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TC00779: Aberdeen Asset Management Plc

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Jurisdiction
England; Scotland; Northern Ireland; Wales

Citation
TC00779

Decision Date
29 October 2010

Court
First-tier Tribunal (Tax)

Judges
J GORDON REID; IAN MALCOLM

Decision
DISMISSED IN PRINCIPLE

Catchwords

Income Tax -

Abstract

Income Tax--emoluments--money's worth--transfer of shares--readily convertible asset--Ramsay approach--tax avoidance scheme--Employee Benefit Trust--Discounted Options Scheme for employees in financial services industry--establishment of employee benefit trust--offshore companies established--money box company--family trust established--grant of option by offshore company in favour of family trust--transfer of shares to employee--value of shares--whether existence of family trust diluted value of shares transferred--Income & Corporation Taxes Act 1988 sections 1 19, 131, 202A&B, 203F The Income Tax (Employments) Regulations 1993 Regulation 2--(Pay As You Earn) Regulations 2003 Regulation 80, National Insurance--Social Security Contributions (Transfer of Functions) Act 1999 section 8.

Full Text

TRIBUNAL:	FIRST-TIER TRIBUNAL (TAX)
DECISION NUMBER:	TC00779
APPELLANT:	ABERDEEN ASSET MANAGEMENT PLC
CASE REFERENCE NUMBER:	SC/3147/2008
NEUTRAL CITATION:	[2010] UKFTT 524 (TC)
RESPONDENTS:	THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS
TRIBUNAL JUDGE:	J GORDON REID Q.C., F.C.I.ARB.
TRIBUNAL MEMBER:	IAN MALCOLM

LOCATION:	SITTING IN PUBLIC AT EDINBURGH
DATE:	28TH -30TH JUNE AND 1ST & 2ND JULY 2010
FOR THE APPELLANTS:	KEVIN PROSSER Q.C., AND REBECCA MURRAY
FOR THE RESPONDENTS:	IAIN ARTIS
RESULT OF THE APPEAL:	DISMISSED IN PRINCIPLE

Decision

Introduction

1. These appeals relate to a tax avoidance scheme known as the Discounted Options Scheme ("DOS") established by the Appellants to provide additional remuneration to a number of their employees in the financial services industry. The essential question for the Tribunal is whether the arrangements work and thus avoid liability to account for tax under the PAYE and National Insurance regimes.

2. A Hearing took place at Edinburgh on 28th, 29th, and 30th June and 1st and 2nd July 2010. At the Hearing, the Appellants were represented by Kevin Prosser Q.C. and Rebecca Murray, barrister, (both of the English Bar). The Respondents ("HMRC") were represented by Iain Artis, Advocate. Both parties produced a Statement of Case, Skeleton Argument and Response. Between them, the parties produced some twenty arch lever files of documents. They also helpfully provided an Agreed Statement of Facts Not In Dispute (reproduced below).

3. Mr Prosser led the evidence of Frank Matthews, a former employee of AIB Bank (CI) Ltd, Richard Sweetman CA, an expert in share valuation, and William Rattray, finance director of the Appellants HMRC led the evidence of Barrington Marriot, an investigator in HMRC Special Investigations Directorate, Manchester and Elizabeth Reeves C.A., a member of the Finance Professionals Unit within HMRC. Parties arranged for the proceedings to be recorded by a stenographer from Merrill Legal Solutions, London. A daily transcript of the proceedings was provided in electronic and hard copy format.

The Appeals

4. The Appellants appeal against a number of Notices of Determination dated 16/1/07 determining tax payable by the Appellants under Regulation 80 of the Income Tax (pay as You Earn) Regulations 2003. They also appeal against a number of Notices of Decision of the same date made under section 8 of the Social Security Contributions (Transfer of Functions etc) Act 1999, and sections 3(1), 6(1) and 10(1) & (2) of the Social Security Contributions and Benefits Act 1992 that the Appellants are liable to pay primary and secondary Class/Class 1A National Insurance Contributions *in respect of earnings of various employees who received awards under the Discounted Option Scheme.*

5. The appeals (all heard together as one appeal) relate to the tax years 2000/2001, 2001/2002 and 2002/2003. The total amount of income tax claimed is in the order of about £5.4m. The amount of national insurance contributions claimed is in the order of about £1.6m. We return to the detail of the figures at the end of this Decision.

The Scheme in Outline

6. The essence of the Scheme is that the Appellants establish an offshore Employee Benefits Trust ("EBT") for their employees, which is a discretionary trust with professional trustees from the Isle of Man. The beneficiaries with which we are concerned, are senior employees or directors of the Appellants who are to be rewarded with additional remuneration for past performance. Substantial funds are transferred by the Appellants into the EBT. An Isle of Man company (a "money box company") with £2 share capital is created or acquired for each employee who, because of his good performance, is to be favoured. The directors of these money-box companies are professional administrators from Jersey or the Isle of Man from the same organisation as the professional trustees. The EBT subscribes for the two shares in the Isle of Man company. One share is paid for at par (£1); the other at a very substantial premium which might range from about £100,000 to over £1m.

7. At or about the same time, a Family Benefits Trust ("FBT") is established by the trustees of the EBT for each of the favoured employees; the beneficiaries are the employee and his immediate family with a charitable longstop. The trustee of the FBT is a professional trustee again from the same organisation. The fam-

ily trust fund is a nominal £10 provided by the EBT. The company's authorised share capital is increased by £10,000 and it then grants to the FBT an option to subscribe for 10,000 ordinary shares in the company. The existence of the option is said to dilute the value of the two original shares. One or both shares in the company are transferred to a nominee company for behoof of the favoured employee. The option subsists usually for a year and then lapses without exercise.

8. The individual employee holds the beneficial interest in the money box company. He benefits by *inter alia* receiving soft loans (i.e. loans at low interest rates which will not be required to be repaid; the interest is not paid either or is funded by a further loan) or the use of property from the company. In this way, the employee receives substantial additional financial benefits which are said to be immune from liability for PAYE and National Insurance contributions. Had the employee simply been paid a cash bonus of an identical amount to the sums paid into the money box company for good performance, the bonus would have fallen within the PAYE and National Insurance regimes. The money-box company is ultimately stripped of its funds by one means or another. Some tax consequences may ensue depending on how this is carried through.

9. There can be no doubt, and it is accepted by the Appellants, that the DOS is a tax avoidance scheme. The question is "Does it work?" for the years of assessment to which it relates. The Appellants accept that subsequent legislation has ensured that such schemes no longer work.

Legislative Framework

10. At the relevant time the charge to income tax was established by section 1 of the Income and Corporation Taxes Act 1988. Schedule E was set out in section 19 under which tax was charged in respect of any office or employment on emoluments therefrom.

11. Section 131 defined emoluments as including all salaries, fees, wages, perquisites and profits whatsoever.

12. Section 135 dealt with share option schemes.

13. Sections 202A and 202B established the receipts basis of assessment and set forth the meaning of *receipt* in various circumstances as follows:-

> **202A Assessment on receipts basis**
>
> (1) As regards any particular year of assessment-
>
> (a) income tax shall be charged under Cases I and II of Schedule E on the full amount of the emoluments received in the year in respect of the office or employment concerned;
>
> (b) income tax shall be charged under Case III of Schedule E on the full amount of the emoluments received in the United Kingdom in the year in respect of the office or employment concerned.
>
> (2) Subsection (1) above applies-
>
> (a) whether the emoluments are for that year or for some other year of assessment;
>
> (b) whether or not the office or employment concerned is held at the time the emoluments are received or (as the case may be) received in the United Kingdom.
>
> .....
>
> (4) Section 202B shall have effect for the purposes of subsection (1)(a) above"
>
> **202B Receipts basis: meaning of receipt**
>
> (1) For the purposes of section 202A(1)(a) emoluments shall be treated as received at the time found in accordance with the following rules (taking the earlier or earliest time in a case where more than one rule applies)-
>
> (a) the time when payment is made of or on account of the emoluments;
>
> (b) the time when a person becomes entitled to payment of or on account of the emoluments;
>
> (c) in a case where emoluments are from an office or employment with a company, the holder of the office or employment is a director of the company and sums on account of the emoluments

are credited in the company's accounts or records, the time when sums on account of the emoluments are so credited;

(d) in a case where the emoluments are from an office or employment with a company, the holder of the office or employment is a director of the company and the amount of the emoluments for a period is determined before the period ends, the time when the period ends;

(e) in a case where the emoluments are from an office or employment with a company, the holder of the office or employment is a director of the company and the amount of the emoluments for a period is not known until the amount is determined after the period has ended, the time when the amount is determined.

(2) Subsection (1)(c), (d) or (e) above applies whether or not the office or employment concerned is that of director.

(3) Paragraph (c), (d) or (e) of subsection (1) above applies if the holder of the office or employment is a director of the company at any time in the year of assessment in which the time mentioned in the paragraph concerned falls.

(4) For the purposes of the rule in subsection (1)(c) above, any fetter on the right to draw the sums is to be disregarded.

.....

(11) In a case where-

(a) the emoluments take the form of a benefit not consisting of money, and

(b) subsection (8), (9) or (10) above does not apply,

for the purposes of section 202A(1)(a) the emoluments shall be treated as received at the time when the benefit is provided; and in such a case subsection (1) to (6) above shall not apply

14. Section 203 provided for the establishment of the PAYE system. Section 203A defined *payment* as follows:-

(1) For the purposes of section 203 and regulations under it a payment of, or on account of, any income assessable to income tax under Schedule E shall be treated as made at the time found in accordance with the following rules (taking the earlier or earliest time in a case where more than one rule applies)-

(a) the time when the payment is actually made;

(b) the time when a person becomes entitled to the payment;

(c) in a case where the income is income from an office or employment with a company, the holder of the office or employment is a director of the company and sums on account of the income are credited in the company's accounts or records, the time when sums on account are so credited

15. Section 203B provides as follows:-

203B PAYE: payment by intermediary

(1) Subject to subsection (2) below, where any payment of, or on account of, assessable income of an employee is made by an intermediary of the employer, the employer shall be treated, for the purposes of PAYE regulations, as making a payment of that income of an amount equal to the amount determined in accordance with subsection (3) below.

(2) Subsection (1) above does not apply if the intermediary (whether or not he is a person to whom section 203 and PAYE regulations apply) deducts income tax from the payment he makes and accounts for it in accordance with PAYE regulations.

(3) The amount referred to is-

(a) if the amount of the payment made by the intermediary is an amount to which the recipient is entitled after deduction of any income tax, the aggregate of the amount of that payment and the amount of any income tax due; and

(b) in any other case, the amount of the payment made by the intermediary.

(4) For the purposes of this section, a payment of, or on account of, assessable income of an employee is made by an intermediary of the employee if it is made -

(a) by a person acting on behalf of the employer and at the expense of the employer or a person connected with him; or

(b) by trustees holding property for any persons who included or class of persons which includes the employee.

(5) Section 839 applies for the purposes of subsection (4) above.

16. Section 203F provides as follows:-

203F PAYE: traceable assets

(1) Where any assessable income of an employee is provided in the form of a readily convertible asset, the employer shall be treated, for the purposes of PAYE regulations, as making a payment of that income of an amount equal to the amount specified in subsection (3) below

(2) In this section "readily convertible asset" means-

(a) .....

(e) an asset consisting in anything that is likely(without anything being done by the employee) to give rise to, or become, a right enabling a person to obtain an amount or total amount of money which is likely to be similar to the expense incurred in the provision of the asset;

(f) an asset for which trading arrangements exist; or

(g) an asset for which trading arrangements are likely to come into existence in accordance with any arrangements of another description existing when the asset is provided or with any understanding existing at that time.

.....

(3) The amount referred to is the amount which, on the basis of the best estimate that can reasonably be made, is the amount of income likely to be chargeable to tax under Schedule E in respect of the provision of the asset.

(3A) For the purposes of this section trading arrangements for any asset provided to any person exist whenever there exist any arrangement the effect of which in relation to that asset is to enable that person, or a member of his family or household, to obtain an amount or total amount of money that is, or is likely to be, similar to the expense incurred in the provision of that asset.

(3B) References in this section to enabling a person to obtain an amount of money shall be construed-

(a) as references to enabling an amount to be obtained by that person by any means at all, including, in particular-

(i) by using any asset or other property as security for a loan or advance, or

(ii) by using any rights comprised in or attached to any asst or other property to obtain any asset for which trading arrangements exist; and

(b) as including references to cases where a person is enabled to obtain an amount as a member of a class or description of persons, as well as where he is so enabled in his own right.

(3C) For the purposes of this section an amount is similar to the expense incurred in the provision of any asset if it is, or is an amount of money equivalent to -

(a) the amount of the expense so incurred, or

(b) a greater amount; or

(c) an amount that is less than that amount but not substantially so.

(4) For the purposes of this section, "asset" does not include-

(a) any payment actually made of, or on account of, assessable income;

(b) any non-cash voucher, credit-token or cash voucher (as defined in sections 141 to 143) or

(c) any description of property for the time being excluded from the scope of this section by PAYE regulations

(5) Subject to subsection (4) above, for the purposes of this section "asset" includes any property and in particular any right or interest falling within any paragraph in Part 1 of Schedule 1 to the Financial Services Act 1986.

.....

17. Section 203J provides *inter alia* as follows:-

203J s 203B to 203I: accounting for tax

(1) Where an employer makes a notional payment of assessable income of an employee, the obligation to deduct income tax shall have effect as an obligation on the employer to deduct income tax at such time as may be prescribed by PAYE regulations from any payment or payments he actually makes of, or on account of, such income of that employee.

(2) For the purposes of this section-

(a) a notional payment is a payment treated as made by virtue of any of sections 203B, 203C and 203F to 203I, other than a payment whose amount is determined in accordance with section 203B(3)(a) .....

18. Regulation 2(1) of the Income Tax (Employments) Regulations 1993 provides *inter alia:-*

"emoluments" means the full amount of any income to be taken into account in assessing liability under Schedule E after the deduction of-

(a)) Allowable superannuation contributions, and

(b) Any sum withheld from an employee in accordance with section 202 of the Taxes Act;

"employee" means any person in receipt of emoluments;

"employer" means any person paying emoluments;"

19. Regulation 6(1) provides *inter alia* as follows:-

"..... every employer, on making any payment of emoluments to any employee during any year, shall deduct ..... tax in accordance with these Regulations..."

20. Regulation 26 provided that the employer should pay to HMRC the amounts of tax which he was liable to deduct.

21. The Income Tax (Employments) (Notional Payments) Regulations 1994 provide *inter alia* as follows:-

Regulation 7

(1) Paragraph (2) below prescribes the time at which an employer shall deduct income tax in accordance with subsection (1) of section 203J in respect of a notional payment made by him of assessable income of an employee .....

(2) The time prescribed is any occasion on or after the time when the notional payment is made and falling within the same income tax period, on which the employer actually makes a payment of, or on account of, assessable income of that employee.

Regulation 8

(1) Paragraph (2) below prescribes the time at which an employer shall account to the Board in accordance with subsection (3) of section 203J for an amount of income tax in respect of a notional payment made by him of assessable income of an employee ....

(2) The time prescribed is within 14 days of the end of the income tax period in which the notional payment was made.

Facts

22. As noted above, parties provided an Agreed Statement of Facts which are not in dispute. It is in the following terms:-

"

1. The Appellant is a public limited company incorporated in Scotland with company number SC082015. Its registered office is at 10 Queens Terrace, Aberdeen, Aberdeenshire AB10 1YG. Its year end is 30 September.

2. The Appellant is an international investment management group, managing assets for both institutions and individuals from offices around the world. It has been listed on the London Stock Exchange since 1991 and is a FTSE-250 company.

3. The Appellant appeals against decisions and determinations dated 16 January 2007.

(1) The determinations were in respect of unpaid tax on emoluments allegedly paid to employees, assessed to total £5,396,710.69, plus interest, as follows:

2000/2001	C D Fishwick	£580,000.00	
	M J Gilbert	£200,000.00	
	P Reed	£300,000.00	
	A Laing	£100,000.00	
	S Campling (sic)	£88,708.14	
	E Protheroe	£72,000.00	£1,340,708.14
2001/2002	C D Fishwick	£1,140,000.00	
	M J Gilbert	£400,000.00	
	P Reed	£600,000.00	
	A Laing	£210,000.00	
	I Reid	£710,405.20	£3,060,405.20
2002/2003	C D Fishwick	£558,655.70	
	M J Gilbert	£326,941.65	
	A Laing	£110,000.00	£995,597.35

(2) The notices of decision were in respect of unpaid Class 1/Class 1A National Insurance contributions, assessed to total £1,586,050.66, plus interest, as follows on earnings allegedly paid to employees:-

2000/2001	C D Fishwick	£175,544.00	
	M J Gilbert	£54,840.17	
	P Reed	£91,498.23	
	A Laing	£29,692.98	
	S Campling (sic)	£27,933.73	
	E Protheroe	£21,869.69	£401,378.80
2001/2002	C D Fishwick	£337,576.52	
	M J Gilbert	£112,369.02	
	P Reed	£178,499.72	
	A Laing	£61,496.52	
	I Reid	£209,572.43	£899,514.21
2002/2003	C D Fishwick	£164,916.56	
	M J Gilbert	£88,526.26	
	A Laing	£31,714.83	£285,157.65

4. On or about 4 December 2000 the Appellant established an employee benefit trust (the "EBT") appointing as trustees JF Worthy trust Limited and J.F. Nominees Limited, both companies carrying on business in Jersey. The trust was in favour of the current and former employees of the Aberdeen group and their families and authorised the trustees to "refer to the Remuneration Committee of the [Appellant] established for the purpose of identifying Beneficiaries which are worthy of receiving a benefit under the Trust Fund and the appropriate level of such a benefit". The Remuneration Committee was a committee of non-executive directors set up by the Board of the Appellant for various purposes concerning group remuneration.

5. The Appellant settled funds in the EBT as follows:

		Y/E totals	
4 December 2000	£1,000		
18 December 2000	£12,568,850		
26 January 2001	£789,450		
16 May 2001	£20,000		
25 July 2001	£1,000,000		
13 August 2001	£400,000	£14,779,300	(to 30 September 2001)
30 October 2001	£70,000		
17 December 2001	£6,000,000		

18 December 2001	£3,000,000		
4 January 2002	£6,350,000		
19 March 2002	£500,000		
5 April 2002	£15,000	£15,935,000	(to 30 September 2002)
29 November 2002	£426,000		
26 September 2003	£15,000	£441,000	(to 30 September 2003)

6. In its Annual Report and Accounts for the years ended 30 September 2000 and 2001 the Appellant disclosed contributions to discretionary employee benefits trusts of £12,569,000 and £15,018,000. No other such payments were disclosed in those years. None were disclosed in the Appellant's Annual Report and Accounts for the years ended 30 September 2002 and 2003.

7. Over the relevant periods the EBT acquired 15 Isle of Man companies.

8. In the case of each Isle of Man company, the company had an issued share capital of two £1 ordinary shares. The EBT subscribed for one share in each company at par and for the other at a premium.

9. The EBT purported to settle a nominal sum, typically £10, upon a family benefit trust in favour of the relevant employee and his family, and executed agreements purporting to grant options, valid for various periods, to the family benefit trust to subscribe for 10,000 £1 ordinary shares at par; for the avoidance of doubt, references herein to "purporting to grant options", or to "option", "option grant" or like expressions are without prejudice to the parties' respective positions as to whether options were or were not truly granted by such agreements.

10. In the case of each Isle of Man company, both of the issued ordinary shares were transferred to that employee, although in several cases only one of the issued shares was transferred initially.

11. The companies, the relevant employees, the share premier[1] paid by the EBT, the dates of agreements purporting to grant options and the date or dates upon which the EBT's shares in the companies were transferred to the employees were as follows (two transfer dates indicating the shares were transferred separately):

[1] We assume that what is meant is premium

Company	Employee	Premium	Date of Option Agreement	Transfer date(s)	
Croyde Limited	Mr Fishwick	£2,899,998	06/03/01	Mar-01	Oct-01
Bittium Limited	Mr Fishwick	£2,799,998	04/02/02	Feb-02	Oct-02
Codium Limited	Mr Fishwick	£430,770	10/12/02	Dec-02	
Diniz Limited	Mr Gilbert	£999,998	06/03/01	Mar-01	Oct-01
Glycera Limited	Mr Gilbert	£999,998	04/02/02	Feb-02	Dec-05
Edulis Limited	Mr Gilbert	£299,998	03/04/02	Apr-02	May-05
Eastergate Limited	Mr Laing	£499,998	06/03/01	Mar-01	Oct-01
Serratus Limited	Mr Laing	£549,998	04/02/02	Feb-02	Dec-02
Fade Limited	Mr Campling	£224,998	06/03/01	Mar-01	
Flimwell Limited	Mr Protheroe	£179,998	06/03/01	Mar-01	
Dymock Limited	Mr Reed	£749,998	06/03/01	Mar-01	
Dilsea Limited	Mr Reed	£1,499,998	04/02/02	Feb-02	
Piniped Limited	Mr Reid	£1,399,998	20/08/01	Dec-01	
Zostera Limited	Mr Reid	£374,998	04/02/02	Feb-02	
Heamatopus Limited	Mr Reid	£449,998	06/03/03	Mar-03	

12. In the report of directors' remuneration in its Annual Report and Accounts for the years ended 30 September 2000, 2001, 2002 and 2003 the Appellant disclosed as "other benefits" or "deferred benefits" paid to or receivable by each of Mr Fishwick, Mr Gilbert and Mr Laing (and in the case of the 2002 Accounts a "payment" to Mr Fishwick) sums which include the amounts respectively subscribed by the EBT for the shares in the companies set opposite each of their names in the table above and transferred to them in the year.

13. The individuals referred to in the decisions and determinations were at the material times all employed directors or senior employees of the Appellant. Mr Fishwick, Mr Gilbert and Mr Laing were executive directors. Mr Reed, Mr Reid, Mr Campling and Mr Protheroe were senior employees.

14. The amounts assessed on the Appellant in the decisions and determinations correspond to the amounts subscribed for shares by the EBT, with the exception of Codium Limited. In cases where the subscription for shares occurred in a different tax year to the time when the shares were transferred to one of the individuals named above, the assessments relate to the year of transfer.

15. The arrangements leading up to the transfer of shares to each employee comprised a number of steps:

> (1) the Remuneration Committee decided that it would be appropriate for the employee to be rewarded and that it would be appropriate for the EBT trustees to subscribe for shares in an Isle of Man company;

(2) the Remuneration Committee wrote to the EBT trustees requesting that they subscribe for the issued share capital of an Isle of Man company, one share at a substantial premium and the other at par;

(3) the Remuneration Committee further requested that the EBT trustees should apply £10 of the trust monies in setting up a family benefit trust for the employee and his family (unless such a trust already had been set up earlier by the EBT);

(4) the EBT trustees subscribed for and were duly allotted the shares as requested;

(5) where appropriate, by an instrument of appointment in favour of Worthytrust Company Limited, the EBT trustees appointed £10 to be held on the trust of a family benefit trust in favour of the employee and his family, of which Worthytrust Company Limited was the trustee;

(6) the Remuneration Committee wrote to the trustees of the EBT requesting that they consider arranging for an option in the Isle of Man company to be granted to the relevant family benefit trust. That option would be to subscribe for 10,000 ordinary £1 shares for £10,000;

(7) the EBT trustees as shareholders of the Isle of Man company signed a resolution approving the grant of an option by the company in the terms requested, for nominal consideration and the company executed a deed granting the option accordingly;

(8) the Remuneration Committee wrote to the EBT trustees recommending that the shares held by them in the Isle of Man company should be transferred to the individual. In certain cases the Remuneration Committee recommended that only one share be transferred initially; they recommended that the other be transferred later if the individual was still employed by the Appellant at the end of the then current financial year; and

(9) the EBT trustees transferred the shares (or one share where appropriate) held by them in the Isle of Man company to the employee. In no case where one share was transferred initially did the employee leave the Appellant's employment before the end of the then current financial year and in most cases the second share was transferred to him within a few months of that time, as had been recommended. In the case of Martin Gilbert, however, one share in Glycera Limited was transferred to him in February 2002 and a share in Edulis Limited was transferred to him on 4 April 2002. In each case it was envisaged that the second share would be transferred about six months later but it was subsequently decided that this should not happen. The second share in Glycera was actually transferred to him on 28 December 2005. The second share in Edulis was transferred to him on 6 May 2005.

16. On no occasion did the trustees of the EBT fail to follow a formal recommendation, formal suggestion or formal request made by the Appellant.

17. All transfers of shares to the employees were without consideration.

18. Although the arrangements for different individuals are not the same, there are very considerable similarities between them and the parties have agreed to take Messrs Fishwick and Campling as examples for the purposes of this Agreed Statement of Facts.

Mr Fishwick

(1) In the relevant periods Mr Fishwick received shares in Isle of Man companies representing the following book values:

2000/01:		
March 2001	£1,450,000	Croyde Limited
2001/02:		
October 2001	£1,450,000	Croyde Limited
February 2002	£1,400,000	Bittium Limited
2002/03		
October 2002	£1,400,000	Bittium Limited
December 2002	£430,772	Codium Limited

In the report of directors' remuneration in its Annual Reports and Accounts for the above years the Appellant disclosed as "other benefits", "deferred benefits" or "payment" paid to or receivable by Mr Fishwick sums equal to the amounts subscribed by the EBT for the shares in the above companies transferred in the year to Mr Fishwick.

(2) Croyde Limited was incorporated in the Isle of Man on 1 December 2000. Bittium Limited was incorporated on 11 December 2001, and Codium Limited on 24 October 2002.

(3) On 27 February 2001 the Remuneration Committee of the Appellant recommended to the Trustees of the EBT that the EBT should subscribe at a premium for two shares in five companies,

one of which was to have a premium of £2,899,998. That company was Croyde Limited. At the same time the Remuneration Committee requested that the trustees should establish discretionary trusts with initial settled property of £10 for the benefit of, amongst others, Mr Fishwick and his family.

(4) By resolution dated 2 March 2001 the EBT trustees resolved to subscribe for the entire issued share capital of Croyde Limited at a price of £2,900,000. One share having already been subscribed at incorporation the resolution was effective for the allotment of the one additional share at a premium of £2,899,998. The EBT trustees resolved also to settle a discretionary family benefit trust for the benefit of Mr Fishwick, the trustee being Worthy Trust Company Limited. They settled £10.00.

(5) On 6 March 2001 the Remuneration Committee of the Appellant wrote requesting that the EBT trustees consider arranging for Croyde Limited to grant an option to subscribe for 10,000 £1 ordinary shares for £10,000 to the trustees of the Chris Fishwick Family Trust.

(6) The EBT trustees as shareholders of Croyde Limited signed a resolution approving and requesting the grant by Croyde Limited of an option on the terms requested for consideration of £5. Croyde Limited executed an option agreement to that effect on 6 March 2001, originally exercisable for a period of one year but subsequently labelled "replaced".

(7) On 7 March 2001 the Remuneration Committee of the Appellant recommended that in recognition of his services Mr Fishwick be provided benefits from the EBT in the form of shares in Croyde Limited (amounting to 50 per cent. of the EBT's shareholding), with the suggestion that the remaining share be transferred to him provided he remained in employment with the Appellant at 30 September 2001.

(8) By resolution dated 7 March 2001 the EBT trustees resolved to distribute one share in Croyde Limited to Mr Fishwick, holding the same in a nominee capacity for him, and to consider transferring the remaining share provided he remained with the Appellant until 30 September 2001, all subject to his acknowledgement and acceptance.

(9) The two shares in Croyde Limited were distributed to Mr Fishwick on or after 7 March and 29 October 2001 (these being the dates of the resolutions of the EBT Trustees to make the transfers). Each represented assets contributed of £1,450,000.

(10) On 17 December 2001 the Appellant recommended to the EBT trustees that the EBT should subscribe at a premium for two shares in a further five companies, one of which was to have a premium of £2,799,998. That company was Bittium Limited.

(11) The EBT trustees subscribed accordingly on 10 January 2002.

(12) On 4 February 2002, in accordance with a recommendation of the Remuneration Committee dated 23 January 2002, Bittium Limited entered into an agreement with the Trustee of the Chris Fishwick Family Trust whereby an option was granted for consideration of £5 to subscribe for 10,000 ordinary £1 shares at par at any time within ten years from the date of agreement.

(13) On 6 February 2002 the Remuneration Committee of the Appellant recommended that in recognition of his services Mr Fishwick be provided benefits from the EBT in the form of shares in Bittium Limited (amounting to 50 per cent. of its shareholding), with the suggestion that the remaining share be transferred to him provided he remained in employment with the Appellant at 30 September 2002.

(14) The two shares in Bittium were transferred to Mr Fishwick on or after 7 February 2002 and 11 October 2002 (these being the dates of the resolutions of the EBT trustees to make the transfers).

(15) By countersigning a letter dated 7 March 2001 on 6 July 2001 and by countersigning a letter dated 7 February 2002 on 16 February 2002, Mr Fishwick acknowledged receiving the benefit of the initial shares issued to him in Croyde Limited and Bittium Limited respectively as part of his remuneration package from the Appellant.

(16) On 9 December 2002 the Remuneration Committee of the Appellant recommended, and the EBT trustees resolved, to subscribe for the entire issued share capital of another Isle of Man company at a subscription price of £430,772.00, representing a premium of £430,770.00. That company was Codium Limited. The Remuneration Committee described the purpose of the company as being to provide compensation for loss of office to Mr Fishwick in respect of his employment with the Appellant and to ensure that he would not take legal action against the Appellant should they be found to be in breach of his service agreement.

(17) On 9 December 2002 the Remuneration Committee of the Appellant requested that the EBT trustees in their capacity as beneficial owner of the shares consider arranging for Codium Limited to grant an option to subscribe for 10,000 £1 ordinary shares for £10,000 to the trustees of the Chris Fishwick Family Trust. The EBT trustees as shareholders of Codium Limited signed a

resolution approving the grant by Codium Limited of an option on the terms requested, for a consideration of £5, exercisable within a period of ten years. An option agreement to that effect was executed by Codium Limited.

(18) On 11 December 2002 the Remuneration Committee of the Appellant recommended that as part of Mr Fishwick's compensation for loss of office he be provided with the shares in Codium Limited.

(19) By resolution dated 16 December 2002 the trustees of the EBT resolved to distribute its two shares in Codium Limited to Mr Fishwick.

(20) Mr Fishwick received the following sums from the companies in which he holds shares:

31/01/2003	£350,000	Bittium Limited
31/07/2003	£1,000,000	Croyde Limited
31/07/2003	£1,000,000	Bittium Limited
18/03/2004	£650,000	Bittium Limited
31/03/2004	£320,000	Croyde Limited
11/10/2004	£205,000	Bittium Limited
20/10/2005	£800,000	Croyde Limited
21/11/2005	£75,000	Codium Limited
06/12/2005	£170,000	Croyde Limited
13/02/2006	£215,000	Bittium Limited
27/04/2006	£230,000	Bittium Limited
04/07/2006	£250,000	Bittium Limited
04/08/2006	£25,000	Codium Limited
04/08/2006	£70,000	Croyde Limited

(21) Without prejudice to the parties' contentions (the Appellant contending that these sums were truly advanced by way of loan and the Respondents contending that the sums were never intended to be repayable), in respect of these payments loan agreements which provided for various repayment dates and for interest were executed between the companies and Mr Fishwick (and two loan agreements consolidating the first six, one in respect of the Bittium loans and one in respect of the Croyde loans, were each executed on 16 December 2004). The principal cash sums received have not yet been repaid.

(22) None of the options granted to the Chris Fishwick Family Trust have been exercised.

Mr Campling, Senior Portfolio Manager

(23) Fade Limited was incorporated in the Isle of Man on 1 December 2000. A subscriber share was issued for £1 being its nominal value.

(24) By letter dated 2 March 2001 the trustee JF Worthytrust Limited applied to Fade Limited to be allotted 1 share for a subscription price of £224,999.00, representing a premium of £224,998.00.

(25) By resolution dated 2 March 2001 Fade Limited, noting that funds of £225,000 were due to be received, resolved to allot 1 share of £1 par value at a premium of £224,998 to the trustees of the EBT.

(26) On 6 March 2001 the Remuneration Committee of the Appellant requested that the EBT trustees consider arranging for Fade Limited to grant an option to subscribe for 10,000 £1 ordinary shares for £10,000 to the trustees of the Neil Campling Family Trust.

(27) On 6 March 2001 the shareholders of Fade Limited signed a resolution to grant to the trustees of the Neil Campling Family Trust for consideration of £5 an option to subscribe for 10,000 new ordinary shares in Fade Limited. The option was originally exercisable within one year but the agreement was subsequently labelled "replaced". The option granted was not exercised.

(28) On 7 March 2001, pursuant to a request of the Remuneration Committee of the Appellant, the trustees of the EBT resolved to distribute the shares in Fade Limited to Mr Campling.

(29) By countersigning the letter dated 7 March 2001 on 13 March 2001 Mr Campling acknowledged receiving the benefit of the shares issued to him in Fade Limited as part of his remuneration package from the Appellant.

(30) Mr Campling received the following sums from Fade Limited, amounting in total to £220,000:

2001	
20 April	£110,000
16 May	£20,000
22 June	£30,000
1 July	£7,000
25 July	£9,000
14 August	£30,000
16 October	£10,000

26 November	£4,000

(31) Without prejudice to the parties' contentions (the Appellant contending that these sums were truly advanced by way of loan and the Respondents contending that the sums were never intended to be repayable), in respect of the payments loan agreements were executed between Fade Limited and Mr Campling which were each for a term of one year, repayable on demand, and interest bearing. None were repaid.

(32) In the period 2 March 2001 to 5 April 2003, £760 was settled in the family trust, of which £750 was paid in trustee's fees.

(33) Mr Campling left the Appellant's employment in November 2002.

(34) On 3 January 2006 the Neil Campling Family Trust was terminated.

(35) Fade Limited was struck off the Isle of Man register of companies on 23 March 2006.

General

19. All copy documents lodged as productions are deemed to be the equivalent of principals.

20. All documents are deemed to be what they purport to be, and to have been prepared by the person whose name, if any, they bear as author, signed by the person whose signature they bear to contain, and prepared on behalf of the organisation, if any, on whose letterhead or on whose behalf they bear to have been prepared.

All documents bearing to be items of correspondence are deemed to have been sent on the date they bear to have been created and to have been received in the ordinary course by the recipient(s) to whom they bear to have been addressed."

10. The Tribunal makes the following additional findings of fact (for convenience we have, in places, set out our views in relation to some of the facts)--

Service Contracts

21. The Appellants' business is dependent upon the success of the funds it manages and its ability to attract investors and clients. It is therefore important to the Appellants that they attract fund managers who have the talent successfully to manage the funds and the reputation to attract investors. This type of business is highly competitive. Such individuals are much in demand and highly mobile. Salary and benefits packages have to competitive within the market which they operate in order to attract and retain such individuals.

22. With the exception of Paul Reed, senior executives of the Appellants were employed by the Appellants in terms of Service Contracts. While these contracts were not all identical, they typically contained provisions for a bonus to be paid at the discretion of a Remuneration Committee. For example. the terms of employment of Messrs Campling and Protheroe were in standard form for executives below main board level. Clause 6 provided

> The employer operates a discretionary bonus scheme which the employee will be eligible for consideration.

Although Paul Reed had no service contract he was regarded by the Remuneration Committee as eligible for bonuses even although the contract of employment relating to him (dating from 1991) made no mention of bonuses. This may be inferred from letters to him from the Appellants' Group Personnel Manager dated 20th October and 17th November 2000.

23. The service contracts of the employees who were directors (Fishwick Gilbert and Laing) were in slightly different terms from those set out above. Mr Fishwick's contract of employment dated 30 August 1996 provided *inter alia* that:-

> 5.3 In addition to the fixed salary above specified, the Executive may be entitled to an annual bonus of such amount, if any, as the Remuneration Committee in its sole discretion may determine.
>
> 5.4 Such bonus, if any, shall be paid to the Executive not later than twenty one days after the accounts of the company have been certified by the auditors and in any event not later than ten months after the end of the financial year in question of the Company.

24. Gilbert's and Laing's contracts of employment contained the same terms

25. The auditors certified approval of the Appellants' accounts on 19/12/00.

The Remuneration Committee

26. The Remuneration Committee was established in accordance with the Combined Code on Corporate Governance. The Committee comprised three independent non-executive directors. Its role was to monitor, review and recommend the Appellants' group remuneration policy and to recommend to the Board of the Appellants the remuneration packages of the executives and other senior employees of the Group. This included the consideration of incentive schemes but mainly focused on remuneration and other rewards provided to the top level executives.

27. The Terms of Reference for the Appellant's Remuneration Committee provide *inter alia* that:-

> The Committee shall:
>
> > 5.1 determine the specific remuneration packages for the Chief Executive, the Chairman and the other executive directors. The remuneration of the non-executive directors shall be a matter for the Chairman and the executive directors.
> >
> > 7.1 The Committee shall make a statement in the annual report detailing the Group's remuneration policy and practices.

The Appellants' Remuneration Policy attached to their Annual Report and Accounts 1999 provides *inter alia* as follows:-

> Remuneration comprises basic salary, annual cash bonus, participation in the company's employee benefits trust, employee share ownership plan, share option .....

28. The Remuneration Committee met at or about the end of each financial year of the Appellants to determine the allocation of the bonus pool which they had previously determined. Before the operation of the Scheme with which these appeals are concerned, bonuses were declared by the Remuneration Committee and subsequently paid in cash directly into the employee's bank account.

29. The Remuneration Report as set out on page 26 of the Appellants' Annual Report & Accounts 2000 states *inter alia* that:-

> **Remuneration Policy**
>
> The Group's remuneration policy is designed to reflect the importance of recruiting and retaining senior executives of the calibre necessary to maintain and improve the Group's position in the fund management sector. The policy seeks to reward performance in a manner which aligns the interests of executives and shareholders. Executive remuneration comprises basic salary, annual cash bonus, participation in the Company's Discretionary Employee Benefits Trust, Employee Share Ownership Plan .....
>
> The aggregate amounts of cash bonus and benefits from the Discretionary Employee Benefits Trust available in any year are dependent upon the Group's overall profit performance and new business generated. Individual bonuses which are non-pensionable are discretionary based upon the Remuneration Committee's assessment of the achievement of objectives. The Remuneration Committee will make requests to the Trustees of the Discretionary Employee Benefits Trust for the provision of benefits to individuals based on the Committee's assessment of the achievement of objectives. Individual bonuses and benefits requested for key employees are made on condition that a proportion is either deferred or is repayable in the event of the individual leaving the Group's employment within the following year

30. The Remuneration Report as set out on page 28 of the Appellants' Annual Report & Accounts 2001 states *inter alia* that:-

> **Remuneration Policy**
>
> The Group's remuneration policy is designed to reflect the importance of recruiting and retaining senior executives of the calibre necessary to maintain and improve the Group's position in the fund management sector. The policy seeks to reward performance in a manner which aligns the interests of executives and shareholders. Executive remuneration comprises basic salary, annual cash bonus, participation in the Company's discretionary Employee Benefits Trust, Employee Share Ownership Plan .....
>
> The aggregate amounts of any cash bonus and benefits from the Employee Benefits Trust available in any year are dependent upon the Group's overall profit performance and new business generated. Individual bonuses which are non-pensionable are discretionary based upon the Remuneration Committee's assessment of the achievement of objectives. The Remuneration Committee will make requests to the Trustees of the Employee Benefits Trust for the provision of benefits to individuals based on the Committee's assessment of the achievement of objectives.

Individual bonuses and benefits requested for key employees are made on condition that a proportion is either deferred or is repayable in the event of the individual leaving the Group's employment within the following year.

31. The Remuneration Report as set out on page 28 of the Appellants' Accounts for 2002 states *inter alia* as follows:-

Remuneration Policy

The Group's remuneration policy is designed to reflect the importance of recruiting and retaining senior executives of the calibre necessary to maintain and improve the Group's position in the asset management sector. The policy seeks to reward performance in a manner which aligns the interests of executives and shareholders. Executive remuneration comprises basic salary, annual cash bonus.....

The aggregate amount of any cash bonus in any year is dependent on the Group's overall performance and profitability, individual bonuses, which are non-pensionable, are discretionary and based on the Remuneration Committee's assessment of the achievement of objectives. Individual bonuses for key employees are made on condition that a proportion is repayable in the event of the individual leaving the Group's employment within the following year.

32. The Remuneration Report as set out on page 23 of the Appellants' Accounts for 2003 provides *inter alia* as follows:-

Remuneration Policy

The Group's remuneration policy is designed to reflect the importance of recruiting and retaining senior executives of the calibre necessary to maintain and improve the Group's position in the asset management sector. The policy seeks to reward performance in a manner which aligns the interests of executives and shareholders.

As it stands the remuneration policy, which applies to executive directors and senior employees, will remain unchanged for 2004 and subsequent years except that there are currently no plans to make further deferred bonus awards. The aim, within the overall policy design of retention and motivation, is to pay basic salaries and award benefit packages which are reasonable and competitive with the asset management sector. In addition, the policy is designed to deliver additional rewards through appropriate incentive schemes, both annual and long term. These are directly linked to performance at both a corporate and an individual level

Executive remuneration

Executive remuneration has a number of different elements:

i) **Basic salary**

.....

ii) **Annual bonus**

The policy is to recognise corporate and individual achievements each year through an appropriate annual bonus scheme. The aggregate amount of cash bonus available in any year is dependent on the Group's overall performance and profitability.....

viii) Deferred bonus

The Group implemented a one-off deferred bonus scheme in 2003 designed to encourage the retention of certain key employees identified as critical to the Group's achievement of its longer term goals. An employee benefit trust has been established for the purposes of paying potential awards under the scheme. Deferred payments to be made in the form of cash bonuses have been recommended by the Committee and will be paid to qualifying employees over a three year period..... None of the executive directors were awarded any benefits under the scheme.

33. The DOS was an integral part of the Appellant's remuneration policy. The Committee approved the strategy of the DOS, recommended the amount to be made available in respect of each individual and made a formal recommendation to the EBT trustees. Contributions to the EBT were debited to the Group's profit and loss account as an element of staff costs

34. The only form of benefit for which the Remuneration Committee was entitled to recommend was cash bonuses or benefits from the EBT

35. The position of the directors was different from other senior employees as noted above.

36. The Remuneration Committee met on or before 15th December 2000 and made determinations and recommendations. These were communicated to the EBT on or about 15th December 2000. The effect was that instead of awarding bonuses the proposal was that a lump sum be paid to the EBT with a view to employees receiving benefit from the EBT. A schedule allocating sums to about 400 individuals accompanied that letter.

37. Employees who were to benefit received letters dated 20th and 21st December 2000 (we give further consideration to these letters below under the heading *Administration of the Scheme*). They accepted shares on the basis that they formed part of their remuneration package.

38. In due course the Committee sent letters of wishes to the EBT trustees asking them to provide benefits to various employees *in the form of shares* in their respective companies. For Messrs Laing, Fishwick and Gilbert only a 50% holding was to be transferred if the individual remained in employment with the Appellant for a further specified period. This came to be known as the *golden handcuff* arrangement.

39. An example of the Remuneration Committee proposing golden handcuff arrangements is to be found in the Minutes of their Meeting dated 7 March 2001, which records *inter alia* that:-

> 3 The Committee identified that this was also an opportunity for the Trustees to also consider a "golden-handcuffing" exercise for certain individuals. Accordingly, it was proposed that it would be appropriate for the Trustees to retain 50% of the issued shares in relation to the following individual companies. It should be recommended to the Trustees that these retained shares would then be transferred to the individuals providing the individuals remain in employment with [the Appellants] as at 30 September 2001.....
>
> 4 These proposals were agreed by the meeting. It was agreed that Bill Rattray should send a letter of wishes to the trustees of the Trust indicating the above recommendations, and acknowledging that the trustees had a complete and independent discretion over the amount and destination of any distributions from the Trust.

The Scheme

40. The DOS was marketed by HLB Kidsons, accountants and tax advisers, as a tax avoidance scheme. They approached the Appellants between June and September 2000 offering the DOS and another scheme, known as the Conditional Share Arrangement as means of providing employees with incentive bonuses in a tax efficient manner. Their letter dated 28 November 2000 to Mr Rattray, which he signed the following day, set out the basis on which they were to act for the Appellants in connection with *remuneration planning and the use of the discounted option arrangements as a means of paying tax efficient rewards*. Although in these proceedings the accountants are referred to as Kidsons or HLB Kidsons, their correct name appears to be HLB Kidsons Fiscal Solutions which is or was a trading name of Solutions @ Fiscal Innovation Limited. Nothing appears to turn on these differences in description. The letter stated that advice would be provided in relation to *inter alia Appropriate Board Minutes and Letters of Instruction,* and *Corporate/ Trust structuring.*

41. A further letter from HLB Kidsons to Mr Rattray of the same date set out the basis on which they were to act for the Appellants *in connection with the setting up of an Employee Benefit Trust (EBT) for the benefit of the company's employees and the company's trade*. The proposals, which Mr Rattray again accepted on behalf of the Appellants on 29th November 2000, included the *provision of Trustee services.* The letter also set out the charges of HLB JF Worthytrust Limited for acting as trustee and administrator of employee benefits trusts.

42. In or about November 2000, the Appellants accordingly engaged HLB Kidsons to set up the EBT and the DOS. HBL Kidsons provided draft documents to be used for the purposes of setting up the EBT the FBT the money box companies and all the relevant administration. The Appellants subsequently entered into a contract with JF Worthytrust Ltd (see below) for the administration of the DOS.

43. HLB Kidson's brochure marketing the DOS noted under the heading Technical Analysis that if the option granted in favour of the FBT were exercised, that would trigger a liability on the employee by virtue of section 135 of ICTA. It also noted that

> Funds could be totally stripped out by way of soft loans

44. HBL Kidsons acted as the Appellants' agents and advisers in relation to the creation and operation of the DOS. When any of the individuals representing any one or more of the offshore companies (trust companies or money-box companies) contacted HBL Kidsons for advice or information, that advice or information was being provided by HBL Kidsons as the agent of the Appellants.

45. Employees were informed on 20th December 2000 of the value of the benefits they were to receive for past performance in the year in relation to which the benefits were declared. By letters dated 21st December 2000, selected senior executives and directors were given the opportunity to participate in the DOS.

46. All the participants in the DOS received a letter dated about 21 December 2000 which stated *inter alia*:-

> As you will see from the enclosed note, the essence of the scheme is that your benefit from the EBT will be paid into an Isle of Man registered company, the shares in the company would then

be gifted to you. There will be no UK tax charge on the cash held within the Isle of Man company until such time as you bring the cash back into the UK, for example by way of dividend or by liquidating the company

You will incur no costs in setting up the Isle of Man company but annual administration costs after ownership is transferred to you will be for your account.....

47. By letter dated 27 February 2001 to HLB Worthytrust Ltd the Remuneration Committee recommended that the EBT subscribe for shares five specified Isle of Man Companies. The letter continued

The purpose of these companies is to provide remuneration to valued employees of [the Appellants]

We also request that you establish discretionary trusts, with initial settled property of £10, for the benefit of the following employees and their families ....

We acknowledge that under the Trust Deed creating this Trust the amount, destination and timing of any Trust transaction is a matter for the sole discretion of the Trustees.

Under the Trust deed, creating the Trust the trustees are required to take account of the expressed wishes of the Committee, in deciding how those trustees should exercise the powers and discretion conferred upon them by that trust deed. The Remuneration Committee have authority to consider and make suggestions to the Trustees concerning possible distributions and loans from the Trust.

It is explicitly stated in the Trust Deed and it is clearly recognised by [the Appellants] that the Trustees have a complete independent and unrestricted authority under that Trust Deed to determine whether, and if so, how and in what manner, to exercise some or all of the powers and discretion conferred upon them by the Trust Deed.

The Employee Benefit Trust

48. On or about 1 December 2000 the Appellants decided to establish the EBT. The Trust Deed establishing the EBT provides *inter alia* that:-

2 The Trustees shall stand possessed of the Trust Fund and the income thereof during the Trust period upon trust;-

(a) to pay or apply the income thereof to or for the benefit of all or any one or more to the exclusion of the other or others of the Beneficiaries for the time being living provided always that the Trustees shall have power in their absolute discretion to accumulate all or any part of the income.

(b) to pay or apply all or any part or parts of the capital of the Trust Fund to in favour or for the benefit of all or any one or more to the exclusion of the other or others of the Beneficiaries for the time being living

.....

12 The Trustees may refer to the remuneration committee of the Company established for the purpose of identifying Beneficiaries which are worthy of receiving a benefit under the Trust Fund and the appropriate level of such a benefit

49. We have not identified any other provisions setting forth how the trustees are to exercise their discretion or what to take into account or what other criteria they should consider in relation to the distribution of the Trust Fund or its income.

50. Other provisions of the Trust Deed confer wide administrative powers of investment etc on the trustees including granting options, and making loans and providing bonuses to employees whether in cash or in kind. They are for example empowered to generally do anything which in the opinion of the Trustees will or may be expedient for the maintenance of the contentment loyalty and goodwill of the Employees [clause 6(g)]

51. The trustees were JF Worthytrust Ltd and JF Nominees Ltd. These two companies were owned by Jackson Fox, a firm of chartered accountants based in Jersey. HLB Kidsons had a connection with Jackson Fox. According to Mr Matthews they were both *badged with the HLB network of chartered accountants.* JF Worthytrust Ltd charged the Appellant a fee for acting as trustee and administrator

52. JF Worthytrust Ltd, sometimes at least, traded (if that is the correct expression) under the name HBL JF Worthytrust.

53. All the individuals actually administering the EBT were employees of a bank AIB (CI) Ltd.

54. The EBT trustees discussed most matters with HLB Kidsons who were generally their first point of contact at the stage up to the transfer of shares to the various employees. Until that stage all information was channelled through HLB Kidsons who were the Appellant's agents. HLB Kidsons assisted with the drafting of letters of recommendation which ultimately the EBT considered and accepted. Their consideration was essentially formal. Kidsons advised on and essentially dictated strategy which the EBT trustees always accepted.

55. Although Mr Matthews said in his statement that the trustees retained and exercised their discretion as to how to apply the trust fund, the reality was that any recommendations made to the trustees were always implemented. While these recommendations may have been preceded by dialogue with Kidsons, there was no evidence that the EBT trustees ever made any positive contribution to that dialogue. The documentation for processing the DOS was standard, previously prepared by Kidsons. Thus, there was standard documentation for the EBT subscribing for shares in the offshore company, setting up the FBT, granting the option, and transferring the shares to the employee, and for the Minutes of the related meetings.

56. The first set of financial statements for the period from 4 December 2000 to 30 September 2001 recorded *inter alia* that *There has not been any diminution in value attributable to the granting of options to family trusts to subscribe to further shares in the Isle of Man Companies.* The details of distributions of shares are not reported in the financial statements for the years 2002 and 2003; however an unexplained permanent diminution of investments in the Isle of Man companies is recorded and the earlier statement is described as a mistake.

57. Those financial statements also recorded that Trustee fees were £416, whereas administration fees were £123. For the following year to 30 September 2002 those fees were respectively £54,188 and £4927 (although these figures are not borne out by the Notes to the accounts which suggest that trustees' fees were £6000 being a £1000 for each of six offshore companies set up). For the year to 30 September 2003, the fees were respectively £938 and £5268. For each of the ensuing years to 30 September 2007, the trustees' fees are £1000. For the year to 30 September 2008 they drop to £368.

58. An illustration of the "golden handcuffing" arrangements is to be found in the Minutes of the EBT trustees (JF Worthytrust Ltd and JF Nominees Ltd) dated 7 March 2001 in relation to Mr Fishwick and Croyde Ltd. The trustees resolved to distribute 50% of the company's share capital but hold the shares in a nominee capacity for the employee; the Minutes also record that the Trustees would consider transferring the remaining shareholding of one share providing the applicable employee remained in the Appellants' employment until 30 September 2001.

59. The EBT Trustees wrote to the employees advising them of the passing of resolutions e.g. to transfer the entire issued share capital of an offshore company to the employee by way of distribution. They required him to accept the offer of beneficial ownership and that the benefit formed part of his remuneration package from the Appellants.

The Family Benefit Trusts

60. The trustee was initially Worthytrust Company Limited and subsequently AIB Worthytrust Ltd. The latter is the successor of HLB JF Worthytrust. AIB Worthytrust Ltd subsequently became AIB Jersey Trust Ltd. AIB Jersey Trust Ltd was a subsidiary of AIB Bank (CI) Ltd.

61. The employee for whom the EBT established an FBT was regarded by the by the FBT trustee as the primary beneficiary.

62. The Neil Campling Family Trust is an example of the terms of the trust deed setting up the FBTs. It is dated 2 March 2001. The settlers are JF Worthytrust Limited and JF Nominees Limited (the trustees under the EBT); the trustees under the FBT are Worthy Trust Company Limited. The trust deed gives the trustees wide powers to apply the income and capital of the Trust Fund which is a nominal £10. The Beneficiaries are Mr Campling, his wife and children and the Royal National Lifeboat Institution.

63. To illustrate the granting of options in favour of the FBTs reference may be made to the Minutes of Meeting of the Shareholders of Fade Ltd held on 6 March 2001. The shareholders were JF Worthytrust Ltd. The Minutes disclose that the shareholders resolved to grant an Option to subscribe for 10,000 new ordinary shares in Fade Ltd to the Trustees of the FBT. A corresponding Minute of the FBT trustees approving of the option dated 9 March 2001 was produced. The consideration for the Option as disclosed in the Option Agreement between Fade Ltd, and Worthy Trust Company Ltd (as trustee of the Neil Campling Family Trust), was £5; the consideration for the acquisition of the 10,000 shares was £1 per share.

64. The trustees of the various FBTs had little or no information about the beneficiaries under the FBTs and thus little or no basis upon which to exercise a genuine discretion in accordance with their duties as trustees or to make an informed decision as to whether to exercise the options conferred on them. What was described in evidence by Mr Matthews as due diligence and money laundering checks was nothing more than obtaining a photograph and utility bill from the principal beneficiary i.e. the employee) and the dates of birth of his wife and children.

65. There was little or no communication between the trustee and the beneficiaries of the FBT. On occasion the trustee discussed matters with Kidsons.

66. The options granted for twelve months dated 6 March 2001 were, at some point between about March 2001 and November 2002, after they had expired, purported to be amended by Worthytrust by the substitution of pages bearing to confer an option for ten years. The deeds affected were marked *replaced*. This was done without the authority of either the granter or the beneficiary of the options. This was done after policy advice from Kidsons that ten year options should be used instead of one year. The advice was accepted without question. Ultimately, however, the purported amendment was not regarded by anyone as being effective and has been treated as an administrative error which should not have occurred.

67. The option was the only significant asset held by the trust. Once the option lapsed, there were no other trust assets of any substance to administer. No option in favour of an FBT was ever exercised except in relation to Piniped and Mr Reid's FBT where the circumstances were exceptional. The employees' expectation was that the options would never be exercised. It was part of HLB Kidsons' strategy that the options would not be exercised. The FBT trustees would not have exercised the options without positive advice to that effect. No such advice was given except in relation to Piniped Ltd. If the FBT trustees were independently applying their minds to the question of the exercise of the option, they would probably have considered that it would benefit the trust as a whole to exercise the option as soon as reasonably practicable.

68. There was, however, no realistic prospect of the options being exercised save in exceptional circumstances. The risk of the unexpected exercise of the option was negligible. Although the last date for exercise of each option was formally diarised by Mr Matthews or a colleague, the FBT trustee would not have exercised the option unless advice to that effect had been given by HLB Kidsons.

The Offshore Companies

69. The nominal shareholder in each company was JF Worthytrust Ltd. That company held the shares as nominees under a declaration of trust under which the company undertook to act in accordance with the employee's wishes. For convenience, we shall simply refer to the shares being transferred to and held by the employee.

70. The directors of the companies did not communicate at all with the employees until after the transfer of shares. The directors were not bound to comply with the employees' wishes, including after the transfer of shares. However, where the employee had a 100% shareholding the directors could easily have been compelled to do so by virtue of the relevant company law procedures by having the resistant directors removed and replaced with directors who would comply with the employee holding 100% of the issued shares. Even where only 50% shareholding was held temporarily, the reality was that the directors would generally comply with the employees wishes as regards loans and investment.

71. There was generally no discussion between the Appellants and the employees regarding the benefits which might be provided by the offshore companies. There was no standard way in which the companies applied their respective funds: each company invested in different kinds of investment and or made *soft* loans to the employee who held all or half of the issued shares.

72. Employees obtained benefits from *their* company in a variety of ways. Examples include the making of loans by the company to the employee; the taking of assets of the company as a dividend, and the purchase of land by the money box company substituting itself as party to land purchase agreements which a senior employee had entered into (for example Mr Fishwick and the purchase of land at Summersales Farm, Crowburgh, East Sussex. With one exception, loans granted by a money box company to its employee shareholder were never repaid.

Share Valuation

73. The existence of the options granted in favour of the FBTs did not devalue the shares. On being transferred to the nominee of the various employees, the shares in the offshore companies were capable of being turned to pecuniary account. Their value was substantially the same as the net asset value of the offshore company or 50% thereof where only one of the two shares was so transferred.

74. On the assumption that it is almost inevitable that the option granted in favour of each FBT is not exercised, the value of each of the two shares in the offshore company is one half of the net asset value of the company.

75. On the assumption that it is almost inevitable that the option granted in favour of each FBT is exercised, the value of each share is as set out in Mr Sweetman's Report.

Some Individual Arrangements

76. Mr Gilbert entered into various arrangements in 2002 which led to the deferment of his receipt of the second share in offshore companies Glycera Ltd and Edulis Ltd. The detail need not be discussed. These arrangements arose out of difficulties which the Appellants encountered with an investment vehicle known as split capital investment trusts.

77. Mr Fishwick left the Appellants in the wake of the difficulties with split capital investment trusts. He was paid one year and eleven weeks salary on severance. He received compensation of £430,772 under a compromise agreement as compensation for the termination of his employment. The sum was paid as a termination bonus in the same matter as the bonus paid in the previous year i.e. by way of the DOS. Mr Fishwick received shares in a company, Codium Ltd after that company had been capitalised with the compensation payment.

78. With reference to Finding of Fact 18(16) above the Termination Agreement between the Appellants and Mr Fishwick dated 14th October 2010, provided *inter alia* as follows:-

> 1 The Company [sc the Appellants] shall .....
>
> 1.1 pay to [the EBT] the sum of £430,772 by way of compensation for the termination of his employment..... The Company will issue a formal request to the EBT that this sum be paid to the employee a s a termination bonus in the same manner as the bonus in the previous year

79. In at least one case, the shares of the company (Heamatopus Ltd), were held by the Appellants (and not the EBT) and subsequently transferred by the Appellants to the employee (Mr Reid).

The Administration of the Scheme

80. HLB JF Worthytrust was engaged by the Appellants to administer the DOS. Their fees were deducted from the trust funds; if those funds were insufficient then HLB JF Worthytrust rendered invoices to the Appellants. The trustees of the EBT were JF Worthytrust Ltd and JF Nominees Ltd. However, both the trustees and HLB JF Worthytrust were linked. They both in effect deferred to HLB Kidsons who were acting on behalf of the Appellants implementing their instructions, as agent, in accordance with the DOS which had been set up.

81. HLB JF Worthy Trust was also engaged by each individual employee to administer the companies and the FBT.

82. While the trustees under the EBT received formal recommendations from the Appellants, their general line of communications, before transfer of shares to employees, was through HLB Kidsons. The trustees had very little independent information about the individual employees whom they regarded as the primary beneficiary under the trusts. They deferred to HLB Kidsons on any tax related matter. The trustee under the FBTs deferred to HLB Kidsons in relation to the exercise of the option granted in their favour.

83. Thus, the letter dated 15 December 2000 from the Chairman of the Remuneration Committee to one of the EBT trustees contained a long list of names of employees, identified the department in which they work, set out in a column headed *Total Benefit Value* a sum for each employee and in relation to a few of them in an additional column headed *Proposed Deferred Element (released 30/9/01)* another figure. While the letter stated *inter alia*

> The Committee are currently considering a number of remuneration planning proposals put forward by HLB Kidsons. The Committee anticipates that more detailed recommendations will be made in the next few days for the Trustees to consider.
>
> In the meantime, we would request that the Trustees consider the allocation to individuals of benefits in kind in the value of the amounts as listed on the attached Appendix.
>
> We acknowledge that under the Trust Deed creating this Trust, the amount, destination and timing of any Trust transaction is a matter for the sole discretion of the Trustees.
>
> Under Clause 12 of the Trust Deed, the Trustees are directed to refer to the advice of the Remuneration Committee, in deciding how they should exercise the powers and discretion conferred upon them by that Trust Deed. The Remuneration Committee Aberdeen Asset Management PLC have authority to consider and make suggestions to the Trustees concerning possible distributions from the Trust.
>
> It is explicitly stated in the Trust Deed, and it is clearly recognised by the Committee, that the Trustees have a complete independent and unrestricted authority under that Trust Deed to determine whether, and if so, how, when and in what manner, to exercise some or all of the powers and discretion conferred upon them by the Trust Deed.

there was no evidence of the Trustees giving active consideration to the contents of the Appendix. There was no material on which they could exercise any considered discretion. They had names and figures and nothing else but the recommendation of the Remuneration Committee. They did not test that recommendation in any way. They did not ask why one individual should benefit by £1000 another by £75,000 and yet another by £500,000. They simply followed the Remuneration Committee's proposal. There was no realistic possibility of the Trustees exercising their *sole discretion* by for example redistributing the total amount equally among all the named employees. There was no realistic possibility of the Trustees exercising their *independent and unrestricted authority under the Trust Deed* other than as proposed, and scripted in advance. While the Trustees may not have acted in breach of fiduciary duty, there was, realistically. always only one way in which their discretion could be exercised and that was in accordance with the views and requests of the Remuneration Committee. They did not give independent thought to the question as to who should be benefitted or by how much. Moreover, while the Trustees may not have been inevitably compelled to comply with the employees' wishes, the reality was that they were inevitably compelled to comply with the wishes of the Remuneration Committee which in turn reflected the Appellants' policy for remuneration.

84. On 20 and 21 December 2000 the Appellants wrote to the seven employees informing them that they were beneficiaries of the EBT and asking them whether they wish to participate in the conditional share scheme or DOS (for example N71 p171-172, K2). The clear intention was that those choosing to participate in DOS would receive shares in an offshore company. If the EBT trustees were truly exercising a genuine discretion it could not be confi-

dently stated that those choosing to participate in DOS would receive shares in an offshore company. The trustees had not at that stage, on the evidence presented to us, given any consideration to the formation of offshore companies. However, as part of the pre-arranged scheme there was no real doubt that that is what would in due course happen even although there was no binding obligation requiring the trustees to act in a certain way.

85. The duration and value of loans granted by the offshore companies were agreed in a dialogue with the employee who had beneficial ownership of the shares. The dialogue was formal and loans were invariably granted. Employees with a 100% shareholding could have required the company to grant the loan using company law procedures had there been any resistance from the directors. Even employees holding only 50% shareholdings, albeit temporarily, would have been unlikely to have met any opposition to their requests for loans. Such credit checks as were carried out were formal.

86. While there were no standard DOS exit procedures Baker Tilly, who took over from Kidsons assisted Mr Protheroe under procedures devised by them and described as "DOS Exit" procedures to repatriate Flimwell Ltd, pay out its assets by way of dividend (after his repayment of loans from the company) and dissolve it.

87. An unusual feature of the Scheme was, in relation to several employees, the operation of a deferred entitlement to the second share. The underlying rationale was to secure the services of the employee in question for a further period, hence the phrase *golden handcuffs* which was applied to this particular feature of the Scheme. This arrangement would not have sat happily with the existence of the options in favour of the FBTs unless there was no realistic possibility of the options being exercised. If the option was likely to be exercised the value of the deferred entitlement would be very much reduced thus negating the restraint imposed by the golden handcuffs in the first place.

Treatment in Appellants' and EBT Financial Statements

88. The Appellants, through past practice, had established an expectation of the payment of bonuses at a certain level. Thus in 1998 bonuses and other benefits which represented 8.3% of the Appellants' turnover, were disclosed as paid or payable to directors. In 1999 bonuses and other benefits, which represented 8.2% of turnover, were disclosed as paid or payable to directors

89. Some £5,550,000 of the £14,779,300 settled in the EBT in the year to 30/9/01, were allocated in payments made under the DOS and accounted for as expenses in the Appellants Group financial statements for the year to 30/9/00. Some £6,225,000 of the £15,935,000 settled in the EBT in the year to 30/9/02, were allocated in payments made under the DOS and accounted for as expenses in the Appellants' Group financial statement s for the year to 30/9/01.

90. The Group accounts generally for the years in question do not distinguish between those directors who received shares in off-shore companies and those, such as Mr Rattray, who did not participate in the DOS, but in some other scheme or arrangement.

91. Payments through the DOS to directors were reported in the Appellant's annual accounts as directors' emoluments in the year for which they were earned, and accrued as an expense in that year. The sums reported were the amounts by which the relevant offshore companies that the directors received had been capitalised. The sums were expressed as "paid". No distinction was made between those who participated in the DOS and those who did not. The accounting treatment of the description and presentation of employee bonuses in the years ending 30 September 2001 and 2002 is correct and in accordance with UK GAAP, except that the disclosure of directors' emoluments is incomplete and not wholly in accordance with the rules, in particular by not including the deferred elements in the table of remuneration in the year in which the liability was recorded.

92. According to the table of directors' emoluments in the accounts for the years to 2000, and 2001, there were no bonuses paid; in the year to 2002 only £200,000 was paid to Mr Reid. However, substantial *other benefits* were reported as emoluments in all three years.

93. The first accounting period for the Trust ran from 4/12/00 to 30/9/01. The financial statements for that period were approved by the trustees on 21/8/02. Note 7 to these Financial Statements states *inter alia* (after recording various share transfers in offshore companies to various employees) that:-

> There has not been any diminution in value attributable to the granting of options to family trusts to subscribe to further shares in the Isle of Man companies

94. The 2002 Accounts of the Appellants under the heading *Directors' emoluments* contained *inter alia* the following statement:-

> The deferred benefits from the Group's discretionary Employee Benefits Trust that were disclosed in the Annual Reports to 30 September 2001 were duly paid to Mr Fishwick (£1,400,000)..... . Mr Gilbert (£650,000) and Mr Marshall (£62,500) have elected to waive their entitlements.
>
> Mr Fishwick resigned as a Director of the Company, by mutual agreement, on 14 October 2002. A payment of £431,000 was made to Mr Fishwick and a pension contribution of £53,000 was made on his behalf, thereby releasing the Company from all further contractual obligations.

95. The 2003 Accounts record the introduction of a three year deferred bonus scheme. This involved the payment of cash bonus spread over three years through an employee benefit trust. This was different from the DOS which appears to have been brought to an end. The accounts themselves noted that there were *currently no plans to make further deferred bonus awards.*

96. The accounting treatment originally adopted by the EBT for the period ended 30 September 2001 is correct in stating that there has not been any diminution in value attributable to the granting of options to family trusts to subscribe to further shares in the Isle of Man companies. The requirement is to report the substance of the transactions when viewed as a whole, including the subsequent transfer to the beneficiary of the shares which the EBT owns in the offshore companies. The requirement is not to take into account only one element in a series of transactions such as the options.

97. In the second period of account, namely the year to 30/9/02, the EBT financial statements of the description of payments to beneficiaries under the DOS changed although they were still treated as a deduction against the capital account. Instead of being disclosed as distributions to beneficiaries, they were disclosed as a permanent diminution of investments. This did not reflect the substance of the transactions when viewed realistically as a whole.

General

98. The DOS and similar schemes have been under investigation by HMRC for a number of years. There have been about forty or fifty users of the discounted option scheme. Agreements were reached with Baker Tilly, who had taken over from HLB Kidsons, on behalf of those of the employers who adopted the scheme and for whom they acted, that PAYE and NIC would be paid in full on the amounts that had been paid recipients under the schemes. In return HMRC undertook *inter alia* not to enforce various statutory penalties

The Issues

11. Mr Prosser identified six issues for determination and Mr Artis did not demur from that approach although he did not rigidly follow it. We are content to proceed generally on that basis although there is some degree of overlap. These issues are:-

(1) Whether there was a contractual entitlement to payment of a bonus outwith the DOS Scheme (the Contractual Entitlement Issue)?

(2) Whether the employee in reality receives a payment of money (the Ramsay Issue)?

(3) Whether the employee should be regarded as receiving money, being the money owned by the offshore company, when he acquired shares in that company on the basis that the money owned by the company was unreservedly at the disposal of the employee (the Cash Box Issue)?

(4) Whether the grant of the Option Deed was a sham (the Sham Issue)?

(5) The valuation of the shares (the Valuation Issue).

(6) Whether the shares were readily convertible assets as defined (the PAYE Issue)?

12. We shall consider these issues in turn and deal with any other issues which arise. We should also record that both parties invited the Tribunal to make a substantial number of additional findings. Where these findings are not controversial we have incorporated them with such modifications as we consider appropriate, even although the facts found may not be relevant or may be only of peripheral relevance. Where the proposed factual findings are to any extent controversial we have expressed our factual findings bearing in mind counsel's proposals but have not always adopted the language proposed. We should also add that some of the documents contained statements that their governing law was the law of Jersey or the Isle of Man. In the absence of any expert evidence of such laws, we have to assume that they are the same as Scots law.

(1) The Contractual Entitlement Issue

Submissions

13. Mr Prosser submits that none of the seven employees ever become contractually entitled to payment of or on account of any emoluments. *Entitlement* meant present entitlement in the sense of due and payable. He referred to *Pardoe v Energy Power Development Corp 2000 STC 286.* The employees had no present entitlement because there was nothing in their contracts about becoming entitled to a bonus. Payments were discretionary.

14. The position was different in relation to the three directors by virtue of clause 5.4 of their contracts. Any cash entitlement in the future must have been given up when the directors agreed to participate in the DOS around December or early January 2001

15. Mr Artis submitted that the employees became contractually entitled to payment for the purposes of sections 203, 203A and the PAYE Regulations when the value of the awards were intimated to the employees on or about 20/21 December 2000. His skeleton argument (paragraph 74) referred to payment being made when the employees became entitled to bonus payments by the exercise of the remuneration committee's discretion in favour of the declared bonus.

16. The alternative submission was that the shares received are profits of employment (the value of which is not discounted by the options) which are capable of being turned into money and therefore payment was made when the shares were transferred Reference was made to *Sempra Metals v R & CC 2008 STC (SCD)1062 at paragraphs 141-140,* and *Garforth v Newsmith Stainless Steel Ltd 1979 1 WLR 409, Tennant v Smith 3 TC 158at 164 per Lord Chancellor Halsbury; Abbott v Philbin 1959 39 TC 82.* We discuss this submission below under the Cash Box issue.

17. Mr Artis, in his skeleton argument, also argued that if payment is treated as having been made by the EBT as intermediary then section 203B and 203J along with Regulations 7 and 8 of the Income Tax (Employments) (Notional Payments) Regulations 1994 applied.

Discussion

18.*Pardoe* concerned the timing of a statutory direction by the Revenue that tax be withheld from the price for shares of a company which owned a power station in the UK, although at the time there was no contract yet in existence for the sale and purchase of the shares. The statutory phrase *any person entitled to any consideration* was construed by the Special Commissioner as meaning entitlement under a contract. In refusing the Revenue's appeal, Lightman J held that the phrase in ordinary usage meant any person *presently entitled* as opposed to a prospect of future entitlement however imminent. The statutory context did not require a wider meaning.

19. We consider that Mr Prosser is correct that entitlement to receipt of the additional remuneration (whether in the form of cash or shares) did not arise at the stage at which the Remuneration Committee made its recommendations. In terms of the directors' service contracts the obligation to determine bonuses rests with the Remuneration Committee. As a matter of contract that obligation does not appear to be one for which they could delegate responsibility or assign to a third party such as the EBT without the consent of the director employee. Liability to pay arises 21 days after certification of the accounts by the auditors or ten months after the end of the financial year in question. Agreement to participate in the DOS must, in our view, constitute a variation of these provisions of the service contract. Accordingly, entitlement under clause 5.4 is discharged in favour of the formal exercise of the EBTs discretion on the recommendation (rather than the determination) of the Remuneration Committee.

20. As is apparent from the findings of fact, the payment of bonuses to non-director employees was, in terms of their contracts of employment, plainly discretionary.

21. It is difficult to equate a recommendation that an employee be given £x with £x being unreservedly at the employee's disposal. The employer's obligation to pay had not yet arisen; nor could any such obligation be discharged. Entitlement only arose following the EBT's decision. The matter might be tested by considering what remedy the employee would have once the Remuneration Committee had made a favourable recommendation as opposed to a determination. In our view, the employee could not sue for payment. At best, he could sue the EBT seeking implement of their duties as trustees. However, once the EBT had agreed or resolved to implement the Remuneration Committee's recommendation, the employee could sue the EBT, requiring them to subscribe for shares at the price which reflected the Remuneration Committee's recommendation and thereafter require them to transfer the shares to him. He would sue as beneficiary of a trust seeking implement of the trustee's obligations. Payment or its equivalent would only be made when the shares were transferred.

22. However, we do not consider that the finding of no entitlement at the early stage of the composite transaction assists the Appellants. We refer to our discussion below in relation to the other issues.

(2) The Ramsay Issue

Submissions

23. Mr Prosser accepted that in the context of the Schedule E PAYE provisions, the legislation was focusing on the broad practical position as opposed to the legal effect of a particular step in a series of transactions. He referred to *Barclays Finance Ltd v Mawson 2005 1 AC 684* at paragraphs 26-39, and to *DTE Financial Services Ltd v Wilson 2001 STC 777.* He accepted that in the present appeal there was a series of transactions which were intended to operate together, beginning with money being paid to the EBT and ending with the acquisition of the shares in the offshore companies by the employees. The overall effect of the composite transaction, he submitted, was the receipt of shares, not money as in *DTE.* The package ended with the acquisition by the employees of the shares.

24. Mr Artis submitted that all the EBT was doing was distributing the bonus pool as the payment mechanism for what had done in previous years prior to the introduction of the DOS. If that were not the case and there were doubts in the minds of employees about being able to receive or enjoy such bonuses, it would undermine the underlying purpose of attracting and incentivising talented employees. All steps in the DOS fall to be disregarded. The employee received cash emoluments by way of salary bonuses in the amounts allocated to them from the EBT funds. The DOS was merely the mechanism to deliver the cash bonuses and the shares were the currency of payment. The composite transaction began with decision by the appellants to give their executives bonuses and ends with the receipt by each executive of shares which give him the right to control the cash equivalent in amount to bonus to which the appellants declared he was entitled. The shares are profits of employment with an undiscounted value and are thus chargeable as emoluments

Discussion

25. For our part, we do not see at as our function as a Tribunal of first instance to embark upon yet another exposition of the law in this area. We are content to adopt the succinct statement of Ribeiro PJ, quoted with approval in *BMBF* at paragraph 36 that

the ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.

26. In *DTE,* a company adopted a scheme to provide a bonus to each of three directors. The scheme was designed to avoid liability for national insurance contributions and to enable an employer to make payments to employees in a manner which fell outside the PAYE system. The scheme depended for its success on ensuring that the emoluments received by the directors consisted of a contingent reversionary interest under a trust and which was not a tradeable asset as defined in section 203F of the 1988 Act. The court held that the *Ramsay* approach applied to the PAYE system; the Court of Appeal held that the concept of payment was a practical, commercial concept (at paragraphs 42, 49 and 50). The *Ramsay* approach has also been held to apply to National Insurance Legislation (*NMB Holdings Ltd v Secy of State for SS 2000 73 TC 85.*)

27. In our view, it is reasonably clear on the facts found that there was a composite transaction consisting of a series of steps which began with the establishment of and transfer of money into the EBT and ended with the transfer of the shares to the employees. Thereafter, a variety of financial arrangements and transactions could and indeed did take place.

28. There was no dispute between the parties that *payment* was a practical commercial concept which took its colour from the context and ordinarily meant a transfer of cash or its equivalent (*Garforth v Newsmith Stainless Steel Ltd 1979 1 WLR 409 DTE Financial Services at paragraph 42 , Sempra Metals at paragraph 139.* It is plain that the receipt of shares is a benefit and that the shares were the profits of employment which had a money value. Shares are capable of being turned into money (*Tennant v Smith 3 TC 158 at 164 per Lord Chancellor Halsbury; Abbott v Philbin at 120 and 127.*

29. Our assessment of the facts is that the structures put in place simply operated as means of channelling the additional remuneration from employer to employee. The form and shape of the additional remuneration or benefit may have changed from the time it left the Appellants' control to the time it came under the employee's control but the substance of what was being provided did not. As the Appellants' accounts indicate, bonuses are awarded for performance, as an incentive and to encourage senior employees to remain with

the company. That is what the Appellants' senior executives expected and that is what they received. The cash is put into the hands of the employees by the transfer to them of the control of the offshore money box company which has no assets other than the cash injected by the EBT received from the Appellants; each employee is given the key to the money box. The assets of the company, namely cash, are effectively at the disposal of the employee. While the control over the assets of the company may be clothed in requests for loans etc and minutes of professional directors giving apparent *due consideration* to the requests, the facts, viewed realistically, show unequivocally that control is vested in the employee who has access to the pot of money contained within the corporate money box.

30. The DOS was a mechanism to pay cash bonuses. That is the effect of the various elements of the DOS which are intended to operate together. That is a form of payment which the statutory provisions, in question, construed purposively, were plainly designed to catch. In our view, this conclusion is entirely consistent with the theme of the *Ramsay* approach, namely to have regard to the purpose of a particular provision (or, here, combination of provisions) and interpret the statutory language so far as possible in a way which best gives effect to that purpose. The charging provisions are or at least include a combination of sections 1, 19, 131, 202A, 202B, 203 and the 1993 Regulations. Their overall purpose is to tax the material rewards of employment.

31. If the correct analysis of the facts is that the employees received shares, then we consider that the shares are a profit which is taxable and subject the PAYE and National Insurance Contributions regimes. We consider this aspect further below in our discussion of the cash box issue. However one classifies what the employees received it plainly arose from their employment with the Appellants and was in reference to the services the employees rendered by virtue of his employment; and was in the nature of a reward for such services (see *PA Holdings Ltd v R&CC 2009 UKFTT 95)TC), 2009 STI 1970 SC 3142/2007,* a case to which we were not referred, but which considers similar issues to the present appeal).

32. We discuss, below, the value to be attributed to the shares.

(3) The Cash Box Issue

Submissions

33. The issue is whether the employee should be treated, on receipt of the shares, as receiving money. This issue, as Mr Prosser recognised, merges somewhat with the second issue. The Appellants rely on *Garforth v Newsmith Stainless Ltd 1979 STC 129* to contrast the facts there with the present circumstances. Mr Prosser submitted that the mere fact that the employee is the sole shareholder does not mean that the money is unreservedly at his disposal, that being the test as set forth in *Garforth.* Money belonging to a company should be contrasted with shares in the company belonging to an individual. He reminded us that a company is a separate legal entity from its shareholders under reference to *EBM Co Ltd v Dominion Bank 1937 3 AER 555* and *Woolfson v Strathclyde Regional Council 1978 SC (HL) 90* and that the corporate veil is not to be pierced except where it is a facade concealing the true facts. The cash is the company's cash. He also submitted that even if one looked at the earlier point of time when the money is paid to the offshore company by the EBT in return for shares, the money could not be treated as the cash of the employee. He also relied on *Dextra Accessories Ltd & Ors v MacDonald 2002 STC (SCD) 413* for the proposition that neither when the money was held by the EBT nor when it was paid to the offshore companies could it be said that the EBT trustees or the directors of those companies were inevitably compelled to comply with the employee's wishes.

34. Mr Artis, in addition to the submissions recorded under the *Ramsay Issue* above, disclaimed any attempt to lift the corporate veil. Collapsing the DOS into a composite transaction did not pierce the corporate veil. The issues were the transaction, what was the emolument and its value.

Discussion

35. *Sempra Metals* concerned an employee benefit trust arrangement. There, as in the present appeal, maintaining senior employees of high quality was critical and achieved by payment of bonuses. While, in relation to part of the subject matter of the appeal, the legislative regime was not identical to that applicable in the present appeal (see paragraph 129 and 130), the bonus mechanism, with its recommendation by the company directors, payments into an employee benefit trust and the establishment of family benefit trusts has a resonance which makes the decision worthy of study. Of particular interest was the issue whether the

payments made by the appellant company into (rather than out of) both trusts constituted payment of emoluments or earnings to its employees giving rise to an obligation to deduct income tax and pay it to HMRC. The Tribunal held that they did not.

36. The Tribunal acknowledged that the placing of money or a perquisite or profit unreservedly at the disposal of an employee was equivalent to payment; and that the concept of payment was a practical, commercial concept which, for the purposes of the PAYE system, ordinarily meant actual payment i.e. a transfer of cash or its equivalent (paragraph 139). However, on the facts, the payments to the trusts did not amount to the payment of money or a profit equivalent to cash because no such money or its equivalent was placed unreservedly at the disposal of the employees.

37. The basic facts in *Sempra* were that the directors met, decided what total sum to pay into the employee benefit trust, and then made recommendations of specific amounts in relation to various employees. These recommendations were not binding on the trustee (an Isle of Man management company promoting the scheme) although they were always followed. Some loans were made to employees; other funds were invested at the employee's request; interest on loans was not demanded and repayment was not generally expected or required. Following a change in the law in 2003, a family benefit trust was set up with a view to establishing that payments into such a trust would be deductible for corporation tax purposes but would not give rise to an employment income tax charge or to a liability to pay national insurance contributions. Again, the company paid money into the trust and made recommendations which the trustee always accepted. The trustee made loans to employees which were never repaid. Some interest was repaid but it was allocated to the repaying employee and sometimes made the subject of an additional loan (see paragraph 141).

38. Notwithstanding those facts, the Tribunal held that the trustee had a continuing discretion and was not a mere cipher; accordingly the payments to the trusts did not amount to the payment of money or a profit equivalent to cash to the employees (paragraphs 142-144). The employees were not free to do what they liked with their allocated funds. For the same reasons the Tribunal held that payments made by the appellants to both trusts did not constitute earnings paid for the benefit of earners and so did not give rise to a liability on the appellant to pay national insurance contributions. By *cipher*, we assume the Tribunal meant a person of no importance or value although the trustee's existence was necessary for the scheme.

39. While we accept the statements of principle in *Sempra,* the facts were on close analysis somewhat different from those which we have to consider.

40. In *Garforth* the two directors who were the controlling shareholders voted themselves bonuses which were partly paid and partly credited to their accounts in the books of the company; the latter without the deduction of income tax; notices were served on the company *qua* employer demanding income tax, namely PAYE deductions. In these circumstances the court held (reversing the Special Commissioners) that this constituted a payment of income for income tax purposes. As a matter of fact, the moneys were placed *unreservedly at the disposal of* the directors as part of their current accounts with the company; they had a clear legal right to the money. It would make no difference, Walton J pointed out at page 135, if they had to sue for payment. However, we consider that *unreservedly* does not necessarily mean *immediately.* Walton J did not discuss the money box situation with which we are concerned. In particular, he did not (because there was no need in that case) discuss the position of an employee who is given shares which gives him complete control over the company with the power, to remove the existing directors, appoint himself as director, and pass whatever resolution he thinks fit to pay himself dividend, favourable loans, or even wind up the company.

41. In our view, the cash in the company is to be regarded as unreservedly at the disposal the employee as sole shareholder in the same way as if the sum had been credited to a director's loan account. This accords with one view of the DOS namely that it was a scheme designed to deliver cash or its equivalent to certain employees. The fact that the employee might have to deploy various company law procedures in exercise of clear legal rights (the actions of and exercise of rights by the shareholders and not the company) seems to us to be no different from one of the directors in *Garforth* having to sue the company for payment in exercise of his clear legal right. This conclusion does not do violence to the fundamental principle of company law set forth in *Salomon v Salomon 1897 AC 22,* and *EBM Co Ltd*, nor does it rely on any very special circumstances needed to indicate that the corporate veil is a mere facade concealing the true facts (*Woolfson per*

Lord Keith of Kinkel) as discussed in Woolfson. We make no finding that the money box companies are mere facades. There is no need to pierce the corporate veil here and no circumstances justifying doing so. The test of unreserved disposal is sufficient. We are dealing with a legal entity whose sole existence and purpose is to hold a pot of money, which, in reality, represents a bonus payment. The money technically belonged to the company as would funds held on a director's loan account. However, the pot was at the disposal of the employee; the directors would distribute or deal with the pot in accordance with his wishes. The directors had no other agenda, and no other aims or intentions for the company's prosperity, or trading.

42. In *Dextra,* an offshore employee benefit trust was established; the trustees were requested to have regard to the wishes of the beneficiaries but were required to invest with a long term perspective rather than short term gains. The trustees made revocable deeds of appointment creating sub-funds for three directors and others, and granted loans to them out of the sub-funds. One of the issues was whether the sub-funds were effectively under the control of the beneficiaries and accordingly they should be taxed on them as their emoluments (paragraph 15). This argument failed on the facts. The trustees imposed some investment restraint; while they were likely to comply with any reasonable request that was for the benefit of the beneficiaries (paragraph 16), the directors had no control over the trustees (paragraph 18). Cash in the sub-fund would be equivalent to cash in the individual's money-box only if the trustee was, in a commercial sense, inevitably compelled to comply with the individual's wishes (paragraph 22); that did not accord with the facts. The employee benefit trust in *Dextra* was not categorised as an artificial tax avoidance scheme.

43. We find the reasoning instructive. Unlike the directors in *Dextra* the employees here who had either at the outset or relatively soon thereafter a 100% shareholding, had the means to achieve complete control over the money box company through company law procedures, and thus to control the cash in the company. Those who held on a 50% shareholding for a period would be able to and did in practice persuade the directors to make a loan or whatever investment the employee desired. If it were otherwise, the scheme as an incentive to existing employees and to attract suitably qualified and experienced employees would be relatively worthless. The directors would, in reality, be inevitably compelled to comply with the individual employee's wishes.

44. The evidence about the offshore trust and company administration was somewhat confusing. No doubt it was designed to be confusing and opaque. However, the more one dips into the morass of limited companies trading under different names, often confusingly similar to other related companies and unravels the inter-connecting strands which link the companies, the trustees and the overall administration, one can see that that the whole edifice disguises the fact that none of the trustees exercises any real discretion, but simply goes through the motions to give the appearance of the application of thought leading to a reasoned decision. The reality is that each component of the structure plays its part in giving effect to the decisions of the Remuneration Committee. It is inconceivable that if the Remuneration Committee recommended that a particular employee receive a benefit or bonus to the value of £x, the trustees of the EBT, the trustees of the FBT, and/or the directors of the offshore company would do anything other than to facilitate the benefit or bonus reaching the employee or being placed under his sole direction and control.

45. While it is true that all these entities existed and are genuine in that sense, their actings as trustees or directors in relation to the DOS are entirely artificial; they carry out no genuine independent operations but react to instructions and advice from others. They may go through the motions of carrying out credit checks and performing other tasks but these are hollow steps. It seems to us to be fanciful to suggest that a credit check might result in an employee shareholder being refused a loan from his money-box company where there were sufficient funds in the company. They are essentially actors playing a role created for them in a script written by tax advisers to disguise the fact that large bonuses are being paid by an artificial mechanism devised *inter alia* to elide or mitigate the effect of the PAYE regime. When the artificiality is stripped away, the underlying substance of the edifice is exposed as simply a means of providing successful employees with additional remuneration which falls to be taxed as such.

46. We were not impressed by the evidence asserting that the directors of the company did more than go through the motions of checking the propriety of making a loan to the shareholder employee. We rather think that is exactly what it was done. The fact that after the shares or a share was transferred the directors and the employee entered into discussions about the form of benefit which would be taken, usually loans but sometimes the use of property of one type or another which the company would acquire with the funds transferred from the EBT when they subscribed for the shares, is all nothing to the point. It is accepted by

the parties that following the *Ramsay* approach, the series of transactions comes to an end when the employee (or more accurately a nominee company on his behalf) receives the shares of the money box company. Thereafter a range of unscripted events and transactions might follow. The fact that credit checks, about which we heard some evidence from Mr Matthews, were carried out by the directors of the money box company before granting a loan has no bearing on the fiscal effect of the transaction which ended with the transfer of the shares. We noted a degree of discomfort and unease on the part of Mr Matthews when being cross-examined on the discretion of the FBT trustee. We have in mind his cross examination on Day 2 (pages 61-73 of the transcript). We do not criticise Mr Matthews or impugn his integrity or honesty. That discomfort simply reflected the somewhat artificial role he played in a carefully crafted scheme.

47. Whatever view one takes of the nature of the offshore companies' dealings with the various employees, that whole tract of evidence is concerned with a period of time after the agreed end of the composite transaction or series of steps upon which HMRC found. That tract of evidence, however, demonstrates eloquently the ease with which the individual employees were able to access and turn to pecuniary account the additional remuneration or bonuses which their employer, the Appellants, wished them to receive.

48. Gone are the days, and rightly so, when a taxpayer could elide the literal application of a taxing statute by a complex series of pre-arranged transactions involving an almost impenetrable jungle of companies, trusts and shareholdings with each participant following a well scripted plan which produces a series of genuine documents and legal relationships all designed to defeat the Revenue's fiscal claims. The law is no longer impressed, if it ever was, by superficial facts and apparent discretions. The law looks through these arrangements, identifies the substance of the transaction (by viewing the facts realistically), and considers whether they fall within the taxing provision in issue, construed purposively. The structures created here were essentially the medium by which cash bonuses were paid to senior employees. The statutory provisions under consideration apply to cash bonuses and their equivalent.

49.If we are wrong and the employees do not fall to be treated as having received cash, then we have to consider further the nature of what they did receive. In our view, the employees received the shares as part of their remuneration for past performance.

50. It is clear from *Weight v Salmon 1934 19 TC 174* that the receipt by an employee of valuable shares is an asset which can be turned to pecuniary account or disposed of to his advantage. That is receipt of a profit in the nature of money's worth. In *Weight* the employee was taxed on the privilege of acquiring shares at par and was assessed as the difference between the par price and the market value. On that basis, receipt of the shares without paying anything at all for them must fall within the same principle.

51.*Heaton v Bell 1970 AC 728* (referred to in the HMRC Response to the Appellant's Skeleton Argument) concerned a car loan scheme and the issue was whether the emoluments of a participating employee fell to be assessed under Schedule E gross without reference to the weekly sum deducted by the employer for providing, taxing and insuring the car. It was held by the House of Lords (by a majority), reversing the Court of Appeal, that the gross wage was taxable. A number of observations were made on the definition of *emoluments* and *perquisites.* Lord Reid observed that it would be

> absurd to suppose that a transfer of shares which can immediately be sold to produce money should not be regarded as a perquisite (at 744G),

relying on *dicta* in *Tenant v Smith 1892 AC 150 (capable of being turned into money; that which can be turned to pecuniary account; payments convertible into money*). Lord Morris of Borth-y-Gest adopted a passage in *Tennant* which stated that

> if substantial things of money value were capable of being turned into money they might for that purpose represent money's worth and be therefore taxable (at 754B-G).

He quoted with approval Viscount Simonds' test in *Abbott v Philbin 1961 AC 352 at 366,* namely whether the chattel or right

> was by its nature capable of being turned into money.

Lord Upjohn applied the same principles (page 761) as did Lord Diplock (page 764).

52. The shares were capable of being turned into money being an amount more or less exactly equivalent to the price of the shares paid by the EBT. Subject to the question of the FBT which we discuss below, we doubt whether there could be a more obvious example of shares being a benefit capable of being turned into money or pecuniary account. Each offshore company's assets consisted in the amount paid for the shares by the EBT. Such companies had no other assets or source of funds. The employee could borrow up to that amount. Insofar as relevant, loans were seldom repaid. Interest if demanded could be met by a further loan. Property could be acquired for the exclusive use of the employee or acquired by the employee and paid for out of the money box by one means or another. The correlation between the amount recommended by the Remuneration Committee, the amount paid for shares by the EBT and the amount, which is effectively at the employee's disposal, is sufficiently close to conclude that the facts, viewed realistically, demonstrate that each employee received a payment of money or its equivalent from his employer, the Appellants. The nature of that payment was additional remuneration being a bonus for good performance.

53. It is plain from this line of authority that additional remuneration in the form of shares in a money box company, structured as the offshore companies are in this appeal, is a perquisite or profit which is capable of being turned into money or turned to pecuniary account. If the *Ramsay* approach is applied, and we consider it should be, then the facts viewed realistically show that the employees received bonus in the form of shares which were capable of being turned to pecuniary account. This gives a purposive construction to the charging provisions relating to emoluments.

54. It does not seem to us to matter whether the payment to the money box company or the transfer of the shares are treated as having been made or transferred to the employee (as part of the overall structure of the scheme) by the Appellants themselves, or by the EBT. In our view, the provisions of section 203B would result in payment or transfer by the EBT being treated as payment or transfer by the Appellants. The EBT trustees held property for *inter alios* employees of the Appellants within the meaning of section 203B(5) (see *Sempra Metals at paragraphs 105-106*).

(4) The Sham Issue

Submissions

55. Mr Prosser for the Appellants drew, in relation to the options to acquire shares granted in favour of the family benefit trusts, a distinction between sham, as properly understood, and the commercial risk that the options would ever be exercised. He referred to *Hitch & Ors v Stone 2001 STC 214 at paragraphs 62-69, Protectacoat Firthglow Ltd v Miklos Szilagyi 2009 ICR 835 2009 EWCA Civ 98* and *Autoclenz Ltd v Belcher 2010 IRLR 70* at paragraphs 46-53,

56. Mr Artis referred to *Snook v London & West Riding1967 2 QB 786,* and *Hitch, Protectacoat* at paragraph 42.

Discussion

57. In the light of the authorities we do not see how the Options can be classified as shams. What was created was what was intended to be created. Each Option is not a disguise for some other set of legal relations.

58. The Options are artificial in that it was not envisaged by anyone that, save in exceptional circumstances, they would ever be exercised. However, that, as Arden LJ points out in *Hitch* does not mean that it is a sham (paragraph 67). In *Protectacoat,* the main issue was whether certain documents were a sham and whether the true relationship was one of employer and employee. The court noted that the test for *sham* was context sensitive (paragraph 42) and that the question was always what the true relationship was between the parties (paragraph 55). The employment judge's decision that the written documents were a sham and that the true relationship was that of employer and employee, was upheld.

59.*Autoclenz* was another employment case; various individuals worked as car valeters. The documentation described them as independent contractors. The court emphasised the importance of discovering the actual legal obligations of the parties (paragraph 53 and 91, 92, 103) which required an examination of all the relevant evidence.

60. The cases show that *sham* like fraud (with which we are **not** concerned here) may be found in a variety of guises, shapes and forms. It would be unwise to set out all the ingredients necessary to for something or some document properly to be described as a sham. The classic example arises where the common intention of the parties is to create a different set of legal relations from that disclosed in the document they sign. However, the assertion of sham usually arises in a modern context when one party asserts that the document does not record the true legal relationship, while the other party maintains that it does. The key to identifying any type of sham and the consequences of such identification is perhaps, as the more recent authorities demonstrate, is to examine all the circumstances to ascertain the true nature of the legal relationship between the parties. In other words, in this as in most areas of the law, it is the substance and not the form which is decisive.

61. Ultimately, it may not matter whether the grant of the option is described as a sham or a commercially irrelevant because the prospect of the option ever being exercised was negligible. In our view, the option granted in favour of each FBT was an irrelevant contingency.

The Role of the EBT and FBT trustees

62. We have considered carefully the material on this issue and in particular the written and oral evidence of Mr Matthews. It has become apparent to us that while, superficially, it appears that the EBT trustees in particular were making some form of positive contribution and exercising their discretion, the reality was that they were not. So far as we can see, they made no positive contribution to the dialogue which preceded recommendations made to them. The DOS was well scripted so there would be little need for contribution by them anyway. The documentation relating to the four basic stages of the scheme following the setting up of the EBT and the receipt of the Remuneration Committee's recommendations (subscription for shares; setting up the FBT; granting the option by the offshore company in favour of the FBT; and transferring the shares to the employee) was all standardised. Some variation to the standard pattern occurred from time to time but that does not affect our overall views. As Mr Matthews acknowledged in his evidence in chief (Day 1 page 55) the EBT trustees signed up to and agreed to implement a package.

63. Although the EBT was a genuine trust and granted genuine discretion, that discretion was not exercised by the trustees genuinely weighing up relevant factors for and against the exercise of the discretion. If they started flexing their theoretical muscle and refused to give effect to recommendations, thus depriving say a particular senior executive of access to the proposed money box company (an arrangement to which the executive would have signed up) the executive would, we think, have been horrified; the Scheme would be in disarray and would have provided no performance incentive at all to senior employees.

64. The only exercise of discretion which the FBT trustee had, in theory, to concern themselves with was whether to exercise the option. That concern frequently disappeared after twelve months after the one year options lapsed. The FBTs had no other assets of any substance. As no one expected (save in exceptional circumstances) that the option would be exercised, it is difficult to see what acts of administration the FBT trustee actually performed. Mr Matthews eventually conceded in cross examination that the FBT trustee had no information on which to base the exercise of their powers in the interests of the beneficiaries (Day 2 page 65-66).

65. On the evidence we have heard and our assessment of it, it is plain to us that neither the trustees acting under the EBT nor the trustees acting under the FBTs had any genuine discretion to exercise. They took their instructions from HLB Kidsons or the Appellants or the Remuneration Committee even although these instructions were couched in terms of advice or recommendation. It seems to us that no senior employee signing up to a scheme for distribution of six and seven figure bonuses would have countenanced the possibility that any such discretion might have been exercised in a way which deprived him of the benefit of the very substantial additional remuneration based on the past year's performance which his employer was prepared to provide for him.

66. None of the cases affects our principal conclusion on this issue that the Options are not shams. They created the legal relations which they were intended by all concerned, to create. Insofar as relevant, no one was deceived. Of more significance is our conclusion that there was no realistic prospect that the options would ever be exercised. Rather, the prospect of their exercise was negligible, fanciful or remote unless exceptional circumstances arose. The introduction of the FBTs and in particular the grant of options into the

DOS was commercially irrelevant. They were introduced solely to dilute the value of the shares on the basis of the contingency that the options would be exercised.

(5) Valuation of the Shares

Submissions

67. The Appellants' approach was to consider what the employee could obtain by selling the shares. He referred to *Wilkins v Rogerson 1960 39 TC 344, Weight v Salmon 1934 19 TC 174.* However, ultimately Mr Prosser accepted that the valuation of the shares depended upon the assumption relating to the exercise of the option granted in favour of the FBT. The Appellants submitted that it should be assumed that the option would almost inevitably be exercised. The option was commercially relevant. HMRC, who led no evidence on share valuation, submitted that the exact opposite should be assumed.

Discussion

68. The only expert evidence on share valuation came from Richard Sweetman, a retired chartered accountant with very considerable experience in share valuation for the purposes acquisitions, buyouts, disposals and negotiations with HMRC. He was asked to give his opinion as to the value of shares in the fifteen Isle of Man companies set out in the table in the following paragraph as at the time those shares were transferred by the EBT to the seven executives named in the table. He was asked, in particular, to consider whether the valuation was affected by the existence of the options which we have already described above. He was also asked wither the valuation would be further affected if there was an expectation that the options would not be exercised for so long as the relevant executive owned the shares. The table below sets out his valuations which we discuss in the ensuing paragraphs. His view was that each share had a value of between 1 pence and the maximum value set out in the table at the time of transfer.

Company	**Executive**	**Maximum value per share (£)**
Fade Limited	Neil Campling	£24.27
Croyde Limited	Chris Fishwick	£298.77
Bittium Limited	Chris Fishwick	£292.32
Codium Limited	Chris Fishwick	£46.08
Diniz Limited	Martin Gilbert	£104.94
Glycera Limited	Martin Gilbert	£69.74 (2003) £200.64 (2006)
Edulis Limited	Martin Gilbert	£21.16 (2003) £58.80 (2006)
Eastergate Limited	Andrew Laing	£52.93
Serratus Limited	Andrew Laing	£57.71
Filmwell Limited	Edwin Protheroe	£19.56
Dymock Limited	Paul Reed	£78.69
Dilsea Limited	Paul Reid	£156.14
Piniped Limited	Iain Reid	£144.28
Zostera Limited	Iain Reid	£40.75
Heamatopus Limited	Iain Reid	£52.47

69. His conclusion was that each share issued to the executive would have had little value to an arm's length purchaser, since, if the trustee of the relevant family trust exercised its option, such a share would have constituted just 0.01 per cent of the issued share capital in the relevant company, a very substantial dilution in value. Taking Fade Ltd as an example, Mr Sweetman valued each of the two original shares at no more than £24.27. This valuation proceeded on a net assets basis. The value of each share was essentially the net asset value of the company divided by 10,002. He also noted that a third party purchaser of two shares would discount the net asset value for the uncertainty that he could realise his investment and the risk inherent in a minority holding where he would have a lack of influence over the company's affairs once the options were exercised.

70. Key to Mr Sweetman's conclusion in his report was the assumption that the third party purchaser would, in turn, assume that the option would almost inevitably be exercised, notwithstanding that there was or

might have been an expectation on the part of the executive acquiring the shares that the option would not be exercised so long as he held the shares. It also made no difference to his valuation whether the option granted was exercisable within one year or ten years. Nor did it matter to him whether the shares were transferred separately or both at the same time.

71. In the course of his evidence, Mr Sweetman recognised that if the assumption were that the option would almost inevitably **not** be exercised then his valuation would be different. Our assessment of his evidence is that if that is the correct assumption then the value of each of the two shares would be one half of the net asset value of the company. We accept that evidence on that assumption. There was no adequate evidence of any discount or modification by reason of the phrase *almost inevitably* deployed in each assumption. It seems to us, and this was accepted by Mr Prosser in submissions, that it is one extreme or the other.

72. Mr Sweetman expressed the view that each share on its own (assuming no option agreement) was worth half the company. Mr Prosser was plainly surprised by this evidence and tried to persuade Mr Sweetman to express a different view. Mr Sweetman declined. In his closing submission, Mr Prosser described Mr Sweetman's view as misconceived and suggested that we might allow further submissions and argument on the point if we were issuing a decision in principle.

73. However, this is the uncontradicted view of the Appellants' own, well qualified expert, brought out, not under pressure of cross-examination, but in re-examination. The parties have had a full opportunity to lead whatever valuation evidence they wished. We do not consider that the interests of justice will be served by allowing additional evidence or argument on this point in whatever shape or form. We cannot simply discard evidence because it does not suit the Appellants' arguments. Mr Sweetman did provide some rationale for his view, which might not apply in other circumstances. He equiparated the present circumstances to a joint venture with each joint venturer's share being worth half the company and having the ability to block the proposals of his fellow joint venture. While others may differ from that view, it is one which is maintainable here.

74. We should also record that Mr Artis supported Mr Sweetman's evidence on this point but submitted that it did not matter because if one share was worth less than one half of the net asset value of the company then the second share would be worth correspondingly more. Whether or not that view is well founded, the result in this case is the same.

The correct assumption

75. The purpose of the creation of the FBTs and the grant of the options was to dilute or discount the value of the executive's shares. However, the reality was that there was only a negligible chance of the option being exercised. In theory, it could be exercised and the FBT could be used to benefit some remote relative of the executive. It is inconceivable that an executive in line to receive very substantial benefits (instead of the more traditional form of bonus) as a consequence of the recommendations of the Remuneration Committee would contemplate that the option would be exercised so as to dilute his benefits, save for some unusual or exceptional circumstance. He would simply not expect that to happen. Likewise, the prospect of the FBT trustees ever exercising the option save in such exceptional circumstances was equally remote.

76. Although Mr Matthews gave evidence about diarising the last date for the exercise of each option, we regard that as a matter of pure form. There was never any question of him or the FBT trustees *ex proprio motu* exercising the options at any stage. Nor was there any question of the FBTs being instructed or advised by HLB Kidsons to do so save in the most exceptional circumstances. The value of the golden handcuffs would be destroyed if there were a real prospect of the option being exercised. There would be no incentive for the executive to remain loyal to the Appellants and remain with them until the golden handcuffs are unlocked at the end of the relevant period because the benefit receivable at the end of the period would have been diluted to the extent of being worthless and the beneficiaries under the FBT need not have included the employee himself because of the FBT trustee's wide discretion. Even if the FBT trustee exercised his discretion in favour of the employee the golden handcuff would no longer be golden.

77. For the purposes of share valuation, the only assumption that needs to be made which is inconsistent with the reality of the situation is the assumption that the shares are being sold. It is unnecessary to make any other assumptions inconsistent with the facts and circumstances in existence at the valuation date. To

assume that the option would be exercised is to make an assumption contrary to those facts and circumstances and contrary to the reality of the situation. We would not be viewing the scheme as it was intended to operate. The intention was that the options would never be exercised.

78. In *Wilkins,* it was decided that the taxpayer fell to be assessed not on the cost of the new suit provided by his employer but on the amount the employee would obtain if he sold it. We accept that approach but it does not answer the question on valuation we have to decide. *Weight* was essentially to the same effect. There, the director in question was taxed on the difference in amount between the price he could get for the shares acquired and the price actually paid for them.

79. Our conclusion on the evidence is that the correct assumption to make for the purposes of valuation is to assume that it was almost inevitable that the option would **not** be exercised.

80. In these circumstances the two shares of each money box company fall to be valued at their full value based on the net asset value of the company in question at the material time. Where one share only is transferred, then the valuation should be 50% of the full value; that accords with the evidence of the Appellants' expert, Mr Sweetman.

(6) The PAYE Issue

Submissions

81. Mr Prosser's submissions proceeded on the basis that we had decided that the shares were valued, contrary to his argument, on a full net asset basis without any significant discount in relation to the exercise of the option. Thus the amount obtained in terms of section 203F(3A) and (3C) would be similar to the expense incurred by the Appellants in providing money to the EBT which in turn was deployed to buy the shares and put money into the particular offshore company.

82. He began by pointing out that when considering a benefit in the form of shares, the charge to tax arises when the benefit is provided not when the employee becomes entitled to the benefit. Contractual entitlement is therefore only relevant in the context of a payment of emoluments in money.

83. Mr Prosser, in effect, submitted, that the circumstances simply did not fit the provisions relied on by HMRC. Only sections 203F(2)(e) and (f) were possibly relevant. In relation section 203F(2)(f), there were no arrangements in existence extraneous to the shares. The trading arrangements and the asset cannot be one and the same thing. The inherent qualities of an asset, such as the right to a declared dividend, are not what are being referred to by *trading arrangements.* He referred to *DTE Financial Services Ltd 2001 STC 777* where Jonathan Parker LJ observed that section 203F, in its then form, contemplated trading arrangements *which were extraneous to the asset itself* (paragraph 47). What can be obtained from the asset itself should first be identified; then one asks whether the trading arrangement enables an amount to be obtained which cannot be obtained from the asset itself (i.e. the incidents attaching to the asset). The mere fact that that you can sell the asset is not enough. The fact that the shares were held by a nominee was irrelevant.

84. In relation to 203F(2)(e), Mr Prosser submitted that one could not say that the shares consisted in something that was likely to give rise to or become a right enabling the employee to obtain an amount similar to the expense of providing the asset; moreover something had to be done by the employee to obtain the amount for example in the case of a dividend or winding up and distributing the assets, a dividend would have to be declared or a resolution passed. As the shares were held by a nominee company, the employee would require to instruct the nominee to declare a dividend or procure the passing of a resolution. The Respondent's argument under paragraph (e) was contradictory and illegitimate as it took a broad practical view under the Schedule E legislation but not under the PAYE legislation. Section 203F(3) and sections 203A and 202B show that the Schedule E charge and the PAYE provisions go hand in hand. The lapsing of the option did not change the bundle of rights comprised in the two shares, even although the value of those rights changed.

85. Mr Artis submitted first of all that it was sufficient that the trading arrangements related to the asset. The intrinsic rights which a substantial shareholding has may be part of those arrangements. The pre-existing arrangement whereby the money box company was primed with premium paid for the shares (or at least one of them) and the control over the money in the company which the owner of the shares enjoyed were trading arrangements within section 203F(3A); in effect, the DOS comprises a set of trading arrangements;

thus section 203F(2)(f) applied. Reference was made in his skeleton argument to *DTE Financial Services* and to *Spectrum Computer Supplies v R&CC2006 STC (SCD) 668 at 685.*

86. Alternatively, section 203F(2)(e) applied. The shares (once the option in the FBT lapsed) gave rise to a right enabling the employee to obtain money which was likely to be similar to the expense incurred in the provision of the asset. He could then sell his shares in the market on the basis of the net asset value of the company. While *Ramsay* applies to bring the facts within the charging provisions of the tax regime, the PAYE provisions are applied to the real asset. The Appellants were therefore to be treated for the purposes of the PAYE Regulations as making a payment of the amount likely to be chargeable to tax under Schedule E.

Discussion

87. In *DTE* the dictum that section 203F contemplated trading arrangements which were extraneous to the asset itself was *obiter.* The decision turned on the *Ramsay* approach. The question was whether, in consequence of the assignment of a contingent interest to directors under a settlement (set up by or under the instructions of the taxpayer company) and its falling into possession thereby resulting in the director receiving a substantial cash payment, the cash payment fell under the PAYE regime rendering the company accountable to the Revenue for tax on the payment which should have been deducted. The Special Commissioner and the Court of Appeal held that it was legitimate to apply the *Ramsay* approach to the provisions relating to PAYE. The cash payment received by the director was a payment of assessable income.

88. The reasoning on the section 203F point was brief (paragraph 47). Even if the legislation which the Court of Appeal considered is regarded as being substantially the same as the provisions we have to construe and apply, that does not enable us to identify as universally applicable a condition that the trading arrangements must be *extraneous to the asset* itself. What is or is not extraneous to an asset may be a matter of some debate.

89. As we construe section 203F(3A), what is required is (i) the existence of some arrangement, (ii) the arrangement has an effect which relates to the asset, (iii) the effect is that it enables the employee to obtain an amount of money, and (iv) the amount so obtained is similar to the expense incurred in providing the asset. While the arrangement may be extraneous to the asset itself, it may on occasion be inextricably linked to the asset.

90. In *Spectrum Computer Supplies Ltd v R&CC 2006 STC (SCD) 668,* the issue was whether national insurance contributions and PAYE should have been deducted from a payment in implement of a scheme devised to pay a bonus to a director in the form of assigned trade debts. It was held that deductions should have been made. The question of *trading arrangements*, albeit under earlier legislation, was also discussed. These were the existing arrangements for collecting debts. It was held that, as the arrangements for collecting debts already existed, they were not arrangements made for the purpose of enabling the director to obtain the amount in issue.

91. Here, the asset comprised the two shares (or where appropriate one share) in an offshore company. Such an asset falls within section 203F by virtue of section 203F(5). The company existed by reason of arrangements which had previously been made. Those arrangements are an offshore company primed with money equal to the amount of additional remuneration or benefit which the Remuneration Committee recommended the employee receive, endorsed by the Appellants and then given to the employee by the EBT. The *effect* (the word used in section 203F(3A)) of the arrangements is that the employee is able to obtain an amount of money by means of for example a loan (which will not be repaid). If it were otherwise, senior employees would not be interested in the DOS and it would provide no incentive in relation to current or future performance if in spite of the alleged tax efficient nature of the arrangements there were obstacles preventing or making it difficult for the employees to actually enjoy the additional remuneration or benefit to which they had been informed they would be given. The amount obtained can be obtained *by any means at all* (section 203F(3B)(a)). Although the DOS is exhausted once the shares are transferred to the employee (or more accurately the nominee company), the underlying arrangements created by the DOS remain in existence. The money box company remains in existence. The share capital remains the same as the option in favour of the FBT is not exercised. The pot of money placed in the company remains until drawn down by the employee by one means or another. The company has no real function other than to serve the wishes

of the employee. The directors do not promote the company, or engage in any form of trading or business apart possibly from investment at the behest of the employee.

92. In our opinion, therefore, section 203F(f) of the 1988 Act is applicable to the facts agreed and established. Those arrangements enabled the employee to use the asset to obtain money, for example in the shape of loans from the company, which would not be repaid, equal to the amount subscribed for shares. The bundle of rights which comprised the shares enabled him to use company law procedures to secure the granting of the loan. Where there was only one share, the practical effect of the arrangement was the same. However, it was the pre-existing arrangements (i.e. the DOS which created the money box company), which enabled the employee to obtain the amount in question. But for these arrangements, whereby substantial sums were injected into the company, the shares themselves would have no significant value at all. The amount of the loan and the expense incurred in the provision of the shares (namely the subscription price) would be similar if not identical (section 203F(3A)). In short, the provision of the valuable shares is the culmination or result of the underlying arrangements. Whether or not this is described as an arrangement extraneous to the asset, the ingredients of section 203F(3A) are all present.

Summary

93. We summarise our conclusions as follows:-

1) Entitlement to receipt of the additional remuneration (whether in the form of cash or shares) did not arise at the stage at which the Remuneration Committee made its recommendations.

2) On the facts, there was a composite transaction consisting of a series of steps which began with the establishment of and transfer of money into the EBT and ended with the transfer of the shares to the employees. Thereafter, a variety of financial arrangements and transactions could and indeed did take place.

3) The structures put in place simply operated as means of channelling the additional remuneration from employer to employee.

4) The cash is put into the hands of the employees by the transfer to them of the control of the offshore money box company which has no assets other than the cash injected by the EBT received from the Appellants; each employee is given the key to the money box. The assets of the company, namely cash, are effectively at the disposal of the employee. The facts, viewed realistically, show unequivocally that control is vested in the employee who has access to the pot of money contained within the corporate money box. The directors would, in reality, be inevitably compelled to comply with the individual employee's wishes.

5) The cash in the company is to be regarded as unreservedly at the disposal of the employee as sole shareholder. The DOS was a mechanism to pay cash bonuses. That is a form of payment which the statutory provisions, in question, construed purposively, were plainly designed to catch.

6) If the correct analysis of the facts is that the employees received shares, then we consider that the shares are a profit which is taxable and subject the PAYE and National Insurance Contributions regimes. The receipt by an employee of valuable shares is an asset which can be turned to pecuniary account or disposed of to his advantage. That is receipt of a profit in the nature of money's worth.

7) It does not matter whether the payment to the money box company or the transfer of the shares are treated as having been made or transferred to the employee (as part of the overall structure of the scheme) by the Appellants themselves or by the EBT. The provisions of section 203B would result in payment or transfer by the EBT being treated as payment or transfer by the Appellants. The EBT trustees held property for *inter alios* employees of the Appellants within the meaning of section 203B(5).

8) In the light of the authorities we do not see how the Options can be classified as shams. What was created was what was intended to be created. Each Option is not a disguise for some other set of legal relations. The prospect of the option ever being exercised was negligible. In our view, the option granted in favour of each FBT was an irrelevant contingency.

9) The correct assumption to make for the purposes of valuation is to assume that it was almost inevitable that the option would not be exercised. The two shares of each money box company fall to be valued at their full value based on the net asset value of the company in question at the material time. Where one share only is transferred, then the valuation should be 50% of the full value.

10) Section 203F(f) of the 1988 Act is applicable to the facts agreed and established.

11) In principle, therefore, the appeals fail.

Other Matters

Witnesses

94. We found the witnesses to be generally reliable and credible. We have already commented on one aspect of the evidence of Mr Matthews.

National Insurance Contributions

95. We were not addressed at the hearing to any significant extent on any specialties of national insurance legislation which would lead to conclusions materially different from our findings in relation to the income tax regime (c.f. *Sempra Metals at paragraph 147*). If there are differences of detail, then we will require to be addressed on them in due course.

Quantum

96. Neither counsel addressed us in detail on the precise sums which should be the subject of determination and decision in relation to each of the seven employees. Mr Prosser proposed a decision in principle. HMRC indicated a preference for a Final Decision although there appeared to be some discrepancies over the figures they were putting forward. After the Hearing was concluded, HMRC sent the Tribunal a long letter setting out the precise figures desired to which the Appellants' solicitors have responded in writing (letters 9/7/10 and 13/7/10 respectively).

97. We consider that the prudent course is to issue a decision in principle at this stage. The precise numerical consequences of our decision, or the decision of another tribunal or court, can hopefully be a matter of agreement between the parties. If agreement cannot be reached it is likely that a further hearing will be required. If agreement is reached, the agreement can be reflected in our final determination.

Disposal

98. This decision is a decision in principle. It is not a final determination. Notwithstanding Mr Prosser's elegant presentation and his powerful and succinct submissions (ably assisted by his junior, Rebecca Murray) we have decided most of the various issues in principle in favour of HMRC. We are grateful, too, for Mr Artis's exhaustive analysis of the facts and the law. Our task has also been greatly assisted by the careful assembly and numbering of some twenty five or so lever arch files of documents and statements.

99. We invite submissions (which hopefully can be the subject of agreement between the parties) on the application of our decision to the detail of the notices and determinations under appeal, and the terms in which our final decision should be made. We shall not impose a specific time limit but if, after two months from the date of the release of this decision, no progress has been made, arrangements will likely be made for a further hearing to take place.

Release date: 29 October 2010