income tax and Class 4 contributions due or corporation tax due in respect of such income or profits; and

(b) the contractor requests that the Commissioners for Her Majesty's Revenue and Customs make a direction under paragraph (5).

(5) An officer of Revenue and Customs may direct that the contractor is not liable to pay the excess to the Commissioners for Her Majesty's Revenue and Customs.

(6) If condition A is not met an officer of Revenue and Customs may refuse to make a direction under paragraph (5) by giving notice to the contractor ("the refusal notice") stating –

(a) the grounds for the refusal, and

(b) the date on which the refusal notice was issued.

(7) A contractor may appeal against the refusal notice –

(a) by notice to an officer of Revenue and Customs

(b) within 30 days of the refusal notice

(c) specifying the grounds of the appeal.

(8) For the purpose of paragraph (7) the grounds of appeal are that –

(a) that the contractor took reasonable care to comply with section 61 of the Act and these Regulations, and

(b) that –

(i) the failure to deduct the excess was due to an error made in good faith, or

(ii) the contractor held a genuine belief that section 61 of the Act did not apply to the payment.

(9) If on an appeal under paragraph (7) that is notified to the tribunal it appears that the refusal notice should not have been issued the tribunal may direct that an officer of Revenue and Customs make a direction under paragraph (5) in an amount the tribunal determines is the excess for one or more tax periods falling within the relevant year.

(10) If a contractor has deducted an amount under section 61 of the Act but has not paid it to the Commissioners for Her Majesty's Revenue and Customs as required by regulation 7 (payment, due date etc and receipts), that amount is treated, for the purposes of determining the liability of any sub-contractor in respect of whose liability the sum was deducted, as having been paid to the Commissioners for Her Majesty's Revenue and Customs at the time required by regulation 8 (quarterly tax periods).

12. Regulation 13 of the Regulations gives HMRC power to determine deductible amounts to best judgment in certain circumstances and for appeals to be made against such determinations and so far as relevant provides:

"**Determination of amounts payable by contractor and appeal against determination**

13—(1) This regulation applies if –

(a) there is a dispute between a contractor and sub-contractor as to –

(i) whether a payment is made under a construction contract, or

(ii) the amount, if any, deductible by the contractor under section 61 of the Act from a contract payment to a sub-contractor or his nominee, or

(b) an officer of Revenue and Customs has reason to believe, as a result of an inspection under regulation 51 or otherwise, that there may be an amount payable for a tax year under these Regulations by a contractor that has not been paid to them, or

(2) an officer of Revenue and Customs may determine the amount which to the best of his judgment a contractor is liable to pay under these Regulations, and serve notice of his determination on the contractor.

(3) A determination under this regulation must not include amounts in respect of which a direction under regulation 9(5) has been made and directions under that regulation do not apply to amounts determined under this regulation.

(4) A determination under this regulation may –

(a) cover the amount payable by the contractor under section 61 of the Act for any one or more tax periods in a tax year; and

(b) extend to the whole of that amount, or to such part of it as is payable in respect of –

(i) a class or classes of sub-contractors specified in the notice of determination (without naming the individual sub-contractors), or

(ii) one or more named sub-contractors specified in the notice.

(5) A determination under this regulation is subject to Parts 4, 5 and 6 of TMA (assessment, appeals, collection and recovery) as if –

(a) the determination were an assessment, and

(b) the amount determined were income tax charged on the contractor and those Parts of that Act apply accordingly with any necessary modifications, except that the amount determined is due and payable 14 days after the determination is made."

## APPENDIX 2

## AGREEMENT BETWEEN ISLAND (ISLE OF MAN) AND THE CONSTRUCTION WORKER

An Agreement ----- ISLAND'S COPY - PLEASE RETURN TO US

Parties: Island Contract Management Limited whose registered office is situate at Millennium House, Victoria Road, Douglas, Isle of Man, 1M1 4RW, hereafter known as Island.

This agreement sets out the terms and conditions under which the Consultant will provide the services of himself to Island and the services which Island will provide to the Consultant.

1. Island will not exercise any form of direction or control over the actions or activities of the Consultant and it is expressly acknowledged and agreed between the parties that Island is not the Employer of the Consultant and that no employment obligations exist or will be created by entering into this agreement and that the Consultant is and will at all times remain responsible for all taxes including, but not limited to, Income Tax, Corporation Tax and National Insurance, which may be payable by the Consultant from monies collected by island and remitted to the Consultant.
2. The Consultant will at no time be an employee by Island and will maintain his self-employed status throughout the term of this agreement and Island will not make any payment in relation to holidays or sickness or for any other reason whatsoever, including but not limited to bank holidays and industrial action, neither will it make any payment or contribution to any holiday scheme, pension scheme or other form of benefit.
3. The Consultant will be liable for any loss, injury or damage caused by him whilst at work. Island Contract Management does not expressly insure the Consultant for any loss, injury or damage whilst the Consultant is working, and does not account for any liability for any claim made against the Consultant during the course of the Consultant's work by any contractor or third party.
4. The Consultant will not and has no authority to enter into any agreement or contract on behalf of Island.
5. The Consultant will observe the terms of any agreements entered into by Island with any agency or clients entered into on the Consultant's behalf and with the Consultant's permission.
6. The Consultant will ensure that his time sheet or other form of evidence is signed by a duly authorised representative of Island's client immediately upon completion of his contract or at the end of each working week if the contract is for a duration of more than one week.

7. The Consultant will supply Island with a copy of this time sheet or other form of advice duly signed by an authorised representative of Island's contractor client and will supply such time sheet to Island by no later than 5pm on the Tuesday following the week in which services are provided by the Consultant to Island's client and in addition the Consultant will provide Island with an invoice that correctly reflects the gross amount due from Island's client.

8. Island will invoice the Consultant's client immediately upon receipt of the Consultant's time sheet or other form of payment advice and will endeavour to collect all monies due to the Consultant within three working days thereafter, however, it is expressly agreed between the parties that Island will not incur any liability including but not limited to consequential loss in respect of any delay in payment by Island's client to Island.

9. Island will remit all sums collected on behalf of the Consultant immediately upon receipt of cleared funds from Island's client and such remittance will be made via the Banker's Automated Clearing, but it is expressly agreed between the parties that Island will not incur any liability including but not limited to consequential loss in respect of any delay in payment caused as a result of utilising this system.

10. In the event that the amount collected for work undertaken by the Consultant is less than the amount set out on the Consultant's invoice then Island will remit such lesser amount and it is agreed that both the Consultant and Island will use their best endeavours to resolve all and any such differences, but that [no] further payment will be remitted to the Consultant until further payments are received.

11. In consideration of Island providing these services to the Consultant, the Consultant hereby agrees that Island may deduct a 5% service charge from the gross amount payable to the Consultant, and it is further agreed that the above scale of charges may be varied by Island at its discretion upon giving the Consultant not less than 14 days in writing.

12. Island and the Consultant will maintain full records of all transactions and will keep copies of all time sheets, other advices, invoices and any other documentation so as to provide a full and complete record of all transactions.

13. It is expressly acknowledged and agreed that Island is not a party to any contract conditions entered into between the Consultant and his client and that for the purpose of this clause, a client of the Consultant will include any labour agency and that the Consultant hereby indemnifies Island from any loss including but not limited to consequential loss as a result of any action of the Consultant.

14. This Agreement will continue in force without time limit and will apply to all monies collected on behalf of the Consultant by Island and it is agreed that the receipt of any time sheet or other form of advice or invoice received from the Consultant constitutes an instruction by the Consultant to provide the services set out above.

15. By their signatures below, the parties signify their acceptance of this agreement.