Neutral Citation: **[2024] UKUT 00098 (TCC)**

Case Number: UT/2022/000041

UPPER TRIBUNAL
(Tax and Chancery Chamber)

Hearing venue: The Rolls Building
7 Rolls Buildings
Fetter Lane
London
EC4A 1NL

INCOME TAX – tax avoidance scheme – whether amounts paid by respondent under trust arrangements taxable as earnings from employment under s62 ITEPA 2003 – whether taxable as earnings under Part 7A ITEPA 2003 because paid "in connection with" employment – Edwards v Bairstow challenge – appeal allowed in part – observations in relation to applications for permission to appeal and pleadings before the Upper Tribunal where an Edwards v Bairstow challenge is made

Heard on: 6 and 7 November 2023
With further written submissions on
24 January 2024
Further heard: 27 March 2024
Judgment date: 12 April 2024

Before

MR JUSTICE EDWIN JOHNSON
JUDGE GUY BRANNAN

Between

THE COMMISSIONERS FOR HIS MAJESTY' S REVENUE AND CUSTOMS
Appellants

and

MARLBOROUGH DP LIMITED
Respondent

Representation:

For the Appellants: Julian Ghosh KC and Barbara Belgrano, Sarah Black and Colm Kelly, Counsel, instructed by the General Counsel and Solicitor to His Majesty's Revenue and Customs

For the Respondent: Michael Firth KC, Counsel, instructed by Morr & Co LLP

DECISION

INTRODUCTION

1. Dr Matthew Thomas is a dentist and, at all times material to this appeal, carried on a dental practice through his wholly-owned company, Marlborough DP Limited ("MDPL"), the Respondent in this appeal.

2. MDPL entered into a tax avoidance scheme under which it made payments through certain trust arrangements, described in more detail below, which were then paid to Dr Thomas by way of loans. Essentially, the objective of the scheme was that MDPL would obtain a corporation tax deduction for the payments it made and that Dr Thomas would not pay income tax on the amounts that he received by way of loans.

3. It is now accepted, and it is common ground, that the tax avoidance scheme was not effective. In short, the question now arises as to the correct tax treatment, for both income and corporation tax purposes, of the various payments that were made.

4. MDPL's appeal against (i) determinations in respect of PAYE, (ii) decisions in respect of National Insurance Contributions ("NICs") and (iii) closure notices and discovery assessments in respect of corporation tax came before the First-tier Tribunal (Judge Harriet Morgan and Mr John Woodman) (the "FTT"). The decision of the FTT on the appeal is reported at [2021] UKFTT 0304 (TC) ("the Decision[1]"). The FTT allowed MDPL's appeal in respect of the PAYE determinations and NICs decisions (holding that the payments to Dr Thomas did not constitute employment income in his hands) and, further, concluded that the payments received by Dr Thomas were taxable as distributions in respect of Dr Thomas' shareholding in MDPL. The FTT also concluded (by the casting vote of Judge Morgan, Mr Woodman dissenting) that, if it was wrong and the relevant payments were taxable either as earnings from Dr Thomas' employment or as earnings under Part 7A ITEPA, the payments would be deductible for MDPL in computing its profits chargeable to corporation tax (which we shall refer to as the "Deductibility Issue").

5. The hearing of the appeal to the FTT took place over four days on 16 to 20 November 2020 (with a non-sitting day on 18 November 2020 and with subsequent written submissions received on 20, 25 and 30 November 2020). The Decision was published on 1 September 2021. The Respondents to the appeal to the FTT, the Commissioners for His Majesty's Revenue and Customs ("HMRC"), wrote to the FTT on 3 September 2021, under Rule 37 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) rules 2009 asking the FTT to amend the Decision to make it clear that the Deductibility Issue appeals had been dismissed. HMRC also asked that it be made clearer that the appeals against the PAYE Determinations and the NICs Decisions were allowed, as well as other corrections.

6. HMRC sought permission to appeal on 27 October 2021, again requesting the above clarifications. Permission to appeal was granted on certain grounds by the FTT on 28 March 2022 and the FTT also released an amended Decision (so far unpublished), amended under Rule 37 (clerical errors and accidental slips or omissions). Permission to appeal was granted on all grounds by the Upper Tribunal ("UT") on 3 May 2022. HMRC are therefore the appellants in this appeal against the Decision to the UT.

[1] References below to the "Decision" are to the amended Decision – see paragraph 6 below

7. Prior to the issue of this Decision it has been necessary to deal with two further matters. First, in the course of preparation of this Decision, we drew the parties' attention to a number of authorities which we considered set out helpful statements of general principle but which had not been cited to us. We invited the parties to make submissions on these authorities, if they wished to do so. Those submissions were received on 24 January 2024 and have been taken into account in this Decision. Second, on circulation of this Decision in draft form, for corrections, MDPL contended that there had been a procedural unfairness, which entitled MDPL to make further submissions in relation to one part of what was then the draft version of this Decision. In order to deal with the allegation of procedural unfairness we directed a further hearing on 27 March 2024. Consequential upon that further hearing, and for the reasons which we have set out in a separate decision, supplemental to this Decision, we have decided that there was no procedural unfairness and no right to make further submissions.

8. For the reasons set out below, we allow this appeal in part.

REPRESENTATION

9. At the hearing of this appeal HMRC were represented by Julian Ghosh KC, Barbara Belgrano and Sarah Black, counsel. Mr Colm Kelly, counsel, was also involved in the preparation of the skeleton argument filed by HMRC. MDPL was represented by Michael Firth, counsel. We are grateful to all counsel for their assistance in this appeal.

BACKGROUND

10. All references in square brackets are to the Decision unless the context otherwise requires.

11. The FTT set out in detail its description of the evidence and findings of fact at [9]-[67]. These are not repeated here but, for the purposes of this appeal, the relevant facts can be summarised as follows.

12. MDPL is a company incorporated in England and Wales on 31 May 2007, whose principal activity during the period from 31 May 2007 to 5 April 2015 was that of operating a dental practice. Dr Thomas was the sole shareholder in MDPL for the whole of this period and the sole director since 27 November 2007. Dr Thomas worked as a dentist in MDPL's practice along with an associate.

13. MDPL used a marketed tax avoidance scheme promoted by entities connected with Mr Paul Baxendale-Walker ("BW").

14. Essentially, the scheme attempted to achieve a corporation tax deduction for MDPL in respect of sums paid by MDPL to a "Remuneration Trust" ("RT"), which were approximately equal to the profits made by MDPL for the relevant year (although contributions to the RT exceeded profits for the years 2008-2010 and 2012-2015 and were somewhat less than the profits for 2011).

15. The RT arrangements were as follows.

    (1) On 4 September 2007, Dr Thomas was sent various documents from BW regarding "Remuneration Trust Arrangements".

(2) On 3 October 2007, MTL Management Limited ("MTL") was incorporated in Belize with Dr Thomas as the sole director and shareholder.

(3) BW prepared two similar documents entitled "Report to the Board" dated 16 November 2007 and 5 December 2007 setting out how the RT arrangements were intended to work.

(4) On 20 January 2008, Dr Thomas, as the director of MDPL, resolved to make contributions to the RT. Dr Thomas could not explain why this took place before the RT was established.

(5) The RT was established by Deed executed on 31 January 2008. The RT Deed was made between MDPL and Bay Trust International Limited ("BTIL") of Belize as the trustee. Dr Thomas signed the RT Deed as the director of MDPL.

(6) On 1 February 2008:

(i) BTIL delegated to UPL Holdings Limited, a company established in Belize, "the execution or exercise of all or any of the Trust's powers and discretions conferred upon it as Trustee as regards the management and custody of the Trust Fund."

(ii) UPL Holdings Limited, as "the Principal", and MTL, as "the Fiduciary", entered into a "Fiduciary Services Agreement" pursuant to which MTL was stated to have "all the rights to apply and deal with the Property and the income and capital thereof and all accumulations thereto as if it were the beneficial owner thereof…."

(7) On 19 March 2009 and 26 June 2012, Dr Thomas and BTIL (as trustee of the RT) executed Deeds of Amendment to the RT Deed which were said to have effect retrospectively to the date the RT was established on 31 January 2008.

(8) Several times each year, in the period from 5 March 2008 to 23 March 2015, Dr Thomas, acting as the sole director of MDPL, resolved to make contributions to the RT and, usually within a few days, Dr Thomas would write to BTIL on MDPL headed paper asking it to consider advancing a loan to him. The contributions made by MDPL to the RT comprise all or substantially all the profits made by MDPL from its dentistry practice. A loan would then be made by the RT, via MTL as nominee for the Trustees, to Dr Thomas. In all but two cases the loan was in the same amount as the contribution. In the two other cases, one loan was £1,000 less than the corresponding contribution, and the other loan was £500 more than the corresponding contribution.

16. There were occasions where funds were transferred to MTL before the relevant resolutions were made by MDPL for a contribution to be made to the RT.

17. In each accounting period, MDPL paid Dr Thomas a relatively small salary ranging from £4,390 for the accounting period ending on 31 March 2008 to £10,548 and £9,893 for the accounting periods ending on 31 March 2014 and 31 March 2015 respectively.

18. HMRC opened enquiries into MDPL's tax returns as follows:

Accounting period ended	Return submitted	Enquiry opened
31 March 2009	31 March 2010	21 January 2011
31 March 2012	4 December 2012	28 November 2013
31 March 2013	30 March 2014	1 August 2014
31 March 2014	29 December 2014	15 December 2015
31 March 2015	24 December 2015	9 December 2016

19. HMRC issued closure notices in respect of each of the above enquiries on 2 November 2017.

20. On 28 March 2014 HMRC issued discovery assessments to MDPL for the accounting periods ending 31 March 2008, 2010, and 2011.

21. On 19 March 2015, HMRC issued a Regulation 80 Determination for 2010/11. On 19 February 2016, HMRC issued Regulation 80 Determinations for 2011/12, 2012/13 and 2013/14, as well as Section 8 Decisions for the period 6 April 2011 to 5 April 2014. On 26 April 2016, HMRC issued a regulation 80 Determination for 2014/15 and a Section 8 Decision regarding the year ending 5 April 2015.

THE RELEVANT STATUTORY PROVISIONS

Earnings from employment (including PAYE and National Insurance Contributions)

22. Sums are taxable as employment income under section 6 Income Tax (Earnings and Pensions) Act 2003 ("ITEPA")) if they are "earnings from an employment in a tax year" (section 10(2) ITEPA) where "earnings" are defined by section 62(2) ITEPA as:

> "(a) any salary, wages or fee",
>
> "(b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth" (meaning something that is (i) of direct monetary value to the employee, or (ii) capable of being converted into money or something of direct monetary value to the employee" (under section 62(3) ITEPA), or
>
> "(c) anything else that constitutes an emolument of the employment";

23. An "employment" includes any employment under a contract of service (under section 4 ITEPA)

24. Importantly, for the purposes of the present appeal, provisions in ITEPA that are expressed to apply to "employments" apply equally to "offices" (such as the office of director), unless otherwise indicated and in those provisions, as they apply to an "office", references to being "employed" are to being "the holder of the office", "employee" means the "office holder", and "employer" means "the person under whom the office-holder holds office" (section 5 ITEPA).

25. Section 9(2) ITEPA provides that in the case of general earnings, the amount charged is the net taxable earnings "from an employment" in the year.

26. The PAYE system applies in respect of "PAYE income" for a tax year which includes "PAYE employment income for the year" (under section 683(1) ITEPA) as defined to include "any taxable earnings from an employment in the year determined in accordance with [ITEPA] section 10(2)" (under section 683(2)(a) ITEPA). Under regulation 21 of the PAYE Regulations (made under section 684 ITEPA) an employer is required to deduct income tax from such amounts and account for such tax to HMRC on making a "relevant payment" to an employee.

27. Liability to pay Class 1 NICs on earnings in respect of employment is governed by section 6 of the Social Security Contributions and Benefits Act 1992. Schedule 1 to that Act requires the employer, who pays earnings to an employed earner, to pay both the employer's and the earner's Class 1 contributions to HMRC.

Part 7A Income Tax (Earnings and Pensions) Act 2003

28. HMRC argued that the payments made by MDPL through the RT arrangements to Dr Thomas were taxable as general earnings under section 62 ITEPA. In the alternative, HMRC argued that these payments were taxable under the provisions in Chapter 2 of Part 7A ITEPA ("Part 7A"). Part 7A contains anti-avoidance provisions designed to bring certain payments made by third parties to or for the benefit of employees within the charge to income tax and NICs. Section 554A ITEPA provides:

> (1) Chapter 2 applies if—
>
> (a) a person ("A") is an employee, or a former or prospective employee, of another person ("B"),
>
> (b) there is an arrangement ("the relevant arrangement") to which A is a party or which otherwise (wholly or partly) covers or relates to A,
>
> (c) it is reasonable to suppose that, in essence –
>
> (i) the relevant arrangement, or
>
> (ii) the relevant arrangement so far as it covers or relates to A,
>
> is (wholly or partly) a means of providing, or is otherwise concerned (wholly or partly) with the provision of, rewards or recognition or loans in connection with A's employment, or former or prospective employment, with B,
>
> (d) a relevant step is taken by a relevant third person, and
>
> (e) it is reasonable to suppose that, in essence—
>
> (i) the relevant step is taken (wholly or partly) in pursuance of the relevant arrangement, or
>
> (ii) there is some other connection (direct or indirect) between the relevant step and the relevant arrangement.
>
> (2) In this Part "relevant step" means a step within section 554B, 554C or 554D.
>
> (3) Subsection (1) is subject to subsection (4) and sections 554E to 554Y.
>
> …
>
> (5) In subsection (1)(b) and (c)(ii) references to A include references to any person linked with A.

(6) For the purposes of subsection (1)(c) it does not matter if the relevant arrangement does not include details of the steps which will or may be taken in connection with providing, in essence, rewards or recognition or loans as mentioned (for example, details of any sums of money or assets which will or may be involved or details of how or when or by whom or in whose favour any step will or may be taken).

(7) In subsection (1)(d) "relevant third person" means—

(a) A acting as a trustee,

(b) B acting as a trustee, or

(c) any person other than A and B.

…

(11) For the purposes of subsection (1)(e)— (a) the relevant step is connected with the relevant arrangement if (for example) the relevant step is taken (wholly or partly) in pursuance of an arrangement at one end of a series of arrangements with the relevant arrangement being at the other end, and (b) it does not matter if the person taking the relevant step is unaware of the relevant arrangement.

(12) For the purposes of subsection (1)(c) and (e) in particular, all relevant circumstances are to be taken into account in order to get to the essence of the matter."

Distributions

29. Sections 383 and 384 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA") impose a charge to income tax on "dividends and other distributions of a UK resident company" by reference to amount or value of the dividends paid and other distributions made in the tax year. The term "distribution" has the meaning given by Chapters 2 to 5 of Part 23 of the Corporation Tax Act 2010 ("CTA 2010") (excluding section 1027A). The relevant provisions for present purposes are contained in section 1000 CTA 2010 which relevantly provides:

"1000 Meaning of "distribution"

(1) In the Corporation Tax Acts "distribution", in relation to any company, means anything falling within any of the following paragraphs.

Any dividend paid by the company, including a capital dividend.

Any other distribution out of assets of the company in respect of shares in the company, except however much (if any) of the distribution—

…

(b) is (when it is made) equal in amount or value to any new consideration received by the company for the distribution.

For the purposes of this paragraph it does not matter whether the distribution is in cash or not…… (*Emphasis added*)

30. Section 1113 CTA 2010 provides that "a thing is regarded as done in respect of a share" if "it is done to a person:(a) as the holder of the share, or (b) as the person who held the share at a particular time" (sub-section (3)) and/or if "it is done in pursuance of a right granted, or an offer made, in respect of a share" (sub- section (4)).

Corporation tax deduction

31. For accounting periods ending on or before 31 March 2009 the relevant provision, in terms of the deduction of expenses for corporation tax purposes, is section 74(1) Income and Corporation Taxes Act 1988. For accounting periods ending on or after 1 April 2009, the relevant provision is section 54(1) Corporation Tax Act 2009. Both provisions prohibit the deduction of expenses not incurred "wholly and exclusively for the purposes of the trade" (including a profession or vocation).

THE DECISION

The Decision – The assessment of the credibility of Dr Thomas

32. We were provided with an agreed timetable of the hearing before the FTT. We also have the benefit of a transcript of the hearing. The principal witness at the hearing was Dr Thomas himself, who gave oral evidence on the first day of the hearing, and was cross- examined at some length by Mr Ghosh. At [9] the FTT concluded that Dr Thomas was a credible witness. The FTT stated that this impression was formed at the hearing, and was confirmed in the post hearing discussions of the members of the FTT, which took place very shortly after the hearing itself.

The Decision - Were the payments earnings under general principles?

33. The FTT considered first the issue whether the sums paid by MDPL via the RT constituted "earnings from employment" under section 62 ITEPA under general principles. If the sums were "earnings from employment" MDPL would have been under an obligation to deduct PAYE and account for NICs in respect of those payments.

34. After a detailed explanation of the relevant case-law at [78]-[116], including the decision of the Supreme Court in *RFC 2012 plc (in liquidation) (formerly Rangers Football Club plc) v Advocate General for Scotland* [2017] STC 1556 ("*Rangers*"), the FTT concluded at [126]-131] that the sums in question did not constitute earnings on general principles.

35. At [128] the FTT formulated the question, and it was common ground that this formulation was correct, as follows:

> "(1) whether contributions made by MDPL (which enabled those funds to pass into Dr Thomas' hands as loans) are to be regarded as remuneration or a reward for the provision of Dr Thomas' services as director of MDPL on the basis that that role is the reason why MDPL made the contributions or is a sufficiently substantial case of the contributions for this test to be met; or
>
> (2) whether MDPL made the contributions for a different reason such that they have a non-employment source, the only identifiable other reason being that they were made in respect of Dr Thomas' shareholding in MDPL."

36. The FTT observed at [129] that the difficulty in the case before it was that there was little to indicate what was the underlying purpose of MDPL in enabling the payments to flow into Dr Thomas' hands. However, the FTT considered that such evidence as there was pointed to the conclusion that the relevant sums were not paid to Dr Thomas under the RT arrangements as a reward for his services as director but rather that they were distributions made as a return on his shareholding in MDPL. The distribution legislation was broad enough to capture the relevant sums notwithstanding that they were paid in the form of contributions to the RT and by way of subsequent loans. The FTT said:

> "(1) There was no contractual obligation on MDPL to pay the sums as a reward for Dr Thomas' services as director/dentist and there is nothing in any of the documents or evidence to suggest that that was the reason for the extraction of MDPL's funds into Dr Thomas' hands.
>
> (2) The sums paid to Dr Thomas comprised the totality of the overall profits of MDPL's business, as computed after the deduction of expenses, such as salaries paid to those employed by MDPL including the relatively small salary paid to Dr Thomas and, accordingly they were paid out sporadically.
>
> (3) Dr Thomas' evidence was that, had those profits not been routed through the RT arrangements, they would have been paid to him by way of dividend and not as salary. It lends support to the credibility of Dr Thomas's evidence in this respect that:
>
> (a) As Mr Firth noted, it is a well-known common practice for a sole owner and director of a company to organise matters such that the relevant company pays him or her a low salary and much more substantial dividend payments (and see the comment in [130] below).
>
> (b) That is how Dr Thomas extracts profits from the company he now operates through now he no longer uses the RT arrangements and, as noted, MDPL paid him a small salary during the periods in question.
>
> (4) For the reasons set out in full below, we do not accept HMRC's view that Dr Thomas' evidence is not relevant. In short, (a) his evidence, as the controlling mind of MDPL, indicates that its purpose, in putting in place steps to extract the funds into the hands of Dr Thomas, was to provide him with a return on his investment in it as shareholder in the same way as if it had formally declared and paid a dividend, and (b) it does not detract from this that Dr Thomas and MDPL did not consider that MDPL was making a dividend or check that in making the relevant contributions MDPL was not making an unlawful distribution for company law purposes."

37. The FTT at [130] noted that there was nothing to prevent the sole owner and director of a company from arranging for the profits of the company's business to be extracted in the form of salary and as dividends/distributions in such proportions as he or she may wish. Thus, a sole owner and director of the company (as a person through whom the company acts) could simply choose, in effect, to what extent he or she is to be rewarded by the company for his/her role as director/manager of the company's business and/or shareholder/owner of the company. There was no presumption that, if the profits of such a company are extracted from it into the hands of the shareholder/director otherwise than by way of a dividend (which conformed with company law procedures), the profit must be assumed to be received as a reward for the shareholder/director's services as director/employee.

38. Next, the FTT at [131] considered the following factors which HMRC argued supported their case:

> (1) MDPL received income generated by its dental business because of Dr Thomas' role as director;
>
> (2) the resulting profits represented the "fruits of his labour"; and
>
> (3) the payments of these amounts as contributions to the RT were not declared as dividends and were not related to his shares in MDPL.

39. The FTT rejected these arguments also at [131(1)]. The FTT considered, first, that HMRC's view of the facts was not consistent with the distinction for corporate and tax law purposes between MDPL, as a legal person in its own right, and the individuals involved in its management and operation. MDPL carried on a business of operating a dental practice and engaged with customers for the provision of dental services in return for fees from customers. As a corporate entity, its management was necessarily conducted on its behalf by its director and its operation was carried out by individuals engaged to provide dental services. In that context, MDPL necessarily acted through Dr Thomas' agency as its sole director in conducting its dental business and the overall profit arose from the work done on MDPL's behalf by all of its employees and not just that of Dr Thomas.

40. Secondly, at [131(2)], the FTT took the view that the fact that the relevant sums were paid through (adopting HMRC's terminology) "untruthful" RT arrangements, which were implemented only for tax avoidance purposes, did not of itself (contrary to what HMRC seemed to suggest) provide evidence that the relevant sums were a reward for Dr Thomas' services as director/dentist (or, for that matter, that they were distributions). The FTT noted the following:

> (1) Dr Thomas accepted that (i) the RT arrangements were put in place solely with the aim of getting the profits of MDPL's business into his hands tax-free whilst enabling MDPL to obtain a tax deduction for the payments it made and (ii) the RT arrangements did not succeed in achieving these tax consequences given that they were based on factually incorrect propositions as regards the basis on and purposes for which the contributions were paid by MDPL;
>
> (2) the use of an ineffective structure solely for the purpose of obtaining a tax advantage did not shed light on the underlying reason for the extraction of the funds from MDPL into Dr Thomas' hands. Once the RT arrangements were stripped bare of the "untruths" on which they were based, the FTT was left with the conundrum of determining, as a matter of substance, MDPL's purpose in putting the monies into Dr Thomas' hands.
>
> (3) Thus, the manner in which the relevant sums were extracted from MDPL merely indicated that Dr Thomas/MDPL wanted to avoid a charge to tax on Dr Thomas in respect of those sums whilst ensuring MDPL would obtain a tax deduction for the payments. Since the stated reasons for the arrangements were spurious and unfounded they did not shed light on whether (i) the parties' underlying purpose was to reward Dr Thomas for his services as director, whilst securing for MDPL a tax deduction that an employer would usually obtain in respect of such sums or (ii) to avoid a charge to tax on Dr Thomas on sums intended as a return on his shares in MDPL whilst generating a tax deduction for MDPL which was not usually available.

41. Thus, at [131(3)] the FTT considered that HMRC's reliance on the evidence which, they argued, demonstrated that the contributions/loans did not constitute dividends/distributions was misplaced. Furthermore, in the light of the admitted "untruths" which formed the basis of the scheme it was unsurprising that Dr Thomas said that he and BW did not consider MDPL to be paying dividends under the RT arrangements and did not consider the company law tax consequences of the relevant sums being dividends or distributions. The FTT, noting that Dr Thomas, as director of MDPL, thought that he could achieve a desirable tax result, considered that this left open the question of whether, through the ineffective tax structure, Dr Thomas/MDPL's underlying purpose was to reward Dr Thomas for his services as a director or to provide him with a return on his investment as a shareholder.

42. The FTT noted at [131(4)] that Dr Thomas did not accept that (a) he would have received the same amounts to the RT structure even if he had not been the sole shareholder of MDPL and (b) the relevant sums were not paid in respect of his shares in MDPL.

43. Even if all of MDPL's profits could be regarded as the fruits of Dr Thomas' work as director (because he managed the dental business on its behalf), the FTT at [131(5)] did not consider HMRC's approach to be correct. HMRC had not pointed to any material factor indicating that the relevant sums were sufficiently linked with Dr Thomas' role as director to constitute earnings or that the sums were not paid in respect of Dr Thomas' shares. At [131 (5)(a)(i)-(ii)] the FTT characterised HMRC's case as coming down to a proposition that:

> (1) income/profits arising to a corporate owner of the business which were in part generated by the activities of its sole shareholder and director, were necessarily linked in their entirety to that individual's role as a director; and
>
> (2) unless paid by way of a formal dividend, the extraction of those sums from the company into the individual's hands constituted earnings as the fruits of the individual's work as a director.

44. However, at [131(5)(b)] the FTT considered HMRC's approach to be unsupported and out of line with the case law in relation to earnings. In assessing whether sums constituted earnings, the courts looked at the reasons why the employer makes a payment to an employee/director and not the reasons why the employer receives the funds in the first place. Secondly, the decision in *Rangers* did not assist. In that case the sums in dispute constituted a reward for the footballers' services as employees. Whilst the sums were paid through a trust structure with some similarity to the RT arrangements, this did not prevent those sums being taxed as earnings and it was not of itself the reason why the sums were taxable as earnings.

The Decision - Part 7A ITEPA

45. At [133] the FTT noted that it appeared to be common ground that a relevant step was taken within the meaning of section 554C(1)(a) ITEPA, which provides that a person ("P") takes a step within the section if he pays a sum of money to a relevant person.

46. Next, at [134] the FTT observed that where the relevant conditions were satisfied, Part 7A provided, in broad terms, that the value of the relevant step counted as employment income of A in respect of A's employment with B generally for the tax year in which the relevant step was taken. It was also, apparently, not in dispute that to the extent Part 7A was applicable NICs would also be due in respect of the sums taxable under those provisions.

47. The FTT at [137] agreed with MDPL's submissions that, reading section 554A(1)(c) in context, for there to be a "connection" of the required kind with Dr Thomas' employment, "the employment must be part of the reason for the reward, recognition or loan". On that basis, an assessment of whether it was reasonable to suppose that, in essence the RT arrangement so far as it related to Dr Thomas was (wholly or partly) a means of providing or, was otherwise concerned (wholly or partly) with, the provision of, rewards or recognitions or loans *in connection with* Dr Thomas' employment required essentially the same analysis as that set out in relation to whether the relevant sums constituted earnings under general principles. Accordingly, the FTT concluded that this test (i.e. the connection test) was not met, for the same reasons as set out in respect of the earnings from employment test.

48. There was one further contentious matter which the FTT discussed, at [138]. There was a dispute as to precisely which sums were caught by Part 7A, if contrary to the FTT's conclusion, those provisions were applicable. Part 7A was introduced by the Finance Act 2011 ("FA 2011") with effect in relation to relevant steps taken on or after 6 April 2011 (see paragraph 52(1) Schedule 2 to FA 2011). However, that provision was subject to an "anti-forestalling" provision in paragraph 53 of Schedule 2 to FA 2011. Paragraph 53 provides that:

> (1) Chapter 2 of Part 7A applies to a step
>
> > (a) if on or after 9 December 2010 but before 6 April 2011 a relevant step ("the early step") within section 554C(1)(a) ITEPA is taken,
> >
> > (b) Chapter 2 of Part 7A of would have applied by reason of the early step had the reference in paragraph 52(1) of Schedule 2 to 6 April 2011 been a reference to 9 December 2010, and (c) the early step is not chargeable to income tax by virtue of Schedule 34 to the Finance Act 2004 in whole or in part.
>
> (2) In determining the tax year for which the employment income of "A" (i.e. the employee/director) counts for the purposes of s 554Z2(1) ITEPA, the early step is treated as having been taken on 6 April 2012; but, otherwise, chapter 2 of Part 7A applies by reference to when the early step was actually taken.

49. At [144] the FTT noted that, given its conclusions in relation to the application of Part 7A, it was not necessary to decide this issue. However, the FTT briefly outlined its views as follows:

> (1) it was reasonable to suppose that HMRC's conclusion was that all relevant sums arising in connection with the RT arrangements which were properly attributable to the tax year 2012/13 were subject to income tax in that year. On that basis the FTT considered that HMRC were not precluded from arguing that income tax was chargeable under Part 7A in respect of the 2012/13 tax year by reference to the value of all relevant sums properly attributable to that year, whether they arose in the tax year or in an earlier period under the anti-forestalling rules.
>
> (2) Given that the MDPL did not object to HMRC raising the argument on fairness grounds (and whether Part 7A applied was addressed in full at the hearing), there was no basis for the FTT to preclude HMRC from raising this point.
>
> (3) There was no concern that the relevant sums might be taxed twice by virtue of section 554Z11C ITEPA.

The Decision - The Deductibility Issue

50. In the light of its conclusion that the contributions were not taxable as general earnings or under Part 7A ITEPA, it was not necessary for the FTT to express a conclusion in relation to the Deductibility Issue – indeed, at [145] MDPL is recorded as having accepted that in these circumstances it would not be entitled to a deduction for the contribution in computing its profits for the relevant accounting periods for corporation tax purposes. However, the point having been fully argued, the FTT considered the position on the Deductibility Issue in case it was wrong in its conclusion that the sums were not taxable under ITEPA.

51. On this issue each member of the FTT reached a different conclusion. Judge Morgan decided the Deductibility Issue in favour of MDPL whereas Mr Woodman reached the opposite conclusion. Judge Morgan would have decided this issue, if it had arisen, by virtue of her casting vote, in favour of MDPL.

52. Judge Morgan's views were based on the assumption that the relevant sums "constitute earnings". Accordingly:

(1) MDPL's purpose in paying the contributions (and thereby funding the loans) had to be taken to be to provide Dr Thomas with earnings; and

(2) in choosing to deliver the relevant funds to Dr Thomas as contributions and loans through the RT arrangements, MDPL's purpose must be taken to be to avoid the sums being taxed as earnings on the basis that preserved the usual consequential tax effect of an employer paying such sums, namely, that MDPL would obtain a tax deduction for them in computing its profits for corporation tax purposes.

(3) This was (using the language used in *Scotts Atlantic v HMRC* [2015] UKUT 66 (TCC at [67]) the "ordinary, intended or realistically expected outcome" or, as it was put in *Vodafone Cellular Ltd and others v Shaw* [1997] STC 734, a consequential or incidental benefit of, expending sums which, according to MDPL's "true" intent, were incurred to reward Dr Thomas for his services as director. Furthermore, Judge Morgan did not consider that the assessment of MDPL's underlying true purpose in making the contributions was affected by the fact that:

(a) The particular method for extraction of the relevant sums into Dr Thomas' hands was dictated by the desire to ensure that, contrary to Dr Thomas'/MDPL's "true" purpose, the relevant sums are not viewed as earnings.

(b) In order to give effect to and further this objective, MDPL acted ostensibly on the basis of the justification for obtaining a tax deduction for them which, as Dr Thomas accepted, was untrue, rather than on the basis of the "true" reason namely that the contributions were made to reward Dr Thomas for his services as director.

(4) HMRC's argument was that the existence of inaccurate or untrue statements in the relevant documents as regards the reasons for the routing of the relevant sums through the RT arrangements was a free-standing reason for a corporation tax deduction to be denied. However, it was for the FTT to establish, in all the circumstances, MDPL's purpose in making the contributions. Statements and documents (such as those in the resolutions for the making of the contributions) which were admittedly untrue did not cast light on the "true" purpose for which the sums were expended.

53. Mr Woodman's dissenting view is recorded as being that MDPL pursued a scheme to such an extent that the planned tax efficiency was an object in itself in addition to that of rewarding Dr Thomas. Accordingly, Mr Woodman did not consider that the relevant expenditure was incurred wholly and exclusively for the purposes of its trade.

GROUNDS OF APPEAL

54. It was common ground that the PAYE Determinations and the NICs Decisions stood or fell together. Thus, HMRC's grounds of appeal in relation to the PAYE Determinations applied equally to the NICs Decisions.

55. The core bundle for this hearing included HMRC's application to the FTT for permission to appeal against the Decision, and HMRC's renewed application to the UT for permission to appeal (permission to appeal not having been granted on all grounds by the FTT). In terms of identifying clearly articulated individual grounds of appeal, we found both applications for permission to appeal less than clear. The individual grounds of appeal were not clearly stated. In these circumstances we have found it easier to summarise the grounds of appeal as they are explained in HMRC's skeleton argument. In taking this course, and in considering the arguments of HMRC in the appeal, we stress that we have kept in mind the submissions of Mr Firth that HMRC should not be permitted, in its arguments in the appeal, to go beyond the grounds of appeal for which permission to appeal was granted by the UT. We have therefore been mindful of the need to pay attention to the grounds of appeal as they are identified in the applications for permission to appeal, notwithstanding the difficulties of identifying the individual grounds of appeal. We shall make certain comments about the formulation of HMRC's grounds of appeal later in this decision.

56. In brief summary therefore, the grounds of appeal were as follows.

Ground 1 (the Part 7A issue) – permission given by the FTT

57. The FTT erred in law in finding that Part 7A ITEPA did not apply. In particular, the FTT erred in holding that, as it had held the payments by MDPL to the RT were not "earnings" within section 62 ITEPA, it followed that Part 7A ITEPA could not apply to the arrangements because the tests were the same. The tests were not the same. In the case of Part 7A ITEPA a different test (of connection) applies. If Part 7A ITEPA applied, the issue of the anti-forestalling rules arose.

Ground 2 (the general earnings issue) – permission given by the UT

58. The FTT erred in law in concluding that the payments made by MDPL to the RT were not earnings within section 62 ITEPA. In particular the FTT erred in law,

(1) in reaching the conclusion that the monies "lent" to Dr Thomas each year were not "emoluments" which were "from" Dr Thomas' directorship in MDPL;

(2) in holding that the monies paid by MDPL to the RT were, therefore, distributions made "in respect of shares" held by Dr Thomas in MDPL.

Ground 3 (the Deductibility Issue) – permission given by the UT

59. HMRC argued that there was uncertainty as to the FTT's conclusion in relation to the Deductibility Issue in the FTT's decision released on 1 September 2021. The FTT released a modified decision on 28 March 2022, amended under the "slip rule" in Rule 37 of The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (as amended). HMRC argue that the amendments made by the FTT under the "slip rule" did not resolve this uncertainty.

60. The UT, in its decision granting permission to appeal, specifically gave HMRC permission to appeal in respect of the Deductibility Issue. Moreover, in its Respondent's Notice dated 7 June 2022, MDPL also sought contingent permission to appeal in respect of the Deductibility Issue which was only relevant if MDPL was unsuccessful on Grounds 1 and 2 (i.e. the employment remuneration grounds).

61. HMRC invited us to determine whether the FTT separately and entirely dismissed MDPL's appeals on the Deductibility Issue (in which case the appeal against the Decision on the Deductibility Issue would be MDPL's appeal) or whether the FTT dismissed the Deductibility Issue appeals on a contingent basis, as MDPL contends (in which case the appeal against the Decision on the Deductibility Issue would be HMRC's appeal).

62. In our view, and we do not consider this to be controversial, the Deductibility Issue only arises if we were to find that the payments by MDPL via the RT were either employment income on general principles (section 62 ITEPA) or under Part 7A ITEPA. If, as the FTT found, these payments were distributions in respect of shares the payments would be non-deductible for corporation tax purposes, the Deductibility Issue does not arise. Payments that qualify as distributions are not deductible as revenue expenses laid out wholly and exclusively for the purposes of the trade. Because the FTT allowed MDPL's appeal in relation to general earnings and in respect of Part 7A ITEPA, it followed that MDPL's contributions were non-deductible.

63. It seems to us to follow from this analysis that the FTT would have dismissed the Deductibility Issue appeals because, given its decision that the relevant payments were distributions, the payments could not be deductible for corporation tax purposes. The actual decision of the FTT on the Deductibility Issue, by the casting vote of Judge Morgan, was that MDPL would have been entitled to a deduction for the amount of the contributions in computing its profits for corporation tax purposes, if the contributions had been taxable as employment income in the hands of Dr Thomas. All other things being equal, this conclusion meant that the Deductibility Issue appeals would have been allowed. The appeals were not allowed, but instead were dismissed because they did not arise, in the light of the decision of the FTT to allow MDPL's appeals in relation to the issues of general earnings and Part 7A ITEPA. If the appeals on the Deductibility Issue had arisen, they would have been allowed. We therefore conclude that the FTT would have dismissed the appeals on the Deductibility Issue on a contingent basis, with the consequence that the appeal on the Deductibility Issues is properly characterised as the appeal, or more accurately as part of the appeal, of HMRC against the Decision.

DISCUSSION

Ground 2 – general earnings

64. Although HMRC advanced Part 7A ITEPA as their first ground of appeal, we consider it more logical to address first, as the FTT did, the issue of whether the payments made by MDPL constitute earnings under general principles pursuant to section 62 ITEPA. This was the order followed by the FTT.

65. It was common ground that the FTT had set out the correct legal test regarding whether a payment was "from" an employment for the purposes of section 62 ITEPA; see in particular the Decision at [127].

66. In summary, Mr Ghosh, for HMRC, argued that the payments by MDPL to the RT and the subsequent loans to Dr Thomas constituted payments from Dr Thomas' office as a director of MDPL. Mr Ghosh observed that Dr Thomas drew no or a minimal salary from MDPL during the years in question, but previously had taken drawings. The payments by MDPL to the RT, Mr Ghosh submitted, effectively represented the fruits of Dr Thomas' labours, albeit that they also reflected the labours of other employees in the dental practice. Furthermore, the payments to the RT were authorised by Dr Thomas as a director of MDPL. It followed, so Mr Ghosh's submission went, that the payments by MDPL represented the earnings of Dr Thomas which

were received by Dr Thomas in the form of loans which were never, in reality, intended to be repaid. Moreover, the *Rangers* case established that it was not possible to avoid income tax on earnings by arranging for them to be paid to a third party.

67. Mr Ghosh mounted what was, effectively, an *Edwards v Bairstow* challenge regarding some of the FTT's findings of fact in relation to whether the contributions to the RT were distributions in respect of shares. Essentially, Mr Ghosh submitted that Dr Thomas' evidence was that the contributions by MDPL to the RT had nothing to do with his shareholding. It followed, Mr Ghosh contended, that the FTT's findings to the contrary were perverse or (and there was some dispute whether this fell within HMRC's grounds of appeal) that the FTT had failed to take account of relevant evidence.

68. Mr Firth submitted that the FTT's analysis of the law in relation to whether the payments to Dr Thomas constituted payments "from" employment was unimpeachable.

69. The FTT, Mr Firth emphasised, had analysed the *Rangers* case in detail. He submitted that the actual issue in that case was not to do with whether the payments to a trust were remuneration for the employees' services (they clearly were), but rather whether it was necessary that the employee should receive or be entitled to receive the remuneration in order to be taxed on it. The FTT was fully aware, Mr Firth submitted, that "redirecting" earnings did not stop them being taxable if the payment was "from" employment ("don't pay me, pay someone else"). Redirection of a payment did not inform the question whether it was from employment in the first place. Mr Firth considered that the FTT at [127] had correctly summarised the test to be applied.

70. In our view, the FTT analysed the law in meticulous and commendable detail. There was no misunderstanding of the correct legal principles in relation to the test of determining whether payments were "from" employment. We did not understand the FTT's analysis of the relevant legal principles to be in dispute. What was, however, contested was the application of these principles to the facts.

71. The essential question in this appeal was the *source* of the payments made by MDPL to the RT (see the Decision at [128]): was the source the office of Dr Thomas as a director of MDPL or was the source his shareholding in MDPL? The correct identification of a source of income is an elementary and fundamental question in relation to income tax. This was the point emphasised by Moses LJ in *HMRC v PA Holdings Ltd* [2011] EWCA Civ 1414 ("*PA Holdings*").

72. Historically, under a system dating back to 1803, income tax was assessed under various Schedules which taxed different sources of income. Until 2003, employment income was taxed under Schedule E and, until 2005, distributions by companies in respect of shares were taxed under Schedule F. The Schedules were mutually exclusive and the Crown had no option to select which Schedule applied to income from any particular source. If the income fell primarily within one Schedule it could not be taxed under another (see *Fry v Salisbury House Estate* [1930] AC 432, at 442). Schedule E was abolished by the provisions of ITEPA 2003 in relation to the different types of employment income. From 6 April 2005, ITTOIA 2005 abolished various other Schedules including, relevantly, Schedule F. Now, therefore, employment income is taxed under ITEPA 2003 and distributions are taxed as savings and investment income under ITTOIA 2005. However, the different categories of income (i.e. "employment income" and "savings and investment income") continue to be mutually exclusive. In other words, the mutual exclusivity of the old schedular system continues.

73. There are many judicial decisions about whether a payment is "from" an employment. It was, however, common ground that, after a detailed review of the relevant authorities, the FTT had correctly stated the applicable law at [127] when it said:

> "127. …[I]t is plain from the caselaw that sums constitute earnings if they are paid as remuneration or a reward in return for a person's services as an employee. The courts have consistently recognised that, given the test is centred on why or in return for what a payment is made, establishing the purpose of an employer in making a payment is key to assessing, as it was put in *PA Holdings*, its character in the hands of the recipient "looking at its substance and not its form". As summarised in *Kuehne*[2] the courts have also recognised that this may be a difficult finely balanced exercise where there is more than one reason for a payment. As it was put at [52] of that case, a tribunal or court needs to be satisfied that the payment is from employment rather than from a non employment source. That involves evaluating the reasons and background to the payment and applying a judgment as to whether the payment was from the employment rather than from something else. Whilst employment "does not have to be the sole cause" of the payment "it does have to be sufficiently substantial as to characterise the payment as one from employment" (see [56] of *Kuehne*)."

74. The difficulty in the present case, as the FTT highlighted at [129], was that there was relatively little to tell the FTT what the underlying purpose of MDPL (and therefore the source of the payment) was when it paid the relevant sums to MDPL and which were then on paid to Dr Thomas via loans from the RT.

75. In our view, the FTT was faced with an evaluative judgment as to whether the payment by MDPL via the RT to Dr Thomas was from employment or in respect of his shareholding in MDPL. Essentially, this was an evaluative decision to be reached in the light of all the relevant evidence. It is well-established that this Tribunal should be reluctant to interfere with the decision of the FTT, which heard all the witness evidence and considered all the documentary evidence, in a decision where the underlying legal principles – in this case what constitutes a payment "from" employment – are not in dispute.

76. Section 11(1) of the Tribunals, Courts and Enforcement Act 2007 provides that a party to a case before the FTT only has a right of appeal to the Upper Tribunal on a point of law arising from the FTT's decision. There cannot be an appeal on a pure question of fact which is decided by the FTT. This Tribunal cannot set aside the FTT's findings of fact even if we disagree with the FTT's findings or consider it likely that we would have made different findings if we had been sitting at first instance. However, a tribunal may arrive at a finding of fact in a way which discloses an error of law in the following circumstances.

77. First, we have power to set aside a decision of the FTT if the FTT took into account irrelevant considerations or failed to take into account relevant considerations. On this ground, it must further be shown that the considerations wrongly taken into or left out of account must be material in the sense that they might (not would) have affected the outcome: see Henderson LJ in *Degorce v HMRC* [2017] EWCA Civ 1427 at [95]. Where such a flaw in the fact-finding process is identified, there is no additional requirement to establish "perversity" (as described in paragraph 78 below): see *WM Morrison Supermarkets PLC v HMRC* [2023] UKUT 20 (TCC) at [58]. In this connection, we bear in mind that the categorisation of a fact as probative of (i.e. relevant to) a particular issue or legal test is a question of law and the question whether

[2] [2012] EWCA Civ 34,[2012] STC 840.

it is so probative is a question of fact, although how a tribunal applies any categorisation of a fact to the circumstances of a particular case is likely to be a question of fact and not of law: see Arden LJ at [77] and [101] in *Davis & Dann Ltd v* HMRC [2016] EWCA Civ 142.

78. Secondly, we have the power to set aside a decision of the FTT if the FTT's overall conclusion on any issue if it was one that "no person acting judicially and properly instructed as to the relevant law could have come to" (or, as a shorthand, that it was "perverse") because in those circumstances we would be bound to assume that there has been some misconception of the law and that this has been responsible for the determination (*Edwards v Bairstow* [1956] AC 14 per Lord Radcliffe at 36).

79. As we have indicated, we are satisfied that the FTT thoroughly understood and analysed the correct legal principles at [68]-[116] in respect of whether payments were "from" an employment (including the office of director). We did not understand HMRC to argue to the contrary.

80. Before examining the disputed passages of the Decision and the transcript of the hearing before the FTT, we should record that it was common ground that the authorities established a number of propositions. First, was the proposition that the Decision had to be read fairly and as a whole, not picking upon individual passages in isolation. Secondly, the FTT was under no obligation to deal with every submission or piece of evidence – to conclude otherwise would place an intolerable burden on the fact-finding tribunal. It was necessary only to deal with relevant evidence and submissions. Moreover, the mere fact that the FTT does not refer to a piece of evidence does not mean that the evidence was overlooked or ignored. Thirdly, there was a presumption that if the FTT correctly sets out the law it can be taken to have applied it correctly. Obviously, mistakes can be made and if it can be shown that the FTT did not apply the legal test correctly that presumption can be rebutted.

81. To these propositions, Mr Ghosh added a fourth, viz that the deference accorded to a fact-finding tribunal was diluted if its decision was delivered after a reasonable time. We shall return to this point after considering the disputed passages of the Decision and the transcript of the hearing before the FTT.

82. Mr Ghosh argued that the only reasonable conclusion open to the FTT on the evidence before it was that the contributions made by MDPL to the RT were not made "in respect of shares" held by Dr Thomas in MDPL. Therefore, it followed, that for the reasons set out in paragraph 66-67 above, the payments were from Dr Thomas' office as a director of MDPL and therefore were taxable as general earnings under section 62 ITEPA (or under Part 7A ITEPA). Dr Thomas' evidence in cross-examination made it clear, in Mr Ghosh's submission, that there was, as he put it, a "disconnect" between Dr Thomas' shareholding in MDPL and the contributions.

83. We were taken by Mr Ghosh to various extracts from the transcript of the hearing before the FTT and to certain passages from the Decision. We set these out as follows.

84. In the Decision the FTT stated:

> "43. Mr Ghosh suggested in his submissions that, on the basis of this evidence, Dr Thomas accepted that he would have received 100% of the contributions as loans even if there had been another shareholder such as his wife. However, we do not accept that conclusion can be drawn from this evidence. In cross examination the relevant questions were focussed on whether, if Dr Thomas

had not held all the shares in MDPL, that would have made any difference to the sums contributed to MDPL. Dr Thomas was not asked whether if the shareholdings were different he would still have received all the sums contributed by way of loan.

…

49. It was put to Dr Thomas that the loans he received had nothing to do with him holding shares in MDPL; it was just a good way of extracting that money tax-free. He said: "That's what I was told, yes". We note that Dr Thomas agreed only that this is what he was told; he did not state that he thought that the loans had nothing to do with his shareholding.

53. We do not take from this evidence that, as Mr Ghosh suggested, Dr Thomas accepted that the monies received by MDPL (and passed on to him under the RT arrangements) were all related to his role as director given that he only agreed with that proposition when asked to put to one side the fact that MDPL employed others, such as the associate dentist and hygienist. Otherwise, he was clear that, in his view, but for the RT arrangements, MDPL's profits would have been extracted as dividends and that those profits are generated by other person's activities for MDPL as well as his own (as accords with the evidence set out at [41(2)])."

85. Mr Ghosh then pointed out the following extracts from the transcript from his cross-examination of Dr Thomas, as follows:

[Day 1/57/3-58/17]

Q. I'm asking you something very simple. I'm sorry to press it and make a meal of it, but I do want to hear this from you, so that when I make submissions on your evidence, I don't put a spin on it. At paragraph 22, taking the loans out in a way that's not taxable for you, that was one of the things that appealed to you and one of the objectives of the scheme; that's right, isn't it?

A. One of them, yes.

Q. Yes. Now, let's get to the other one, which is looking at paragraph 24: that the money that's being paid by the company to the trust, you wanted a tax deduction for the company; that's the other feature, isn't it?

A. Yes.

Q. Now, you said there in 24 that the way you'd quantify it, so that the amount of money paid was simply all the profits of the company; that's right, isn't it?

A. Yes.

Q. And that was the only driver, the only component of giving the number of how much was going to be paid: it was to reduce the CT [Corporation Tax] profits to nil, wasn't it?

A. Yes.

Q. And that would have been exactly the same whether you held 100% of the shares or, like now in this other company you've got, your wife held 25% of the shares; it would have been exactly the same, wouldn't it?

A. I'm sorry, I don't ––I don't understand –

Q. Don't you?

A. ––what you're asking, sorry.

Q. The way that you quantified how much the company was going to pay –

A. Yes.

Q. ––was simply the number that reduced the CT profits to zero; yes?

A. Yes.

Q. And my question is: and you would have paid that exact same amount whether you held 100% of the shares or, like in your other new company, 75% of the shares?

A. Yes.

[Day 1/68/22-69/4]

"Q. All right. At 31, if you could just read that. That confirms everything we have said, and you've said, which is that the amount paid was simply to reduce the CT profits to nil and whether you held 100% of the shares or less than 100%, that doesn't make any difference. Is that a fair summary of where we've got to, when we read 31?

A. Yes."

[Day 1/98/9-99/9]

"Q. Okay. Now, have a look, then, back at 712. And just before you do, I'm going to remind you that you accepted before lunch that the primary purpose of the contributions was to be able to make you tax−free loans. Do you remember? Do you remember that?

A. And to reduce the liabilities of tax on the company.

Q. I think I was very careful in how I choose my words, and I said to you the primary purpose was to deliver to you these tax−free loans; but ––and you took a note of it, you said "yes". So are you changing your evidence now?

A. I'm sorry, I don't recall that. But the main purpose was to reduce tax liabilities on the company, as well as to take tax−free loans out for myself.

Q. Yes. And these tax−free loans, just while we're at it, because I'm about to ask you some questions about this resolution, you already accepted that the payments into the trust, they were quantified by reference to just whatever it took to reduce the CT profits to nil . You remember that?

A. Yes.

Q. And nothing to do with shares you held in the company, nothing to do with had anybody else held shares in the company. They weren't relevant; what was relevant was just reducing the CT profits to nil. Do you remember that?

A. Yes."

[Day 1 99/10-22]

"Q. And do you remember me showing you Baxendale Walker ––and just to be clear, by calling the firm "Baxendale Walker", I don't mean any disrespect by calling that firm by its surname ––Baxendale Walker had described the benefit, that's the loan, as a loan and not a distribution . And you said: well, that's quite right. Do you remember me showing you that?

A. Yes.

Q. Equally, the loan had nothing to do with you holding shares in the company, did it? It was just a –what you'd been told, it was a good way of extracting that money tax−free?

A. That's what I was told, yes."

86. Mr Ghosh submitted that the FTT should have found that there was a "disconnect" between the shareholding and the contributions to the RT and between the shareholding and the loans from the RT. Moreover, particularly as regards the evidence at [Day 1 98/10-22], Mr Thomas' evidence could not simply be rejected by the FTT on the basis that it was "merely what he was told".

87. Mr Firth complained that an attack by HMRC on the Decision on the basis that the FTT had failed to take account of relevant evidence was not part of HMRC's grounds of appeal. Moreover, Mr Firth considered HMRC's approach unfair because many, if not most, of the references in the transcript on which Mr Ghosh relied were contained neither in the grounds of appeal or in HMRC's skeleton argument. This complaint was the subject of an intervention by Mr Firth, in the course of Mr Ghosh's submissions, to the effect that it was not acceptable for Mr Ghosh to go through the Decision, identifying what he agreed with and disagreed with, without reference to his grounds of appeal.

88. We experienced a similar difficulty with Mr Ghosh's submissions, in the sense that it was only in the course of Mr Ghosh's oral submissions that HMRC particularised the findings of fact in the Decision which they were challenging, and the extracts from the transcript of the oral evidence heard by the FTT on which HMRC were relying for this purpose. In order to alleviate this difficulty we asked Mr Ghosh to provide us with a short document identifying those paragraphs and extracts from the Decision which were said to be contradicted by the oral evidence of Dr Thomas, in each case accompanied by a reference to the relevant part of the transcript of Dr Thomas' evidence. While this document was produced, following our request, with commendable speed, the document was only provided for the start of the second day of the hearing of the appeal. The net result of this was that we and Mr Firth had this document only shortly before Mr Firth commenced his submissions.

89. The result of all this was that until Mr Ghosh finished his submissions, Mr Firth did not know exactly what case he had to meet, in terms of HMRC's challenges to the findings of fact in the Decision.

90. In his own submissions Mr Firth drew our attention to the decision of the UT in *Ingenious Games LLP v HMRC* [2019] UKUT 0226 (TCC). In their decision in this case, at [55] – [57], the UT (Falk J, as she then was, and Judge Tim Herrington) quoted at length from the decision of the Court of Appeal in *Georgiou v Customs and Excise Commissioners* [1996] STC 463, in relation to appeals said to involve points of law of the kind identified in *Edwards v Bairstow*. The relevant extract from the decision of the UT in *Ingenious Games* is in the following terms:

> "55. In relation to an appeal which is said to involve a point of law of the kind identified in *Edwards v Bairstow*, we were reminded by HMRC of what was said by Evans LJ in *Georgiou v Customs and Excise Commissioners* [1996] STC 463 at 476, as follows:
>
> > "It is right, in my judgment, to strike two cautionary notes at this stage. There is a well-recognised need for caution in permitting challenges to findings of fact on the ground that they raise this kind of question of law. That is well seen in arbitration cases and in many others. It is all too easy for a so-called question of law to become no more than a disguised attack on findings of fact which must be accepted by the courts. As this case demonstrates, it is all too easy for the appeals procedure to the High Court to be misused in this way. Secondly, the nature of the factual inquiry which an appellate court can and does undertake in a proper case is essentially different from the decision-making process which is undertaken by the tribunal of fact. The question is not, has the party upon whom rests the burden of proof established on the balance of probabilities the facts upon which he relies, but, was there evidence before the tribunal which was

> sufficient to support the finding which it made? In other words, was the finding one which the tribunal was entitled to make? Clearly, if there was no evidence, or the evidence was to the contrary effect, the tribunal was not so entitled."

56. He continued:

> "... for a question of law to arise in the circumstances, the appellant must first identify the finding which is challenged; secondly, show that it is significant in relation to the conclusion; thirdly, identify the evidence, if any, which was relevant to that finding; and fourthly, show that that finding, on the basis of that evidence, was one which the tribunal was not entitled to make."

57. He concluded:

> "What is not permitted, in my view, is a roving selection of evidence coupled with a general assertion that the tribunal's conclusion was against the weight of the evidence and was therefore wrong. A failure to appreciate what is the correct approach accounts for much of the time and expense that was occasioned by this appeal to the High Court.""

91. Mr Firth referred us to the four conditions, identified by Evans LJ in the quotation at [56], which need to be satisfied before a challenge to a finding of fact can be said to raise a point of law. As Mr Firth pointed out, HMRC had not, either in their grounds of appeal or in their skeleton argument for the hearing of the appeal, particularised their challenges to the findings of fact in the Decision in this way.

92. In our view Mr Firth was right to stress these quotations from *Georgiou*. In the present case, as we have said, it was not until Mr Ghosh's oral submissions, that the challenges to the findings of fact in the Decision made by HMRC were properly identified and particularised. This was an exercise which should have been undertaken at a much earlier stage in the appeal process and, in addition to this, should have been set out in the skeleton argument prepared on behalf of HMRC for the appeal.

93. We do not think that the position in the present case was that HMRC were prevented from pursuing the challenges to the evidential findings in the Decision which were identified in Mr Ghosh's submissions and in the document referred to above. The relevant point is that the quotations from *Georgiou* set out above serve as a reminder of the need for rigour and particularisation, if evidential findings are to be challenged on appeal as giving rise to points of law.

94. Turning to the substance of the challenges made by HMRC to the evidential findings in the Decision, Mr Firth submitted that the FTT had in fact dealt with all the points on which HMRC relied.

95. In HMRC's grounds of appeal it was not clear whether HMRC were advancing a case on pure *Edwards v Bairstow* grounds, viz that the FTT could not reasonably have come to the conclusion that it did on the evidence before it or, rather, that the FTT had failed to take account of relevant evidence. We shall comment further on the grounds of appeal later in this decision, but much of the narrative in the grounds of appeal indicated that a perversity-type *Edwards v Bairstow* challenge was being mounted, with only sparse indications that a case based on a failure to take account of relevant evidence was being advanced.

96. Mr Firth submitted that [43] of the Decision was directed towards the passage in cross-examination [Day 1/57/18-25 to 58/17] quoted at paragraph 85 above.

97. We agree with Mr Firth. The paragraph of the Decision at [43] plainly has this passage of Mr Thomas' cross-examination in mind. In any event, it appears that Dr Thomas, in that passage, was focusing on the calculation of the amount of the contribution (which would have been the same regardless of the shareholdings) and not on the loans from the RT – a matter which had been the subject matter of Mr Firth's closing submissions to the FTT on the evidence.[3] Evidently, the FTT agreed with the submissions of Mr Firth and we see no error of law in the FTT doing so.

98. Furthermore, we see no contradiction between the decision at [43] and [49], as Mr Ghosh suggested. At [49] the FTT is addressing the passage in the transcript at [Day 1 99/10-22] and at [43] the FTT is addressing the hypothetical situation discussed at [Day 1/57/18-25 to 58/17]. It seems to us that it is entirely within the proper scope of the FTT's fact-finding function for it to interpret the meaning and import of oral evidence (and on which submissions were made on both sides). There is an inherent difficulty in an appeal tribunal attempting to establish what a witness meant when that tribunal has not heard the witness or been present at the full course of the cross-examination, even where the appeal tribunal has the benefit of a transcript. It is clear that the import of the passages in cross-examination were in contention before the FTT in closing submissions. It would only be in a clear case that we would be in a position to overturn the FTT's understanding of the evidence – this is not such a case. Accordingly, we see no error of law in [43] and [49] of the Decision. The FTT plainly had the relevant passages of oral evidence in mind and we consider that the criticisms of its conclusions on this evidence fall well short of what is required successfully to sustain an *Edwards v Bairstow* challenge. It also follows, to the extent that this formed part of HMRC's case, that the FTT did not fail to take account of relevant evidence.

99. Mr Ghosh also challenged [67] of the Decision in which the FTT said:

> "67. We note whilst Dr Thomas accepted that looking at the documents now there are statements in them that are untrue, he was not questioned about (a) whether or, the extent to which, he realised that the relevant statements were untrue at the relevant time when the transactions were entered into (other than as regards the fact that, as he accepted, he must have known that he had not prepared the answers in the questionnaire), or (b) whether he had intended to mislead HMRC in entering into the documents with these statements in them (as opposed to being asked whether the documents were designed to be misleading). We do not, therefore, find it appropriate to express any opinion on whether Dr Thomas knowingly intended to mislead HMRC. We note also that given concessions made by MDPL at the hearing, we do not need to make any findings as to whether Dr Thomas/MDPL acted "deliberately" within the meaning of the relevant legislation."

100. Mr Ghosh submitted that [67] contradicted [65(4)], which reads as follows:

> "(4) [Dr Thomas] agreed that the statements in the questionnaire do not reflect the running of the proposed scheme and that statement in the written resolution that the director made them was untrue when made as he must have known at the time."

101. Mr Firth submitted that the final words of [65(4)], reading the Decision fairly as a whole and taking account of the transcript, should be taken to refer only to the written resolution rather than the statements in the questionnaire.

[3] We note that [41(3)] of the Decision is to the same effect.

102. The relevant passage of the transcript reads:

> **[Day1/133/4 – 14]**
>
> "Q. So now I'm asking you, in terms: does that mean that paragraph 2 ––I'm going to be asking about the rest of it ––is an untruth?
>
> A. Well, they don't reflect the running of the proposed scheme.
>
> Q. I'm asking you to come clean, Dr Thomas. Is it an untruth?
>
> A. Well, that's what I'm saying. It doesn't reflect it, no.
>
> Q. No, I want to hear it from you. Is it an untruth?
>
> A. In hindsight, yes.
>
> Q. All right. And I do want, and it's my job, to get honest answers from you fairly. So you've accepted that it was an untruth that these responses were given by you and I'm quoting here: "Those responses continued to accurately reflect the purpose of the company in establishing the proposed scheme." That's untrue, isn't it?
>
> A. In hindsight, yes.
>
> Q. Why just in hindsight?
>
> A. Well, you've pointed out, and me reading it over and over again; then that's not what happened.
>
> Q. But it never happened. You never gave answers to the questionnaire questions. It is nothing to do with hindsight.
>
> A. No, I ...
>
> Q. So it was untrue at the very beginning, wasn't it?
>
> A. Yeah, it must have been.
>
> Q. So that I'm fair to you: you knew that you had not given answers to those questions in the questionnaire, and you knew that those answers given in the questionnaire were given by Baxendale Walker; that's right, isn't it?
>
> A. Looking at that now, yes.
>
> Q. No, then. Forget now; then. You knew that the answers were given by Baxendale Walker?
>
> A. In -- yes, in the questionnaire, yes, yes. They are not my answers."

103. We accept that, although on its face there does appear to be a contradiction between these two paragraphs of the Decision, in the light of the transcript we consider that the latter part of [65(4)] ("as he must have known at the time") could fairly be taken to refer only to the fact that Dr Thomas must have known the statement that the written resolution of MDPL was made by him was untrue. In any event, we do not consider that it sheds any particular light on the source of the payments made by MDPL or the loans made by the RT.

104. In the course of his submissions, Mr Ghosh drew attention to the fact that there were four loans made to Dr Thomas in respect of which no request for a loan had been made by Dr Thomas on behalf of MDPL to BTIL. When this was put to Dr Thomas in cross-examination Dr Thomas indicated that these were "clerical errors". The FTT at [31] accepted Dr Thomas' explanation that these were "clerical errors". Mr Ghosh submitted that there was no evidential basis for the FTT to accept Dr Thomas' explanation. It was this submission that prompted the interjection by Mr Firth referred to in paragraph 87 above. In the event, it does not seem to us

that the debate about "clerical errors" casts much light on the source of the payments made to Dr Thomas.

105. Similarly, Mr Ghosh noted that HMRC did not accept Dr Thomas' explanation that the incorporation of MDPL was for purposes unconnected with the tax scheme, viz that incorporation provided Dr Thomas with the protection of limited liability. Again, we do not consider Dr Thomas' motives in incorporating his practice to be particularly relevant to the correct categorisation of the payments he received from MDPL via the RT.

106. In relation to the "clerical errors" and the motives for incorporation issues, we would observe that our detailed investigation of the transcript of the evidence heard by the FTT served largely to confirm the difficulty, and dubious value, of reaching conclusions in relation to evidence which we did not hear, and in respect of which we were only exposed to extracts from the transcript.

107. As already noted, Mr Ghosh submitted that the deference accorded to a fact-finding tribunal was diluted if its decision was delivered after a reasonable time.

108. In the present case, the FTT first gave its decision on 1 September 2021, approximately nine months after the hearing. The Decision in its amended form was given on 28 March 2022 (almost 6 months after the application for permission to appeal). In support of his submission, Mr Ghosh cited the decisions of the Court of Appeal in *NatWest Markets Ltd and another v Bilta (UK) Ltd (in liquidation)* [2021] EWCA Civ 680. In that case, which involved allegations of dishonesty, following a five-week trial, the judgment was delivered after 19 months. The Court of Appeal said:

> "THE EFFECT OF DELAY
>
> 43. The danger posed by a seriously delayed judgment in a case which involves assessments of fact and which depends at least in part on the oral evidence of witnesses, is that the delay may have so adversely affected the quality of the decision that it cannot be allowed to stand. In *Goose v Wilson Sandford & Co* [1998] TLR 85 the Court of Appeal ordered a retrial because some of the trial judge's conclusions were held to be unsafe as a result of a delay of some 20 months. Peter Gibson LJ said this at [112]:
>
> > "A judge's tardiness in completing his judicial task after trial is over denies justice to the winning party during the period of the delay. It also undermines the loser's confidence in the correctness of the decision when it is eventually delivered. Litigation causes quite enough stress, as it is, for people to have to endure while a trial is going on. Compelling them to await judgment for an indefinitely extended period after the trial is over will only serve to prolong their anxiety, and may well increase it. Conduct like this weakens public confidence in the whole judicial process. Left unchecked it would be ultimately subversive of the rule of law. Delays on this scale cannot and will not be tolerated."
>
> 44. As Sir Geoffrey Vos, then the Chancellor of the High Court, emphasised in the more recent case of *Bank St Petersburg v Arkhangelsky* [2020] EWCA Civ 408, the general, albeit unwritten, rule is that a judgment should be delivered within 3 months of the hearing. That rule should be adhered to even in long and complex cases because, as he put it at [84]:
>
> > "Justice delayed is justice denied. The parties to civil and particularly commercial litigation are entitled to receive their judgments within a reasonably short period of time. That period should not be longer than

three months. As has been repeatedly said any other approach will lead to a loss of public and business confidence in our justice system."

45. We respectfully agree. A delay of the magnitude in the present case, whatever the explanation may be, is plainly inexcusable. It should not have happened and should not have been allowed to happen, particularly in a case where there were allegations of dishonesty, and the reputations and future employment prospects of the individuals concerned were at stake. Nevertheless, it is quite clear from the authorities that delay alone will be insufficient to afford a ground for setting a judgment aside. However, the delay will be an important factor to be taken into account when an appellate court is considering the trial judge's findings and treatment of the evidence, and the appellate court must exercise special care in reviewing the evidence, the judge's treatment of that evidence, his findings of fact and his reasoning.

46. As Lord Mance JSC said in the course of adumbrating the relevant principles in *Central Bank of Ecuador and others v Conticorp SA and others* [2015] UKPC 11, at [5], an appellate court must be extremely cautious about upsetting a finding of primary fact. Likewise, caution must be applied before overturning conclusions reached by the trial judge after an evaluation of different factors which have to be weighed against each other, on which it is possible for different judges to legitimately differ. (Of course, that assumes that the trial judge has taken all material factors into consideration when carrying out that balancing exercise. Failure to do so will amount to an error of law).

47. The correct approach to be adopted by the appellate court when the appeal is against findings of fact was succinctly summarised by Lord Reed JSC in *Henderson v Foxworth Investments Ltd* [2014] 1 WLR 2600 at [67]:

"In the absence of some other identifiable error, such as (without attempting an exhaustive account) a material error of law, or the making of a critical finding of fact which has no basis in the evidence, or a demonstrable misunderstanding of relevant evidence, an appellate court will interfere with the findings of fact made by a trial judge only if it is satisfied that his decision cannot reasonably be explained or justified."

48. In the ordinary case, where a party seeks to appeal fact-findings which are based on an assessment of credibility, it is well-established that the appeal court will show a considerable degree of deference to the trial judge, who has had the advantage of seeing and hearing the witnesses. The greater that advantage, the more reluctant the court should be to interfere. However, as Lord Mance went on to point out in *Central Bank of Ecuador* at [164] (referring to the "salutary approach" of Robert Goff LJ in *Armagas Ltd v Mundogas SA ("The Ocean Frost")* [1985] 1 Lloyd's Rep 1 at [56]-[57]), a failure by the judge to address the factors and issues that are really significant, or to test the witnesses' account against objective facts proved independently of their testimony, particularly by reference to the contemporaneous documents, or the inherent probabilities, may amount to an error of law such as to justify intervention."

109. In relation to transcripts, Peter Gibson LJ in *Goose v Wilson Sandford & Co* said:

"113. Because of the delay in giving judgment, it has been incumbent on us to look with especial care at any finding of fact which is now challenged. In ordinary circumstances where there is a conflict of evidence a judge who has seen and heard the witnesses has an advantage, denied to an appellate court, which is likely to prove decisive on an appeal unless it can be shown that he

> failed to use, or misused, this advantage. We do not lose sight of the fact that the judge had transcripts of the evidence, as well as very extensive written submissions from counsel. But the very fact of the huge delay in itself weakened the judge's advantage, and this consideration had to be taken into account when we reviewed the material which was before the judge. In a case as complex as this, it is not uncommon for a judge to form an initial impression of the likely result at the end of the evidence, but when he has come to study the evidence (both oral and written) and the submissions he has received with greater care, he will then go back to consider the effect the witnesses made on him when they gave evidence about the matters that are now troubling him. At a distance of 20 months, Harman J. [the trial judge] denied himself the opportunity of making this further check in any meaningful way."

110. Mr Ghosh did not advance the delay in producing the Decision as a separate ground of appeal but rather, as we have noted, he submitted that the deference accorded to the FTT's findings of fact was, in this case, weakened by the delay. We agree with that submission, in principle, but the force with which it applies in any particular case will be fact-dependent.

111. We accept in the present case that the original Decision, delivered on 1 September 2021, was very substantially delayed. Such a delay is unsatisfactory, for the reasons given in *NatWest Mark*ets and the authorities cited therein. However, in the present case it is clear, as we have noted above, that the FTT paid careful attention to the oral evidence[4]. We assume and infer, not least on the basis of this careful attention, that the FTT made use of the transcript of the oral evidence to assist its memory. Beyond this, we note that the delay in the present case was nine months which, while less than desirable, is not of the same order as the periods of delay in *NatWest Markets* and *Goose*. Ultimately, the question is whether the delay in the delivery of the original Decision undermines the findings of fact made by the FTT and the evaluation of the evidence by the FTT. In the circumstances of the present case we do not think that it is possible to conclude that the findings of fact made by the FTT or the evaluation of the evidence by the FTT have been undermined by the delay in the delivery of the Decision. We accept that, even where the validity of a judgment or decision is not in fact undermined by delay, there are good reasons for judgments and decisions to be handed down as promptly as possible, as explained by the Chancellor (as he then was) in *Bank St Petersburg*. In the present case we do not consider that the Decision has been undermined by the delay.

112. We also reject HMRC's case that the FTT misunderstood or misapplied the decision of the Supreme Court in *Rangers*. Mr Ghosh referred to *Rangers* as a case which applied to the redirection of earnings. It is true that, where an employee requires that his/her earnings are paid not to the employee but to someone else ("don't pay me, pay my Mum", as Mr Ghosh put it), the character and source of the payment does not change – the payment remains earnings. The point of the *Rangers* case was whether the fact that the employees were not legally entitled to the payment(s) changed the character and taxability of the payment(s). None of the employees (the footballers) in the *Rangers* case was a shareholder – the only capacity in which the payment was made (or re-directed) was in relation to their employment as employees of football club. *Rangers* is, therefore, not an authority in relation to the *source* of the payment but rather an authority in relation to the taxability of a payment, made by reason of employment, but which is diverted to a third party. Unsurprisingly, the Supreme Court held that the payments made at the direction of the footballers constituted earnings for the purposes of income tax even though the employees had no direct right to payment. In that limited sense, *Rangers* is an authority in

[4] We note that at [9] the FTT's opinion as regards Dr Thomas' credibility was formed at the hearing and confirmed very shortly thereafter.

relation to the redirection of earnings but it does not assist HMRC in seeking to characterise, in this case, the source of the payment.

113. Mr Ghosh advanced before us, as he had before the FTT, a number of reasons why the contributions to MDPL and loans from the RT were "from" Dr Thomas' office as a director of MDPL.

(1) Dr Thomas drew no or minimal salary from MDPL during the years in question, but previously had taken drawings. So far as Dr Thomas did draw a minimal salary from MDPL, this minimal salary was not sufficient for his living expenses or a fair reflection of work done for MDPL.

(2) The payments by MDPL to the RT effectively represented the fruits of Dr Thomas' labours, albeit that it also reflected the labours of other employees in the dental practice.

(3) Furthermore, the payments to the RT were authorised by Dr Thomas as a director of MDPL.

114. At the same time, Mr Ghosh criticised the FTT's finding that the contributions to the RT were "in respect of shares". In particular, Mr Ghosh criticised the reasoning of the FTT at [129] when it noted the following:

(1) there was no contractual obligation on MDPL to pay the sums paid out to the RT as a reward for Dr Thomas' services as a director or dentist;

(2) the sums paid out comprised the totality of the overall profits of MDPL's business (after the deduction of expenses, such as salaries of those employed by MDPL, including the relatively small salary paid to Dr Thomas) and that those sums were paid out sporadically;

(3) Dr Thomas's evidence was that had those profits not been routed through the RT arrangements, they would have been paid to him by way of dividend and not as salary. It was a well-known practice for a company with a sole owner and director to organise matters so that the bulk of the payments were paid by way of dividend and not as salary. Secondly, that was how Dr Thomas arranged his affairs after the MDPL arrangements.

115. In our view, these were all matters which the FTT could fairly consider and to which the FTT could fairly attach weight. The question before the FTT was the source of the payments by MDPL indirectly to Dr Thomas through the RT. It was undisputed that the characterisation of those payments contained in the documentation was untrue. It was, therefore, the task of the FTT, on the basis of all the evidence before it, to assign a tax characterisation to those payments.

116. Reviewing the matters referred to in paragraph 114 above, as taken into account by the FTT, it seems to us that (1) was a relevant but not determinative factor. As regards (2), this also seems to us to be a relevant factor. Dr Thomas's evidence was that what was paid out by MDPL was an amount which emptied the company of profit. There was, as far as we are aware, no evidence that the amount paid out was an amount which was intended to represent a market value salary for a dentist of Dr Thomas' experience and position. In relation to (3), the distribution of residual profit does, indeed, seem to us to be more characteristic of a distribution of profit rather than a payment of salary. Furthermore, the sporadic nature of the payments was also relevant. Indeed, the FTT's recognition that it was a well-known practice of small

companies, which were, in effect, owner-managed businesses, to distribute their profits by way of dividend rather than by way of salary was a perfectly legitimate instance of a specialist tribunal taking judicial notice of an undeniably common practice.

117. It was not clear to what extent the arguments put forward by Mr Ghosh to the FTT and summarised at paragraphs 66 and 113 above were independent grounds of appeal or were, instead, merely statements of disagreement with the Decision. However, dealing with each of those arguments in turn, we observe, first, that the fact that Dr Thomas drew a minimal salary from MDPL (but had previously taken material drawings in the years prior to incorporation) does not impress the payments by MDPL with the character of earnings. Where a trader incorporates his or her business the character of the trader's previous income does not determine the character of the income after incorporation.

118. Secondly, Mr Ghosh's submission that the payments by MDPL to the RT represented the fruits of Dr Thomas' labours (and the labours of other employees in the dental practice) does not lead to the conclusion that the payments by MDPL constitute earnings on general principles. The source of the income arising *to* the payer (MDPL) does not mean that the payments made *by* the payer have the same character. For example, if a company with a sole director/shareholder earns rental income, the onward payment of the profits arising from that activity to the director/shareholder would not usually be regarded as rental income.

119. Thirdly, the fact that the contributions were authorised by Dr Thomas acting as a director cannot, in our view, impart the character of employment income to those payments. A company can only act by the agency either of its director(s) or by resolutions of the company in general meeting. As Mr Firth observed, the question is not *who* decided to make the payment but *why* was the payment made? To suggest that a payment by a company which is authorised by its director imparts that payment with the character of employment income seems far-fetched – that would be a strange conclusion which of itself suggests that the proposition is incorrect.

120. Therefore, none of HMRC's arguments, viewed in isolation or cumulatively, indicate to us that the FTT's conclusion constituted or was based upon any error of law.

121. For these reasons we dismiss HMRC's appeal on Ground 2.

Ground 1 – Part 7A ITEPA

122. Under this Ground, HMRC argued that the contributions made by MDPL and the loans made by the RT to Dr Thomas were taxable under section 554A of Part 7A ITEPA. We have set out section 554A above, but for convenience reproduce section 554A(1)(c) ITEPA here:

> "(c) it is reasonable to suppose that, in essence –
>
> (i) the relevant arrangement, or
>
> (ii) the relevant arrangement so far as it covers or relates to A,
>
> is (wholly or partly) a means of providing, or is otherwise concerned (wholly or partly) with the provision of, rewards or recognition or loans in connection with A's employment, or former or prospective employment, with B,…"

123. In summary, HMRC argued that the FTT erred in law in finding that Part 7A ITEPA did not apply because, having held that the payments by MDPL to the RT were not "earnings" within section 62 ITEPA, it followed that Part 7A ITEPA could not apply to the arrangements because the tests were the same. The words "in connection with A's employment" were

different from and wider than the "from" employment test as regards general earnings in the section 62 ITEPA.

124. The relevant passage in the Decision reads as follows:

> "137. We agree with MDPL's view that, reading s 554A(1)(c) in context, for there to be a "connection" of the required kind with Dr Thomas' employment, the employment must be part of the reason for the reward, recognition or loan. On that basis, an assessment of whether [it] is reasonable to suppose that, in essence the RT arrangement so far as it relates to Dr Thomas is (wholly or partly) a means of providing or, is otherwise concerned (wholly or partly) with, the provision of, rewards or recognition or loans in connection with Dr Thomas' employment requires essentially the same analysis as that set out in relation to whether the relevant sums constitute earnings. Accordingly, we have concluded that this test is not met as regards the connection test for all the same reasons as are set out above."

125. Both Mr Ghosh and Mr Firth referred to two Court of Appeal authorities in relation to the words "in connection with".

126. The first decision was *Barclays Bank plc v HMRC* [2007] STC 747 (David Richards J, as he then was) and [2008] STC 476 (May, Arden and Scott Baker LJJ). In that case, the taxpayer company made payments to pensioners to compensate for the withdrawal of free assistance in preparing tax returns and executor and trustee services. The question arose as to whether these were "relevant benefits" within the meaning of section 612(1) Income and Corporation Taxes Act 1988 which turned on whether the payments were made "in connection with past service."

127. David Richards J, allowing HMRC's appeal, said:

> "[38] The words 'in connection with' are probably as broad a formulation as will be found in statutory provisions for linking A with B. It is a question of fact whether a connection exists within the meaning of the statutory provision in question. In s 612(1) nothing more is required than the payment should be given in connection with past service. The relevant facts are not here in dispute. Where, as here, the free tax service was provided to retired employees and their spouses, because they had been employees or were married to retired employees, it is to my mind clear that the service was provided in connection with past service."

128. Affirming the decision of the High Court, the Court of Appeal (Arden LJ, with May and Scott Baker LJJ concurring) said:

> "18. The primary question in this case is the proper meaning of the words "in connection with past service" in section 612(1) of ICTA. The expression "in connection with" could describe a range of links. In *Coventry Waste Ltd v Russell* [1999] 1 WLR 2093 at 2103, Lord Hope held that in this situation the court must look closely at the surrounding words and the context of the legislative scheme:
>
> > "The majority in the Court of Appeal held that it was a sufficient answer to the appellant's argument to construe the words "in connection with" as meaning "having to do with". This explanation of the meaning of the phrase was given by McFarlane J in *Re Nanaimo Community Hotel Limited* [1944] 4 D.L.R. 638. It was adopted by Somervell L.J. in Johnson v. Johnson [1952] P. 47, 50-51. It may be that in some contexts the

> substitution of the words "having to do with" will solve the entire problem which is created by the use of the words "in connection with." But I am not, with respect, satisfied that it does so in this case, and Mr. Holgate did not rely on this solution to the difficulty. As he said, the phrase is a protean one which tends to draw its meaning from the words which surround it. In this case it is the surrounding words, when taken together with the words used in the 1991 Amending Order and its wider context, which provide the best guide to a sensible solution of the problem which has been created by the ambiguity."
>
> 19. Accordingly, the other parts of the definition of "relevant benefits" and the surrounding provisions of the legislative scheme, will inform the court as to the extent of the link required by any particular provision. Thus the court must examine the function or purpose of the definition of "relevant benefits". Here, the purpose of the definition is to identify the chargeable payments under a retirement benefits scheme. At the very least, Parliament is unlikely to have intended to limit connections to direct connections. That would have left the possibility that taxpayers could easily circumvent the charging provisions. Furthermore, it must have been foreseen that, over the life of the scheme, changes might be made to benefits. The changes would not simply involve a straight exchange or substitution of one benefit for another, but, on occasion, the loss of a benefit and the rendering of some monetary recompense. The charging provisions could only fairly apply if they applied to the giving of the new benefits, or recompense, as much as to the giving of the benefit originally provided by the scheme. It is also significant that Parliament did not limit itself to payments in consideration for services.
>
> 20. Thus I conclude that a connection may be indirect for the purpose of the definition of relevant benefits. Accordingly, it is possible that the making of a payment will have a relevant connection with more than one thing. In that situation, it is in my judgment necessary to see whether the connections can co-exist, or whether one will actually exclude the other. If, on proper analysis the further connection displaces a prior connection, the prior connection ceases to be a relevant connection for the purpose of s.612(1)."

129. The second Court of Appeal decision was *London Luton Hotel BPRA Property Fund LLP v HMRC* [2023] EWCA Civ 362. The judgment in the Court of Appeal was given by Whipple and Falk LJJ. The third member of the Court of Appeal, Lewison LJ, agreed with this judgment. In that case the taxpayer was claiming a business premises renovation allowance on the ground that capital expenditure had been incurred "in connection with" conversion of a building into business premises. The question was whether the phrase "in connection with" should be given a narrow or broad meaning. After reviewing the authorities (including *Barclays Bank*) the Court of Appeal said:

> "[69] These cases show that the meaning of "on, or in connection with" is heavily dependent both on context and policy. The phrase might require what Robert Walker LJ in *Coventry Waste* referred to as "a strong and close nexus" or it might require "a weak and loose one". *Ben-Odeco v Powlson* introduces the concept of remoteness, which is another way of considering the same question."

130. The Court of Appeal held that, having regard to their statutory context and in the light of the purpose of Part 3A of the Capital Allowances Act 2001, the words "in connection with" had to be construed narrowly so as to require a strong and close nexus between the expenditure incurred and the physical works of conversion, renovation or repair that led to the qualifying

building being "used, or available and suitable for letting for use" for business purposes within section 360D(1)(b).

131. The following propositions can be drawn from the decisions in *Barclays Bank* and *London Luton*:

(1) The phrase "in connection with" must be construed by looking closely at the surrounding words and the context of the legislative scheme (*Barclays Bank* [18] and [19]) and at the context and policy of the provision (*London Luton* [69]).

(2) A connection can be both direct or indirect, and this is likely to be the case whenever the phrase "in connection with" is used (*Barclays Bank* [19] to [20]).

(3) There can be a connection with more than one other thing, in which case it is necessary to see if the connections can co-exist or whether one will actually exclude the other (*Barclays Bank* [20] and [25]).

(4) A connection once established is unlikely to be displaced by other factors or connections (*Barclays Bank* [22] to [23]).

(5) A payment made to every member of a class of people is likely to be made in connection with that class (*Barclays Bank* [22] and [26]).

132. Therefore, in construing the words "in connection with" in section 554A(1)(c) ITEPA, it is necessary to have regard to the statutory context and purpose of the statutory provisions.

133. The Explanatory Notes to Clause 26 and Schedule 2 to the Finance (No. 3) Bill 2011, which was enacted by the Finance Act 2011 (section 26, Schedule 2), stated:

> "The June 2010 Budget announced that legislation would be introduced from April 2011 to tackle arrangements using trusts and other vehicles to reward employees which seek to avoid, defer or reduce tax liabilities."

134. As regards the use of Explanatory Notes as an aid to construction, the Upper Tribunal in *Big Bad Wolff Ltd v HMRC* [2019] UKUT 121 (TCC) (Henry Carr J and Judge Richards) said:

> "23. Lord Steyn's speech in *R (Westminster City Council) v National Asylum Support Service* [2002] UKHL 38 establishes that Explanatory Notes to Finance Bills can in principle be relied on as an aid to construction as they may:
>
> '…cast light on the objective setting or contextual scene of the statute, and the mischief at which it is aimed…'
>
> Moreover, the statute does not have to be ambiguous before a court or tribunal can have regard to evidence of the contextual scene set out in the Explanatory Notes.
>
> 24. However, the relevance of Explanatory Notes should not be overstated. It is important to bear in mind that Explanatory Notes might simply reflect the views of the Government (as distinct from Parliament) and, moreover, that Explanatory Notes will often include summaries of statutory provisions prepared by people who are unskilled in statute law.

> 25. Thus, in *R (Westminster City Council) v National Asylum Support Service* Lord Steyn said at [6] of his speech:
>
> > 'What is impermissible is to treat the wishes and desires of the Government about the scope of the statutory language as reflecting the will of Parliament. The aims of the Government in respect of the meaning of clauses as revealed in Explanatory Notes cannot be attributed to Parliament. The object is to see what is the intention expressed by the words enacted.'
>
> 26. The 7th edition of *Bennion on Statutory Interpretation* summarises the position as follows at [24.14]:
>
> > 'Although explanatory notes may therefore be useful as an aid construction, the courts will resist attempts to elevate the notes to a status where they supplant the language of the legislation itself. There is also always a risk that the notes will be wrong or misleading.'"

135. Mr Firth placed emphasis on the words "to reward employees" in the Explanatory Notes, arguing that the purpose of section 554A(1)(c) ITEPA was to address arrangements which were intended to reward employees and not to include arrangements where the connection to employment was indirect or peripheral.

136. We derive little assistance from the Explanatory Notes in this case. It is clear from those Notes that Part 7A of ITEPA is an anti-avoidance provision, but Parliament's intention concerning the meaning of the phrase "in connection with" is best discerned from the statutory words and the context in which they are found. Accordingly, we now turn to examine the parties' submissions and the statutory language.

137. Mr Ghosh submitted that section 554A ITEPA was drafted in very wide terms. It was an anti-avoidance provision which was intended to be interpreted broadly. MDPL's contributions to the RT were authorised by Dr Thomas in his capacity as a director of MDPL and that there was, therefore, a clear and visible connection between those payments and Dr Thomas' office as a director. The contributions and loans represented the fruits of Dr Thomas' work as a dentist working in MDPL's dental practice and as a director.

138. Mr Firth submitted that in construing the words in section 554A(1)(c) ITEPA concerning the provision of loans in connection in employment it was necessary to read the provision as a whole noting that "loans" was grouped together with "rewards or recognition". Therefore, "loans" should be construed *eiusdem generis* with "rewards or recognition". The FTT was correct, Mr Firth contended, in reasoning that the employment had to be part of the reason for the rewards, recognition or loans, in order for them to be "in connection with" the employment. The "arrangement" must be a means of providing or concerned with providing loans with such a connection. The connection with employment must be part of the essence of the arrangement.

139. Furthermore, Mr Firth observed that the mischief at which Part 7A ITEPA was aimed was, according to the Explanatory Notes, "to tackle arrangements using trusts and other vehicles to *reward* employees" emphasis added). The mischief at which the statutory provisions were aimed had nothing to do with charging to employment income tax payments received by individuals who just happen to be employees but where the employment was not part of the reason for the receipt of the payment. It was not permissible, so Mr Firth contended, to redirect the legislation to some other purpose than the mischief to which it was directed.

140. In addition, Mr Firth submitted that in order to satisfy section 554A(1)(c) ITEPA it was also necessary to show that the arrangement was a means of providing or was concerned with

providing loans with a connection to the employment. It could not be Parliament's intention, for example, to catch the declaration of a dividend by a company with a sole shareholder/director – the provision of the dividend would no doubt be a benefit to the director but it would be incorrect to say that the dividend was a "means of" providing benefits in connection with the employment (if such a connection existed).

141. Finally, Mr Firth drew attention to the language of section 554A(1)(c) ITEPA which, in its introductory words, used the expression "it is reasonable to suppose that, *in essence*" (emphasis added). In addition in subsection (12) provided:

> "For the purposes of subsection (1)(c) and (e) in particular, all relevant circumstances are to be taken into account in order *to get to the essence of the matter*." (Emphasis added)

142. Mr Firth submitted that this indicated that a connection with employment that was not part of the essence of the arrangement (because it was not essential) was not sufficient to bring the arrangement within section 554A(1)(c) ITEPA.

143. The first point to note about section 554A(1)(c) ITEPA is that it poses an objective test ("it is reasonable to suppose that").

144. Secondly, it is clear that section 554A ITEPA and its related provisions are drafted in expansive terms and are intended to catch a wide range of arrangements, often involving third parties e.g. trust and other entities, whereby benefits (to use a convenient but non-statutory term) are provided "in connection with" an employment. Mr Firth emphasised that section 554A ITEPA was intended to counteract schemes such as that in *Rangers* (the facts of which pre-dated the introduction of Part 7A) where HMRC had lost before the FTT and the Upper Tribunal before ultimately being successful before the Inner House and the Supreme Court by advancing a new argument concerning redirection of earnings. Even if that is so, it seems to us that we must construe and apply Part 7A in accordance with its terms and its purpose and we cannot limit its application to particular schemes involving redirection of earnings.

145. Thirdly, it is also clear that Parliament used the phrase "in connection with…employment" in section 554A(1)(c) ITEPA in preference to the time-honoured "from an employment" found in the legislation relating to general earnings (section 10(2) read with section 62 ITEPA) or "by reason of" employment (found in related legislation). It seems to us that Parliament's intention was plainly to give section 554A ITEPA a wider scope than the charge to income tax on general earnings. It follows, therefore, that a loan may be provided in connection with an employment even though it is not "from" an employment. An example may illustrate the point. A payment by an employer to an employee will not be treated as earnings under section 62 ITEPA merely because the employee would not have received the payment "but for" the fact he/she was an employee (*Hochstrasser (HMIT) v Mayes* [1960] AC 376), but rather it must be a reward for services. Given the difference in statutory language, which we see as significant, we would be minded to accept, but without deciding the point, that such a payment (i.e. one which would not have been received "but for" the employment) might be capable of being regarded as one which was "connected with" the employment.

146. It seems to us, however, that the words "connected with" cannot be given a limitless meaning in the present context. The purpose of Part 7A ITEPA, as the heading to Part 7A itself states, is to tax (as employment income) payments provided through third parties. There has to be a relatively strong or direct nexus between the employment/directorship relationship and the contribution/loans. We do not think that it was Parliament's intention to catch loans where the

relationship between the loan and the employment was merely incidental or peripheral – merely part of the background, so to speak. We accept Mr Firth's submission that the statutory emphasis on the "essence" of the arrangements in section 554A(1)(c) ITEPA reinforces this conclusion. We therefore consider that, to use the language of the Court of Appeal in *London Luton*, that there must be a strong and close nexus between the loan and the employment albeit one which does not need to amount to one which is causally "from" employment.

147. The FTT's reasoning in the key passage at [137] is very compressed and could usefully have benefited from greater elaboration. However, in our view, the FTT at [137] did not state, as HMRC contended, that the test contained in section 554A(1)(c) ITEPA ("connected with A's employment") was *the same* as that found in sections 10 and 62 ITEPA i.e. "from" employment. What the FTT said was that the employment "must be *part* of the reason for the reward" (emphasis added). When the FTT then stated that the section 554A(1)(c) ITEPA issue required "essentially the same analysis" as that in relation to general earnings, we consider that it was intending to indicate that it had to look again at the various facts and circumstances which it took into account in determining whether the payments by MDPL constitute a general earnings for the purposes of section 62 ITEPA but applying the "part of the reason for the reward" test.

148. In our judgment, however, the FTT erred in law in stating the test as being that the employment had to be part of the reason for the reward. That is not the statutory test. The words used by Parliament involve a test of connection not one of causation. As we have said, we consider that there must be a strong or direct connection between the employment/directorship and the loan. Section 554A(12) ITEPA provides "all relevant circumstances are to be taken into account in order to get to the essence of the matter". We consider that this reinforces the need to identify which (if any) of the various facts found by the FTT constitute the sufficiently close connection required by section 554A(1)(c) ITEPA.

149. In the present case, Dr Thomas, acting as the director of MDPL resolved to make contributions to the RT. Shortly thereafter, Dr Thomas would write to BTIL on MDPL headed paper asking it to consider advancing a loan to him. A loan would subsequently be made by the RT, via MTL as nominee for the Trustees, to Dr Thomas. In our view, that, of itself, is an insufficient degree of connection to Dr Thomas' directorship for the loans to be regarded as made in connection with that office. A company can only act through the agency of its directors and employees, unless it acts in general meeting. We consider that resolving to make the contribution and requesting the loan were not sufficiently closely connected with Dr Thomas' directorship to cause section 554A(1)(c) ITEPA to be engaged.

150. The profits of MDPL, paid as contributions to the RT and then on-lent to Dr Thomas, reflected the profits of the dental practice carried on by MDPL. Dr Thomas was actively engaged in the practice as a dentist and was assisted by a hygienist and an associate dentist (see [52]). At all material times, Dr Thomas was the sole director of MDPL and, therefore, the guiding mind of the company solely responsible for the conduct and direction of its business from which the profits were derived. In our view, this is a sufficiently direct and close connection with Dr Thomas' directorship (treated by section 5 ITEPA as an employment) to ensure that section 554A(1)(c) applied. We are satisfied that treating the profits of MDPL contributed to the RT and on lent to Dr Thomas as connected with his directorship accurately reflects the essence of the overall arrangement.

151. We have therefore come to the conclusion that the loans from the RT to Dr Thomas were connected with his employment/directorship for the purposes of section 554A(1)(c) ITEPA.

152. We therefore allow HMRC's appeal on Ground 1.

Part 7A ITEPA – anti-forestalling provisions

153. Where a relevant step under Part 7A took place in the period from 9 December 2010 to 5 April 2011 inclusive, paragraph 53, Schedule 2 Finance Act 2011 deems that relevant step to have taken place on 6 April 2012 so that any PAYE tax due under Part 7A would be charged in 2012/13 and not 2010/11.

154. In a letter dated 19 February 2016 from HMRC to MDPL enclosing Regulation 80 determinations HMRC stated:

> "We anticipate that the company will have some knowledge of the transactions to which the liability relates. Whatever the level of knowledge of officers of the company has been before now, you need to know that HMRC believes that the payments are arguably within the Income Tax (Earnings and Pensions) Act 2003 and that PAYE and NICs should have been deducted. Without prejudice to any other arguments HMRC may wish to advance, we think the payments are either employment income on first principles or are brought within the charge to employment income by Part 7A of the Act referred to above."

155. The determination for the year 2012-13 stated:

> "All employees and officers of the company who are liable for tax on 'employment Income' (as defined by Section 7, Income Tax (Earnings and Pensions) Act 2003) arising in connection with the company's Remuneration Trust arrangements."

156. The HMRC officer concerned (Mr Cree) had overlooked the fact that where a relevant step under Part 7A took place in the period from 9 December 2010 to 5 April 2011 inclusive, then it was deemed to have taken place on 6 April 2012 (i.e. any PAYE tax due under Part 7A would be charged in 2012/13 and not 2010/11).

157. Mr Ghosh submitted that if Part 7A applied, the anti-forestalling provisions contained in paragraph 53, Schedule 2 Finance Act 2011 applied. Mr Ghosh argued that the determination in its terms concerned the PAYE liabilities arising in that year "in connection with…[MDPL's] Remuneration Trust arrangements" and the loans made between 9 December 2010 and 5 April 2011 were part of those arrangements. The determination for 2012-2013 could be increased to take account of the steps (i.e. the steps that actually occurred in 2010-11) deemed to have occurred on 6 April 2012. This Tribunal could raise the amount of the determination pursuant to section 50 Taxes Management Act 1970, which provides that if the Tribunal, on an appeal decides that an appellant is undercharged by an assessment, the amount of the assessment can be increased.

158. Mr Firth, however, contended that payments in 2010-11 were not part of what the officer had in mind when raising a determination for 2012-13:

(1) These were different amounts that were paid in a different year.

(2) Those amounts were not assessable under the ordinary Part 7A machinery but solely by virtue of deeming machinery tucked away in FA 2011, Schedule 2, para 53 (which includes treating the step has having been taken on 6 April 2012 (para 53(4)).

(3) That deeming machinery had its own mechanism for arriving at the chargeable amount and when it is to be assessed – none of which was in the contemplation of the decision-making officer.

159. Mr Firth referred to the judgment of Henderson LJ in *Clark v. HMRC* [2020] EWCA Civ 204:

> "[106] In the first place, I agree with Mr Jones that the scope of the assessment, and of any appeal from it, must be defined by the subjective discovery that the assessing officer has made. That is the only assessment which the officer has jurisdiction to make, and the scope of the assessment, as opposed to the arguments which may be used to support it, cannot in my view be extended by virtue of the appeal process. The correct approach was in my judgment that stated by Kitchin LJ (as he then was) in the *Fidex* case at [45], in the context of an appeal from a closure notice:
>
> > "In my judgment the principles to be applied are those set out by Henderson J [in the *Tower MCashback* case, at first instance] as approved by and elaborated upon by the Supreme Court. So far as material to this appeal, they may be summarised in the following propositions:
> >
> > (i) The scope and subject matter of an appeal are defined by the conclusions stated in the closure notice and by the amendments required to give effect to those conclusions.
> >
> > (ii) What matters are the conclusions set out in the closure notice, not the process of reasoning by which HMRC reached those conclusions.
> >
> > (iii) The closure notice must be read in context in order properly to understand its meaning.
> >
> > (iv) Subject always to the requirements of fairness and proper case management, HMRC can advance new arguments before the FTT to support the conclusions set out in the closure notice."

160. Mr Firth submitted that the present case was not a case like *Clark*, where a composite set of transactions had two steps and HMRC's decision was, on the face of it, concerned with one step rather than the other but the officer had both steps in mind. There was no reading of the PAYE decision in this case that leads to the conclusion that any amounts other those paid in the year were in contemplation.

161. It was not necessary for the FTT to decide this point in the light of its conclusions on general earnings and Part 7A ITEPA. However, it noted its view at [144]:

> (1) It is reasonable to suppose, on the basis of the broad and general wording in the relevant determination and given the background to its issue (as to which see Part E), that HMRC's conclusion was that all relevant sums arising in connection with the RT arrangements which are properly attributable to the tax year 2012/13 are subject to income tax in that year. On that basis, we cannot see that HMRC are precluded from arguing that income tax is chargeable under Part 7A in respect of the 2012/13 tax year by reference to the value of all relevant sums properly attributable to that year whether they arise in that tax year or in an earlier period under the anti-forestalling rules.
>
> …

> (3) There is no concern that the relevant sums may be taxed twice for the reason given by HMRC [viz that section 554Z11C ITEPA would remove a double charge].

162. In respectful agreement with the FTT, we accept Mr Ghosh's submission that what was in HMRC's contemplation was amounts relating to the RT arrangements which were chargeable under Part 7A ITEPA. Accordingly, the amount of the determination in respect of 2012-2013 could be validly increased.

The Deductibility Issue

163. As we have noted, although not necessary for the Decision, there was a divergence of view between members of the FTT. Judge Morgan considered that the contributions to the RT by MDPL were deductible for corporation tax purposes as being "wholly and exclusively" incurred for the purposes of MDPL's trade. Mr Woodman, however, considered that the contributions were not so expended, and were therefore not deductible, because MDPL pursued a scheme to such an extent that the planned tax efficiency was an object in itself, in addition to that of rewarding Dr Thomas.

164. Given our decision to allow the appeal on Ground 1, the Deductibility Issue becomes a live issue, arising for our decision.

165. In *Scotts Atlantic*, in very over-simplified terms, the taxpayer companies indirectly made payments into an employee benefit trust by subscribing for shares at a substantial premium in a new company which were subsequently devalued, with the value flowing into the trust. The new company was then liquidated and the funds flowed through the trust to the employees. The taxpayers claimed the cost of this indirect provision of the benefit to the employees. The Upper Tribunal accepted that a choice as to how an end was achieved which is dictated by the tax consequences did not mean that there was a duality of purpose (*Scotts Atlantic* at [55]).

166. The Upper Tribunal said this:

> "[65] Thus, on one interpretation of its decision, the FTT appears to have found that SAML and SFML had incurred expenditure for the purposes of their trade, but that because those companies then decided to incur that expenditure in a particular way, their objects in incurring it came to include in addition the object of avoiding corporation tax.
>
> [66] If that was the FTT's reasoning we do not agree with it. That reasoning would be to confuse the object of the expenditure with the reasons for incurring it in the way in which it was in fact incurred. As we have already noted at para [55], above, a taxpayer is entitled to order its affairs in a way which incurs the least tax liability and the mere fact that a choice is influenced or dictated by the tax consequences does not necessarily mean that the choice involves a duality of purpose. It does not, therefore, necessarily follow that the adoption of the scheme by SAML and SFML results in a duality of purpose (although it may do so as a matter of fact) unless this is one of those cases referred to by Lord Oliver in *MacKinlay v Arthur Young*[5] (see para [53], above) where the results (in the present case, the securing of deductions) are so inevitably and inextricably involved in particular activities (in the present case, the making of the contribution and the effecting of the scheme) that they cannot but be said to be a purpose of those activities."

[5] [1989] STC 898 at 905, [1990] 2 AC 239 at 255

167. In the event, the FTT in that case had found that one of the purposes of incurring the expenditure was to obtain the tax deduction:

> "[71] Thus we conclude that the FTT's decision contains a finding that one of the purposes of the contributions, in contrast with the purpose of the method of effecting the expenditure by way of the scheme, was to obtain a corporation tax deduction which would not have been available if the contribution had been made by more conventional means, and that in these particular circumstances such purpose was not an incidental consequence of the expense. Whatever else, the FTT did not conclude that because the tax benefit was a consequence of the contribution, it was a purpose of the expense."

168. Accordingly, the taxpayers' appeal was dismissed.

169. We have no doubt that Mr Woodman's view, that the contributions were non-deductible, was correct. On Dr Thomas' own evidence the contributions were made in such amounts as were necessary to reduce the taxable profits of MDPL to nil. The twin objectives of the BW scheme adopted by MDPL and pursued by Dr Thomas were to empty MDPL of profit and to advance that profit via the RT to Dr Thomas by way of non-taxable loans; see also the Decision at [3], [41] [54(2)] and [129] second sentence. There was no intention or purpose to benefit the trade of MDPL.

170. Judge Morgan's analysis appears to proceed on the assumption that the contributions were to reward Dr Thomas for his services as director (see [159(2)]) or MDPL's purpose in making the contributions "must be taken to be to provide Dr Thomas with earnings…" (see [159(1)(a)]). However, that is language indicative of the charge to tax in respect of general earnings under section 62 ITEPA. In fact, as we have decided, the loans were caught by the anti-avoidance provisions of Part 7A ITEPA as being loans connected with Dr Thomas' employment/directorship. A deduction for those sums cannot, therefore, using the words of *Scotts Atlantic* at [67], simply be regarded as an "ordinary, intended or realistically expected outcome of making salary, bonus or equivalent payments" and Judge Morgan's holding otherwise, in our view, constitutes an error of law. A charge to income tax under Part 7A ITEPA was neither intended nor desired and making a payment which was taxable under those provisions was certainly not the purpose of MDPL.

171. Instead, disregarding the untrue reasons given in the resolutions for the contributions, the intention of MDPL in making the contributions was to empty the company of profit in order to fund a tax-free benefit (i.e. the loans) to Dr Thomas. There was no trading purpose and no benefit to MDPL's trade. It is impossible, we think, to conclude that, simply because these payments were caught by the anti-avoidance provisions of Part 7A ITEPA, the sums were expended wholly and exclusively for the purposes of the trade of MDPL – that is simply unrealistic. We agree with Mr Woodman that the purpose of MDPL in making these payments was to achieve a tax avoidance purpose for the benefit of Dr Thomas and MDPL and was an end in itself.

172. We therefore allow HMRC's appeal on Ground 3.

CONCLUSION

173. In respect of Ground 2 (general earnings), HMRC's appeal is dismissed.

174. In relation to Ground 1 (Part 7A ITEPA), HMRC's appeal is allowed. Pursuant to section 12 Tribunals, Courts and Enforcement Act 2007 we may (but need not) set aside the Decision.

In the light of our conclusion that the Decision contains an error of law, which it seems to us is plainly a material error of law, we set the Decision aside, so far as the FTT decided that the loans made to Dr Thomas are not taxable as employment income under Part 7A ITEPA.

175. We must then decide whether to remit the case to the FTT or remake the Decision, so far as it deals with the subject matter of Grounds 1; that is to say the question of whether the loans made to Dr Thomas are taxable as employment income under Part 7A ITEPA. Given the terms of our decision on Ground 1 we consider that it would be both disproportionate and unnecessary to remit the case to the FTT. We refer back to our analysis and conclusions on Ground 1. Applying our own conclusions on the correct application of the provisions of Part 7A ITEPA to the facts of the present case, as those facts are recorded and determined by the FTT in the Decision, we are able to decide that Part 7A ITEPA did apply to treat the loans to Dr Thomas as employment income in the hands of Dr Thomas. There is no need for a remission to the FTT for any further or different findings of fact to be made. Accordingly, we have decided to remake the relevant part of the Decision, finding that the loans/contributions in respect of the relevant years were chargeable to income tax under Part 7A (and the anti-forestalling provisions in respect of any loan/contributions made on or after 9 December 2010 but before 6 April 2011).

176. In respect of Ground 3, the Deductibility Issue, we have also concluded that the Decision contains an error of law which, again, seems to us plainly to be a material error of law. In these circumstances we allow the appeal on the Deductibility Issue, which we have identified as being the appeal of HMRC, and set aside the Decision, so far as the FTT decided that the contributions are deductible in computing the profits of MDPL for corporation tax purposes. Again, we see no need for a remission to the FTT in relation to the Deductibility Issue. Applying our own analysis and conclusions on Ground 3 to the facts of the present case, as recorded and determined by the FTT in the Decision, we are able to decide that the contributions are not deductible in computing profits of MDPL for corporation tax purposes. In these circumstances we remake the relevant part of the Decision by deciding that the contributions made by MDPL in each of the applicable accounting periods are non-deductible for corporation tax purposes.

POSTSCRIPT - GROUNDS OF APPEAL AND EDWARDS V BAIRSTOW CHALLENGES

177. As we have already noted in this decision, we have had some difficulty in identifying the individual grounds of the appeal of HMRC, from reading the applications for permission to appeal made to the FTT and the UT. In addition to this, the case advanced by HMRC in relation to the findings of fact made by the FTT was not properly particularised until the oral submissions of Mr Ghosh and the provision of the document particularising, with FTT transcript references, the parts of the Decision where the FTT was said to have gone wrong in its findings. This in turn put both Mr Firth and ourselves at something of a disadvantage, in terms of our respective preparations for the hearing of the appeal.

178. Where an application for permission to appeal is made, either to the FTT or the UT, it seems to us essential that the application should identify, as clearly as possible, each individual ground of appeal. Ideally, each ground of appeal should be stated, as a numbered ground of appeal, in a single paragraph, which is clearly identified as stating that ground of appeal. If elaboration of a ground of appeal is required, this can be done in a set of following paragraphs, which are also clearly identified as elaborating upon that ground of appeal.

179. Where an appeal is made on *Edwards v Bairstow* grounds, it is not sufficient simply to state that the FTT erred in law by holding as it did. The precise nature of the error and why it constitutes an error should be set out, as succinctly as possible, if necessary using extra paragraphs, additional to the paragraph setting out the relevant ground of appeal, for the purposes of particularising/elaborating on the alleged error of law.

180. Equally, where an appeal is made on *Edwards v Bairstow* grounds, it is important to particularise, in advance of the hearing, the parts of the relevant decision and the parts of the evidence before the FTT which are the subject matter of the appeal. In the present case this was achieved by the document produced at the conclusion of Mr Ghosh's oral submissions. This particularisation exercise enabled us to consider, compare and contrast those parts of the Decision which were said to be inconsistent with the oral evidence of Dr Thomas against those parts of the transcript of oral evidence of Dr Thomas which were said by HMRC to demonstrate the alleged inconsistency. In our view a condensed version of this particularisation exercise should have been carried out at the stage when the application for permission to appeal was made and, for ease of reference, should have been repeated (in the fuller terms of the document produced by Mr Ghosh), in the skeleton argument filed by HMRC for the appeal hearing. It seems to us that the same applies to other appeals made on *Edwards v Bairstow* grounds. So far as an application for permission to appeal is concerned, this can be done by a set of paragraphs particularising the relevant ground of appeal, in the manner suggested in paragraph 178 above.

181. Finally, and in common with the UT in *Ingenious Games*, we respectfully commend the guidance given by Evans LJ in *Georgiou*. For ease of reference we repeat those parts of this guidance which are, for present purposes, most relevant:

> "... for a question of law to arise in the circumstances, the appellant must first identify the finding which is challenged; secondly, show that it is significant in relation to the conclusion; thirdly, identify the evidence, if any, which was relevant to that finding; and fourthly, show that that finding, on the basis of that evidence, was one which the tribunal was not entitled to make."
>
> "What is not permitted, in my view, is a roving selection of evidence coupled with a general assertion that the tribunal's conclusion was against the weight of the evidence and was therefore wrong. A failure to appreciate what is the correct approach accounts for much of the time and expense that was occasioned by this appeal to the High Court."

COSTS

Any application for costs in relation to this appeal must be made in writing and served on the Tribunal and the person against whom it is made within one month after the date of release of this decision as required by rule 10(5)(a) and (6) of the Tribunal Procedure (Upper Tribunal) Rules 2008.

MR JUSTICE EDWIN JOHNSON
JUDGE GUY BRANNAN

UPPER TRIBUNAL JUDGES
Release date: 16 April 2024