

EMPLOYEE BENEFIT TRUST – whether deduction of contributions postponed until taxable as emoluments under FA 1989 s.43(11) – no – whether sub-funds in favour of directors who controlled the company taxable as emoluments on Ramsay principles or as a benefit in kind under TA 1988 s.154 – no -- whether loans to directors taxable as emoluments – no

THE SPECIAL COMMISSIONERS

**DEXTRA ACCESSORIES LIMITED, PHONES 4U LIMITED,
THE MOBILE PHONE REPAIR COMPANY LIMITED, 4U
LIMITED, 20:20 LOGISTICS LIMITED, SINGLEPOINT 4U
LIMITED, JOHN D CAUDWELL, BRIAN CAUDWELL, MRS K
H CAUDWELL, MRS P CAUDWELL, MRS B J CAUDWELL
AND CRAIG BENNETT**

Appellants

- and -

**RONALD MACDONALD
(HM INSPECTOR OF TAXES)**

Respondents

Special Commissioners: DR JOHN F AVERY JONES CBE
A EDWARD SADLER

Sitting in private in London on 22 to 25 July 2002

Andrew Thornhill QC instructed by Ernst & Young LLP for the Appellant

Timothy Brennan QC and Hugh McKay Instructed by the Solicitor of Inland Revenue for the Respondents

DECISION

1. These are 12 appeals heard together relating to the deductibility of payments to an employee benefit trust (EBT) by six group companies, namely Dextra Accessories Limited, Phones 4U Limited, The Mobile Phone Repair Company Limited, 4U Limited, 20:20 Logistics Limited and Singlepoint 4U Limited, in the year ended 31 December 1998, and the taxability and liability to National Insurance Contributions of the allocation of funds within the EBT on sub-trusts for three director-shareholders, and the wives and the mother of two of the directors, namely Mr John Caudwell, Mr Brian Caudwell, Mr Craig Bennett, Mrs K H Caudwell, Mrs P Caudwell and Mrs B J Caudwell (together called "the six"). There are also PAYE determinations and Notices of Decision for National Insurance Contributions for 1998/99 in relation to the amounts allocated within the EBT, and closure notices in case the allocation to sub-funds is a benefit in kind since no PAYE would then be due and the tax would have been payable in the self-assessment return, but it is accepted that in that event no National Insurance Contributions would be due.
2. The group sells mobile telephones and mobile air time having been founded in 1987 initially to operate in the second-hand car business. It has been extremely successful growing from 30 employees in 1989 when the mobile phones business succeeded the second-hand car business and Mr Craig Bennett joined as commercial manager, to an international organisation with subsidiaries in six countries with a turnover of £1,000m, a profit of £20m and staff of 2,800. Mr Bennett told us that during the past 11 years the group had achieved a compound annual growth rate of 55% in turnover and 54% in profits. Although it was not mentioned at the hearing we were shown recruitment advertisements that stated that the company was voted "Business of the Year" for 1995, 1997, 1998 and 2000, John Caudwell was voted "Business Man of the Year" for 1995, and Craig Bennett "Accountancy Age FD of the Year" for 2000. John and Brian Caudwell each own 46.5% of the shares in the holding company, Craig Bennett, the finance director, holds 3.5% which he acquired by borrowing partly from a bank on the security of his parents' house and partly from the company, 2% of the shares are held by the trustees of a settlement made by John Caudwell for the benefit of his children and the balance of 1.5% is held by the EBT.
3. We heard evidence from the three directors, Advocate Alan Dart, a director of the initial trustee of the EBT, Mr Ben Cooke, formerly with Ernst & Young Trust Company (Jersey) Limited, originally the administrator of the trust and subsequently a director of the successor trustee company, and Mr Craig Gibson, an employee who is a beneficiary of the EBT.
4. In outline Mr Brennan QC for the Revenue contends in relation to the companies that section 43(11) of the Finance Act 1989 prevents the deduction of payments into the EBT until the employee is taxed on the fund as an emolument. In relation to the six individual appellants he says that the allocation of funds within the EBT to sub-trusts for individual directors and their families is taxable either as an emolument for income tax, or earnings for National Insurance Contributions, or is chargeable to income tax only as a benefit in kind under section 154 of the Taxes Act 1988. Alternatively he says

that loans made to the six from the EBT out of the funds allocated to their respective sub-trusts are emoluments or earnings.

Statutory provisions

5. We deal with the two statutory provisions before setting out our detailed findings as to the facts: both provisions raise self-contained points of interpretation relevant to employee benefit trusts generally and the issues are not specific to the circumstances of the EBT. Section 43 of the Finance Act 1989 provides

- (1) Subsection (2) below applies where—
 - (a) a calculation is made of profits or gains which are to be charged under Schedule D and are for a period of account ending after 5th April 1989,
 - (b) relevant emoluments would (apart from that subsection) be deducted in making the calculation, and
 - (c) the emoluments are not paid before the end of the period of none months beginning with the end of that period of account.
- (2) The emoluments—
 - (a) shall not be deducted in making the calculation mentioned in subsection 1((a) above, but
 - (b) shall be deducted in calculating profits or gains which are to be charged under Schedule D and are for the period of account in which the emoluments are paid.
- ...
- (10) For the purposes of this section 'relevant emoluments' are emoluments for a period after 5th April 1989 allocated either—
 - (a) in respect of particular offices or employments (or both), or
 - (b) generally in respect of offices or employments (or both).
- (11) This section applies in relation to potential emoluments as it applies in relation to relevant emoluments, and for this purpose—
 - (a) potential emoluments are amounts or benefits reserved in the accounts of an employer, or held by an intermediary, with a view to their becoming relevant emoluments;
 - (b) potential emoluments are paid when they become relevant emoluments which are paid.

6. Mr Brennan QC contends that contributions by the appellant companies to the EBT are "potential emoluments" within section 43(11) since they are held by the trustee of the EBT, who is conceded to be an intermediary, with a view to

their becoming relevant emoluments, defined as emoluments for a period after 5 April 1989 in respect of a particular office or employment. This provides symmetry between deductibility by the companies and taxability of the employees which he says is the purpose of the section. Mr Thornhill QC contends that the section is irrelevant since the contributions to the EBT are neither relevant emoluments nor are they potential emoluments, since they are not held by the trustee with a view to becoming emoluments because benefits can be provided out of the EBT in other forms, in particular loans or other benefits. He says that the reference in section 43(11) to amounts reserved in the employer's accounts gives a flavour of what is intended: an amount in relation to a prospective payment is only reserved or provided for in a set of accounts prepared under accounting standards if there is a present obligation, legal or constructive, to make that payment, so that, for example, the section postpones the deduction of provisions in the accounts on account of bonuses based on future events until the bonus is paid; to be "potential emoluments" amounts held by an intermediary must be invested with a similar degree of probability that they will become relevant emoluments. He points out that Mr Brennan's interpretation means that sums may never become deductible if they are never paid as emoluments, notwithstanding that they are applied in some other way to provide employee benefits. He draws attention to the fact that his interpretation is the one adopted in the Revenue's Manuals.

7. Mr Brennan's interpretation is heavily influenced by his argument on the facts which we consider below because he contends that the allocation of sub-funds to the six results in their receiving emoluments, so that effectively the section merely postpones the deduction in respect of allocations to other employees whose benefits are subject to future performance conditions until those conditions are satisfied, and prevents deduction for unallocated funds in the EBT. Mr Thornhill's interpretation is influenced by the fact that he contends that on the facts the allocations do not result in emoluments for the six but money held in a sub-fund which may or may not result in emoluments.
8. We prefer Mr Thornhill's interpretation. We read "with a view to their becoming relevant emoluments" as meaning that for the subsection to apply the contributing company's purpose in making the payments to the trustee, the intermediary, has to be that the funds should be used to provide emoluments. Here the companies have no such purpose. The funds are to be used as provided by the EBT, one of the possible results of which is that they become emoluments, but there are also many other possible results, particularly that loans are made, as actually happened, which are not themselves emoluments. It cannot therefore be said that the contributing company had a view that the payments would become emoluments and so the section is irrelevant. One is thrown back to the deduction of the payments on general principle, which is not disputed.
9. Mr Brennan's alternative argument is that the allocation to a sub-fund is a benefit in kind taxable under the general provisions for taxing benefits, in section 154 which provides:
 - (1) Subject to section 163, where in any year a person is employed in employment to which this Chapter applies and—

- (a) by reason of his employment there is provided for him, or for others being members of his family or household, any benefit to which this section applies; and
- (b) the cost of providing the benefit is not (apart from this section) chargeable to tax as his income,

there is to be treated as emoluments of the employment, and accordingly chargeable to income tax under Schedule E, an amount equal to whatever is the cash equivalent of the benefit.

- (2) The benefits to which this section applies are accommodation (other than living accommodation), entertainment, domestic or other services, and other benefits and facilities of whatsoever nature (whether or not similar to any of those mentioned above in this subsection), excluding however—
 - (a) any benefit consisting of the right to receive, or the prospect of receiving, any sums which would be chargeable to tax under section 149; and
 - (b) any benefit chargeable under section 157, 158, 159AA, 160 or 162;

and subject to the exceptions provided for by sections 155, 155ZA, 155ZB, 155AA, 155A and 156A.

10. Mr Brennan contends that since the purpose of the allocation to a sub-fund is to motivate the employee it must be a benefit – something without value or benefit to the employee would not motivate the employee or encourage him to remain in the employment. The employees were aware that a power could be exercised in favour of a beneficiary and in accordance with *Re Manisty* [1974] Ch 17, particularly at 25F-G, the trustees are bound to consider a request to exercise the power in favour of the beneficiary. As before Mr Brennan's approach is heavily influenced by his contentions on the facts that the trustee was not expected to exercise an independent will in making appointments to sub-funds, or dealing with the property in the sub-fund.
11. Mr Thornhill contends that all the specific charging sections referred to in section 154 require actual benefits rather than potential benefits. The only exception is where the benefit consists of the right to receive, or the prospect of receiving, any sums which would be chargeable to tax under section 149, relating to sick pay. This is so that tax is charged on sick pay insurance premiums. He relies on *Templeton v Jacobs* [1996] STC 991, 988d: "No benefit is provided for the purposes of s.154(1) until the benefit in question becomes available to be enjoyed by the taxpayer." He points out that the Crown's interpretation would result in double taxation since the benefit could be charged when the sub-fund was created, and again if subsequently distributed as an emolument. Mr Brennan contends that there is no double taxation on the principle of *Abbott v Philbin* 39 TC 82 that the initial creation of the sub-fund is the taxable event and subsequent benefits are ignored.

12. We prefer Mr Thornhill's interpretation. Section 154 deals with actual benefits and not potential benefits or the possibility of benefit, with the exception of sick pay. We are not convinced by Mr Brennan's argument on double taxation. *Abbott v Philbin* merely decided that options were taxable when granted; there was no subsequent taxable event before the exercise of the option was made taxable.
13. Mr Brennan's remaining contentions depend on the facts to which we now turn.

Facts relating to the employee benefit scheme

14. We set out first a chronology of events relating to the setting up and operation of the EBT with the facts found in relation to it.
 - (1) As a private group with all the shares closely held the companies had the familiar problem of attracting and motivating employees by rewarding them for their individual performance and by sharing in the success of the employing group. There had been previous employee schemes, including a phantom share option scheme which had to be abandoned when the liability in the accounts became excessive. Various schemes were investigated on the advice of Ernst & Young leading ultimately to the establishment on 18 December 1998 of the Caudwell Holdings Limited International Employee Trust (the EBT) by a deed between Caudwell Holdings Limited (as Settlor) and Regent Capital Trust Corporation Limited (Regent), a Jersey company (as Trustee).
 - (2) Regent was owned by the partners of a Jersey law firm, Bedell & Cristin. Ernst & Young's trust company in Jersey, Ernst & Young Trust Company (Jersey) Limited (E&Y TC), could not act as trustee because Ernst & Young were the auditors of the Caudwell group. Regent was used only for Ernst & Young clients and there was an arrangement that in the event of the ownership of E&Y TC changing so that it was no longer owned by the auditing firm, or if the regulatory rules changed so that the audit relationship was no longer a bar, E&Y TC could acquire Regent. There was also an arrangement that E&Y TC (acting principally through its director, Mr Ben Cooke) would do all administrative work in relation to trusts of which Regent was the trustee, leaving the decisions to Regent.
 - (3) The parent company as settlor had power to remove and appoint trustees.
 - (4) One of the provisions of the EBT (clause 15(3)) was that allocation of benefits to participators (as defined) must be approved by an independent remuneration consultant, and, in relation to allocations based on non-recurring exceptional profits, the consultant must consider that the allocation was not excessive. Ernst & Young's remuneration consultants were appointed. At the time the first contributions were being considered the consultant, in the absence of

finding any comparable companies, gave a wide range for the salary of John Caudwell, the chairman and chief executive of £250K to £450K, and for Brian Caudwell, sales and marketing director, and Craig Bennett, finance director of £150K to £350K, plus in each case a bonus of up to 150 per cent of salary, so that the totals would be £625K to £1.125m (John Caudwell) and £375K to £875K (the other two). The proposed allocation was £700K for each of the two Caudwells and £550K for Craig Bennett which the consultant advised was not excessive. As the report did not correspond to the requirement in the trust deed that the consultant *approved* the allocation based on normal profits Mr Dart arranged for the trust deed to be amended on 8 March 1999 so that the "not excessive" formula applied in all cases. In accordance with the power to amend the administrative provisions of the deed Mr Dart and his partner, Mr Alan Richardson, gave an opinion that the change was one to an administrative power.

- (5) On 21 December 1998 various group companies made contributions to the EBT totalling £2,750,000.
- (6) On 29 January 1999 various group companies resolved that they wished the trustees to provide for the employees listed in the amounts listed in a schedule. These were expressed either as rewards for past performance (this applied to the six) or future performance (this applied to all the other employees). The future performance criteria were laid down by the companies and communicated to the employees but were not communicated to the trustees until they had been met. The reason for the different treatment of the six was that they did not have any right to remuneration in advance; it was always given in arrears depending on results. Mr John Caudwell holds strong views that managers should be paid only for good results. The total allocations for the six were £1,980,000, and for other employees were £275,000. £495,000 remained unallocated. The beneficiaries were informed of the allocations to them. In the document giving the trustee details of the awards, the contributing company requested the trustee to have regard to the wishes of the named beneficiaries in relation to investment and the disposition of funds, subject to the terms of a policy document in relation to awards based on past performance; and to the directors' wishes in relation to awards based on future performance but once the performance criteria have been met the situation was the same as the past performance funds. Mr Craig Gibson, an employee beneficiary of the EBT, said that he was informed by Ms Rodriguez, a trust officer of EB Trustees, that under Jersey trust law the trustees had a duty to preserve the capital of the fund and look to invest with a long-term perspective rather than for short-term gains. We did not have any evidence of how funds other than Mr Gibson's were invested and we assume that both Regent and EB Trustees applied the same requirements in relation to all the sub-funds. The policy document contains a request that a forfeiture period until 30 June in the year following achievement of the performance targets be included. It also

states that if an employee leaves, the company has a preference for the funds remaining in trust.

- (7) On 10 March 1999 deeds of appointment were made by Regent in favour of the six creating sub-funds for each of them. The deeds were revocable. Until 30 June 1999 (the forfeiture period) the funds was held upon trust for the beneficiaries (the employee, his spouse, parents, children and remoter issue and dependents) living at that date and reverted to the main fund if the employee concerned was not so living and employed. Subject thereto the trustees held the fund, subject to a power of appointment in favour of the beneficiaries, on discretionary trusts for the beneficiaries, with a power to accumulate income, and a statement that any income tax or National Insurance Contributions should be borne by the fund.
- (8) Mr Craig Bennett requested a loan of £120,000 for general living expenses on 11 March 1999 which was granted by board resolution of Regent on 15 March 1999 without any investigation of his means of repaying it. The loan was interest-free and was evidenced by a loan agreement of 15 March 1999 providing that the trustees could require repayment on 90 days notice. The loan was made during the forfeiture period but the deed of appointment permitted the trustees to do this if the trustees considered that this was appropriate having regard to the possibility of revocation of the deed. Mr Dart had previously stated to Ernst & Young that the trustees would be prepared to make loans to a beneficiary during the forfeiture period but that the terms of the loan would have to be carefully considered.
- (9) Loans were also made at the official interest rate to Mr Brian Caudwell of £160,000 on 17 March 1999, and to Mr John Caudwell of £425,000 on 4 August 1999.
- (10) Mr Dart regarded the loans as genuine loans which were liable to be repaid but which could be waived in future if the trustee decided to exercise its powers to that effect. The three directors all regarded the loans as genuine loans on which they were all currently paying interest. They had not considered that the loans would be waived. In view of the significant value of their shareholdings (Mr John Caudwell in evidence estimated the value of 1% of the company at £7m) they would each be in a position to repay them if demanded. The ultimate aim was for a sale or flotation of the company.
- (11) A protector of the EBT was appointed on 12 May 1999. The protector's main duty was to consent to revocation of sub-funds and to consent to giving benefits to beneficiaries other than the principal beneficiary in order to give some assurance to employees that revocation would not arbitrarily occur, for example if the shareholders sold the group.
- (12) On 3 June 1999 a further scheme was proposed which led to the creation of a 10 year wealth creation scheme within the EBT for

employees other than the six. This requires employees to meet 50% of the budgeted profit each year in order to qualify for rewards, which lapse if the employee leaves. Meetings have been held each year with employees and the trustees.

- (13) On 10 December 1999 Regent retired as trustee in place of EB Trustees Limited, of which Mr Cooke had become a director and which was connected with another law firm in Jersey. By that time E&Y TC had been acquired by Royal Bank of Canada.
- (14) As a result of the Revenue's argument that creation of sub-funds resulted in an emolument in June 2000 the sub-funds for employees other than the six were revoked but the trustee continued to have regard to the wishes of the beneficiaries regarding investment. On 9 October 2000 the sub-funds relating to the six were revoked.
- (15) As an example of the trustee's independence Mr Cooke gave an example that at a meeting with Mr Bennett in February 2001 he said he would recommend the trustee to make an award of £10,000 to a particular employee on the basis of his performance rather than none of the £50,000 that had been allocated to the employee subject to performance conditions which was Mr Bennett's recommendation.
- (16) There are no assessments on employees benefiting from the EBT other than the six and the furthest Mr Brennan would go was to say that different considerations might apply to them. It should be noted that by 8 December 1999 21 participants had been identified to receive £275K. In fact awards were made for a total of £275,000 for 19 employees in the first year. We heard evidence from one of them, Mr Craig Gibson who was awarded £15,000 on the basis of future performance targets of which 66% was awarded for meeting the annual operating plan and 33% for exceeding it by more than 20%. In February 2000 he was informed that he had met the targets and an appointment to a sub-fund was made for him and his family. He was informed on 7 July 2000 that the forfeiture period had expired following which he made investment suggestions for the investment of the sub-fund which the trustee adopted. He was also told that the sub-fund had been revoked and reverted to the main fund but that he could still continue to make investment suggestions. Similar awards were made in succeeding years and he also received wealth creation bonds. By 2001 he had received awards of £99K subject to performance criteria out of which he had recently taken a loan of £4,000.
- (17) It was public knowledge that Mr John Caudwell was considering transferring 10% of his shares to the EBT subject to finding a way to do this without incurring a tax charge.
- (18) By 2001 in total the companies had contributed £19.9m to the short-term funds of the EBT and £6.6m to the wealth creation scheme. Allocations had been made to John Caudwell of £11.3m, Brian Caudwell of £4m and Craig Bennett of £2m and their relatives of

£90,000. Loans out of those had been made of £2.275m (approximately 20% of the sub-fund), £1.655m (40%) and £420,000 (20%) respectively. Other employees had received awards of £179,000 in respect of past performance, and £2.9m in respect of future performance of which £762,000 had been achieved. About 100 employees were currently benefiting from the EBT. Loans has been made of £140,538 and £87,413 had been distributed. In addition, employees (not including the six) had received wealth creation immediate bonds of £14m, and future bonds of £64m of which £14m had been achieved. Taking both schemes into account, approximately 33% of the total contributions has been made in respect of employees other than the six.

Surrounding circumstances relied on by the Revenue

15. In contending that the sub-funds are to be treated as the property of the beneficiaries Mr Brennan relies on a number of surrounding circumstances from which he contends we should draw the conclusion that the sub-funds are effectively under the control of the beneficiaries and accordingly they should be taxed on them as their emoluments. These are:
 - (1) In the years 1992/93 to 1997/98 the three directors took nominal cash remuneration and were paid in kind in gold bars, fine wine, and platinum sponge in order to avoid National Insurance contributions.
 - (2) An initial letter dated 6 May 1998 from Ernst & Young commenting on employee benefit schemes states: "Obviously the aim of the arrangements is to provide income tax and NIC deferral for you three for bonuses which would otherwise be paid directly into your hands." It also states that "the implementation of tax planning points head 1) and 2) above [income tax and NIC deferral and (which was never pursued) capital gains tax planning on sale of shares on a flotation] will be viewed by the Inland Revenue as aggressive and therefore contain an element of risk."
 - (3) A Memorandum by Ernst & Young of August 1998 states that "The ultimate success of the proposed arrangement depends upon the EBT having substance and commercial purpose." Mr Bennett's statement notes that we "felt no difficulty with this requirement". Mr Brennan suggests that he was agreeing that this meant that the other employees were only included in the EBT to make it look commercial. The memorandum also notes that tax counsel has recommended an independent remuneration specialist be used to determine remuneration levels for the three director-shareholders. Mr Bennett also referred to the Greenbury Report as a reason for the remuneration consultant because they were then considering a flotation and wished to be seen as following acceptable corporate remuneration policies, which Mr Brennan suggests was so as not to admit that the remuneration consultant was there for tax reasons.

- (4) A note of meeting of 5 August records "not simply the three shareholders" which suggests that the planning for the EBT was for the directors only.
- (5) A note of telephone conversation of 7 December 1998 records "I stated that if John, Brian and Craig were to participate in sub-trusts then it was necessary for other individuals to participate with sub-trusts as well on the same terms. There should be no deviation from this." This suggests that the directors were setting up a scheme for themselves and being advised that others should be included to make it look genuine. (It should be noted that the beginning of the paragraph of the note refers to long-term bonus awards previously awarded under the B share award scheme and so this may not relate to the EBT sub-funds. This is supported by a note of a telephone conversation the following day which refers to sub-trusts of £500K allocated to a general fund to provide long-term bonuses and is clearly different.)
- (6) The forfeiture provisions running to 30 June following the allocation in March which Mr Brennan contended it was fanciful to suggest that it was meaningful for the six.
- (7) The fact that the six received allocations based on past performance whereas the other employees received theirs based on future performance. Mr Brennan suggests that this means that the EBT scheme was originally for their sole benefit.
- (8) The amendment of the trust deed when the remuneration consultant did not give a recommendation in the form envisaged (namely, to "approve" the awards), coupled with the advice given by Mr Dart, who was not independent, that the amendment was to an administrative provision. Mr Brennan suggests that this indicates that the trustee would do what the company required.
- (9) Mr Brennan categorised Mr Dart as providing a "commercial 'service of inevitability'" in that it was for practical purposes inevitable that he would comply with the wishes of the six. Minutes for Regent to approve were all prepared by E&YTC in advance. Mr Cooke said that that these were often discussed with Mr Dart in advance and might be amended in the process, although he could not give any examples as Royal Bank of Canada held the papers. Only one example of a minute prepared by Mr Dart was produced which was the one approving the amendment to the trust deed relating to the change in what the remuneration consultant had to do.
- (10) The policy document (see paragraph 14(6)) was drafted by tax people at Ernst & Young.
- (11) Mr Bennett said in evidence that he would have been surprised if the recommendations of the board had not been taken up by the trustees.

- (12) Mr Dart knew that loans would be requested. He also said that if large loans had been requested it would have been harder to make. He was asked about Mr Bennett's debt-funded life-style and said that he was not aware that Mr Bennett was in debt, which Mr Brennan suggested showed that he did not regard Mr Bennett's debt to the trust as a real debt. Mr Dart also made the loan to Mr Bennett during the forfeiture period without making any enquiries.
- (13) The three directors did not take any, or only nominal amounts of, remuneration (£35,000 pa was mentioned but the evidence was unclear) in the form of outright payments of cash. The whole of what would otherwise be their remuneration was provided through the EBT.

Our conclusions on the facts

16. Mr Brennan requests us to make a finding from these points that the money contributed by the group to the EBT trustee and allocated by the trustee to the respective trust sub-funds of the six is at their absolute disposal because the trustee will always do what they require. We do not consider that such a finding would be justified on the facts. We accept the documents at their face value. In particular, the six are not free to do whatever they like with the sub-funds which are held on the trusts applicable to them, and the loans are genuinely loans and not disguised distributions. In our view it is material that the trustee imposed some restraints on the type of investments in which allocated funds could be invested, and that the trustee was not prepared to advance by way of loan the whole of an allocated fund. In order for the funds to be in the unfettered control of the six the trustee must exercise its discretion and take the further action of appointing those funds absolutely to them as beneficiaries. The highest the case can be put is that the trustee is likely to comply with any reasonable request that is for the benefit of the beneficiaries, which it is hardly surprising in the context of a trust established for the benefit of employees. This falls far short of saying that the trustee is a cipher who will do what it is told by the six. Mr Dart, who described himself as a trust law specialist (as was Mr Richardson the other director who took part in meetings), seemed to us to be someone who well understood his duties as director of a trustee company. We hope we have done justice to Mr Brennan's "Comment on the facts" in summarising its contents but we think it starts from the premise that the EBT is nothing but a tax avoidance scheme and tries to justify the conclusion from inferences from surrounding circumstances which do not add up to such justification.
17. We quite understand the Revenue not liking the asymmetry of the companies obtaining an immediate deduction for the payments into trust without any charge to tax on the employee except perhaps a charge to tax on interest-free loans at the official interest rate, and not even that if the official interest rate is paid, which we understood it eventually was on all the loans. However, it is in the nature of employee benefit schemes that the employer should obtain a deduction having paid away money to such a trust. The reason why the employees are not taxed on funds in the EBT is simply that they do not belong to the employees. The six may have carried this to extremes by not taking any

significant remuneration in cash but their position is entirely different from what it would have been if they had.

18. We have specifically stood back and considered whether the fact that we are dealing with benefits for three directors who between them own nearly all the shares in the company should cause us to reconsider our appreciation of the facts. We consider that it does not. They had no control over the trustee and even the power to remove the trustee would not ensure that a successor trustee would carry out their wishes. If the three fell out there is no reason to suppose that the loans might not be called in by the trustee; the same could happen on a change of ownership of the group (and subsequently the protector was introduced as something of a safeguard against this eventuality). They have been careful not to pay excessive amounts into the EBT through the mechanism of the remuneration consultant. Although not relevant to the year under appeal the remuneration consultant did cut down a proposed allocation for John Caudwell for 1999 from £3.5m to £2.75m and the allocation to Mr Bennett was not increased above £400K although the remuneration consultant said that it could reasonably be higher. It seems odd that almost their entire remuneration has been provided by benefits from the EBT on which little tax has been paid (although their relatively insignificant salary should be seen in the context of individuals who would be rewarded by realising great wealth on any sale or flotation of the group) but, even though they are in control of the company, there is a big difference between having a loan from the EBT and having remuneration outright.

19. We comment on some of the points relied upon by Mr Brennan in paragraph 15 above using the same numbering.

(1) to (5). These show that the company and the directors were strongly influenced by tax considerations, but this is not surprising when dealing with an employee benefit trust which would not be much of a benefit if the employer could not obtain a tax deduction or the employee were taxed on something in advance of receiving it. The process leading up to the EBT from May to December 1998 shows a development of thought. During the development some ideas were discarded, such as using the EBT as a vehicle to hold shares in the group leading up to a flotation. The Ernst & Young documents may show a search for a successor to platinum sponge schemes for avoiding National Insurance Contributions becoming muddled up with thinking for employee schemes generally. The directors were all clear that the EBT was a scheme for rewarding employees generally in which it was important for them to be seen to be included on essentially comparable terms. Having a trustee which was independent of the company was an important feature of the EBT, establishing its credibility in the eyes of employees.

(6) While the forfeiture provisions were unlikely to apply to the six it was possible that they would. The forfeiture provision was a term of the trust and could not be ignored. It seems that if a person died during the forfeiture period even his family would not benefit.

(7) There is a valid reason for the difference between past and future performance conditions in that the directors had no entitlement to

salary during the current year and so they were receiving all of what would be their remuneration in arrears.

- (8) We do not regard the alteration to the trust deed changing the requirement from "approval" of the allocation to its being "not excessive" as significant. The purpose of the provision was to prevent excessive allocations, no doubt with a view to the deductibility of the contributions by the companies. Either basis ensures that the allocations are not excessive and so the change is a minor one. Mr Brennan criticised Mr Dart's opinion that the change was to an administrative provision but Mr Dart stood by his view that it was. As that is a matter of Jersey law we see no reason to doubt his view.
- (9) We see no justification for making such an extreme assertion about a professional trustee.

Construing the relevant legislation using the *Ramsay* approach – the contentions of the parties

20. Mr Brennan put forward arguments of law based on *Ramsay*. He categorises the EBT as a highly artificial tax and National Insurance Contributions avoidance scheme, arguing that it is a pretence that the trust is created for commercial reasons, namely the motivation of employees and that it operates at the unfettered discretion of offshore trustees. He argues that understood commercially the whole point of the arrangements was to allocate bonuses to the recipients while trying to avoid the Schedule E charge on emoluments. Lord Hoffmann in *McNiven v Westmoreland Investments Limited* [2001] STC 273 makes a distinction between legal concepts and commercial concepts. Where the statute uses a commercial concept one must use a commercial approach to the construction of it and view the transaction as a whole. Of the *Ramsay* case itself he said:

"The new principle of construction was a recognition that the statutory language was intended to refer to commercial concepts, so that in the case of a concept such as a 'disposal', the court was required to take a view of the facts which transcended the juristic individuality of the various parts of a preplanned series of operations.

DTE Financial Services v Wilson [2001] STC 777 establishes that the statutory concept of "payment" for PAYE is a commercial one. Mr Brennan argues that "emolument" is also a commercial concept as is "earnings" for National Insurance Contributions and so we are bound to apply a commercial approach to the construction of the legislation to see whether there has been payment of an emolument or earnings. He argues that the sub-trusts created for the six are just a means of bringing about the transmission of cash from the appellant companies to the individual appellants. He says that that the allocation to a sub-trust put cash into the individual's money-box. Alternatively he makes the same arguments in relation to the loans out of the sub-funds.

21. Mr Thornhill argues that we are not in *Ramsay* territory. This is not a tax avoidance scheme. The tax advantages of EBTs are part of advantages they have for rewarding employees. He says that the end result here is that the funds are in trust, not that they are paid as emoluments or earnings. Where loans are made, which is to a limited extent in relation to the six, the loans are genuine loans on which interest is paid.

Applying the *Ramsay* approach - our decision

22. We agree with Mr Brennan that we should apply a commercial approach in construing the relevant legislation to determine whether there has in this case been payment of emoluments or earnings, and that in applying this commercial approach we should view the facts as a whole. This is particularly the case where the six are taking virtually the whole of what would otherwise be their remuneration through the EBT. But however much we view the transaction as a whole, the facts as we have found them do not support the conclusion that he wishes us to reach. Cash in the sub-fund is equivalent to cash in the individual's money-box only if the trustee is, in a commercial sense, inevitably compelled to comply with the individual's wishes, which we have found that it is not. It was the trustee's decision whether to make payments out of the sub-funds and the trustees restricted how amounts in the sub-funds could be invested. If any of the six did something damaging to the group it is likely that they would lose the entire benefits in the EBT. Since the directors are also shareholders it is not very likely that they will do something damaging to the group but it is always possible that there will be a disagreement and loss of the benefits in the EBT would be a possible consequence. This is far removed from the situation in cases like *DTE Financial Services Ltd v Wilson* [2001] STC 777 where the inevitable end result is cash in the hands of the employees. Similarly the loans are factually loans which can be called in, and are not disguised payments of emoluments. Therefore we find that, applying a commercial approach to the relevant statutory concepts, in this case there was no payment of emoluments or earnings by reason of these particular arrangements involving the EBT. If it is necessary for us to decide it we do not categorise the EBT as an artificial tax avoidance scheme.
23. We have decided that section 43 does not prevent the deduction of payments into the EBT. In the light of our decision on section 154 and of the facts we have found, the six are not taxable or liable to National Insurance Contributions on allocations to sub-funds, or on loans from the sub-funds (except under section 160).
24. Accordingly, we allow all the appeals in principle.