

THE SPECIAL COMMISSIONERS

TAXPAYER F1

Appellant

- v -

COMMISSIONERS OF INLAND REVENUE

Respondent

Before: Dr J F Avery Jones CBE (Deputy Commissioner for the special purposes of the Income Tax Acts)

Mr Hugh McKay of Counsel, instructed by Messrs Raymond Gross & Partners, Chartered Accountants, for the Appellant

Mr M D Wilbey, District Inspector, Manchester 7 District.

DECISION

This case concerns receipts by the taxpayer from Iran and I agreed, with the consent of both parties, to give a decision in a form in which the persons mentioned cannot be identified since the methods adopted for taking money out of Iran was not legal in that country. I shall therefore refer to all persons by an initial and give a key on a separate page. If I am requested to state a case I shall adopt the same procedure.

There are three points for determination, relating to the taxability of benefits from the taxpayer living in a house owned by a non-resident company, and two types of receipts. As all the points are connected, I shall first state the facts as I have found them.

The appellant, F1, was born in Iran in 1941. He is the youngest of 4 brothers and 6 sisters all the others of whom are in Iran. He first came to the UK in 1969 when he took a HND course in engineering at Stockport College. This was a sandwich course and for part of the time he worked for B, a subsidiary of a well-known public company, manufacturing heavy machinery. B had an independent agent in Iran, M, the chairman and maybe the owner of which was A, an Iranian who spent part of his time in the UK. A was a close friend of the appellant's father, F2. A has no children, was a devout Muslim and in some ways treated the appellant as his own son. After qualifying as an engineer. the appellant went to work for M as a service engineer on

his return to Iran. During this time he lived in a flat in Teheran and was partly supported by his father, F2, who lived in another part of Iran. F2 was a wealthy man owning a carpet business operated as a sole trader and owning fruit farms and agricultural property. The father was proud of the appellant for being the only son with a professional qualification. The appellant's eldest brother, F3, now operated the family business as the father was now aged 80.

F1 married a British wife. At about the time of the revolution in Iran in 1981 his wife was in England. He wanted to leave Iran to join her, and was forced to resign his position with M in order to obtain an exit visa. He thought that he would be out of Iran only for a short period. He stayed with his wife's parents with their three children all living in one room. He approached his father about helping him obtain some accommodation. His father put him onto S, a former director of B who in 1976 went to work for M. S acted as an intermediary between A and the father F2.

F1 found a house at 130 Main Street, Goostrey. F1 was told by A that a house would be provided for him, he thinks at the expense of A. A Liberian company, Goostrey Properties Limited, of which W is a director was the purchaser, and solicitors, who F1 thought were B's solicitors, were instructed by someone (not the appellant) on behalf of the company. The appellant originally thought that S was behind the company but now thinks that it is managed by W who lives in the Isle of Man. W was a former director of M. The price of the house was £75,000 and it was purchased on 20 January 1981. F1 did not take any part in the arrangements for the purchase. The name of the company was given by the solicitors in a letter of 9 February 1981 to F1's wife (he was away at the time) in connection with the insurance, which suggests that he did not even know the name of the purchasing company.

Later, the appellant explained to A that the property was too far from the children's school for convenience. A suggested that he should move. The appellant arranged with estate agents to put the Goostrey house on the market but took no part in any negotiations for its sale or for the purchase of the new house, Archery House, Leycester Road, Knutsford which was also paid for by Goostrey Properties Limited. There is an authority dated 19 January 1986 signed by W addressed to B confirming A's request to pay £90,000 to the solicitors who were handling the conveyancing. The Goostrey property was sold for £95,000 in March 1986 and Archery House was bought for £180,000 on 14 February 1986. The £90,000 is clearly the balance of the price of the new house and I find that it was paid for by A and deduce that the same applied to the Goostrey property. Support for this is also obtained from a letter and affidavit by W who does not name the owner of Goostrey Properties Limited but states that he is dead, which is true of A. I do not give much weight to W's evidence as he did not come from the Isle of Man to give evidence and I agree with Mr Wilbey that the letter looks as if it was written for him, but everything he says is confirmed by other evidence. I have also seen a draft licence which the appellant must have signed allowing him to occupy Archery House as licensee. This was sent to him by the solicitors acting for Goostrey Properties Limited with a covering letter dated 5 February 1986 stating that the licence was required for his taking up occupation of the property. Goostrey Properties Limited pays the general and water rates and the appellant pays the gas, electricity and telephone bills. No major works were carried out to either house.

A died about three years ago but no changes to the arrangement have taken place since then. The appellant said that he hoped eventually to buy the property and he hoped that he could do so at cost, although there is no evidence to show that this expectation is shared by A's family.

The appellant received sums from B which are agreed to have been paid on behalf of M. The payments were authorised by W and paid by the credit controller of B out of a commissions due to M. The appellant believes that the payments derive from his father who puts M in funds in Iran and M, through W, then instructs B to make the payments out of commissions owing to M. In effect M's financial position is unaltered, except that it has funds in Iran instead of England.

The appellant attended liaison meetings at M's premises at which their business with Iran was discussed. The appellant said that he attended these meetings from 1981 about three or four times a year. They lasted between half an hour and one hour. He received no payment or expenses for attending them. He attended as a favour to M and in order to keep up with M's affairs in case he could resume his employment with them and to assist B which had been helpful to him during his training. I was shown the minutes of two of these meetings, one of which was attended by the appellant. No duties were required of the appellant arising out of matters discussed at that meeting. It is an agreed fact that the appellant was unemployed between 1981 and 1987. I was given a certificate from the Companies Registration Department of Teheran that the appellant has never held any shares in M.

The Inspector called C, the commercial manager of B, as a witness. B is a subsidiary of a household name public company and has a turnover today of £70m in the heavy electrical goods field for which Iran is a good market. M has been B's independent agent in Iran for 30 of 40 years. C first met the appellant in Iran in 1980 but has seen little of him since then except since 1992 when C became commercial manager of B. He said that the liaison meetings took place every 6 weeks (except during holiday periods) and had started 5 or 6 years ago. He chairs them. The appellant attends occasionally and provides useful local knowledge about Iran, for example about whether the machinery will be subjected to dust. He was not aware until recently about the payments to the appellant. They were made by B's credit controller. There is a conflict in the evidence about the frequency of the meetings and I prefer C's evidence that they were held every 6 weeks but that the appellant was right in saying that he attended three or four times every year, which fits in with C's expression that the appellant attends occasionally. I had been shown a note of a meeting between two Inspectors Mr Kelly and Mr Wilbey and C in February 1994 in which it is stated that the appellant still works as Agent and adviser to M, and that he could be described as the equivalent of a UK representative to M. However, C explained that what he was trying to convey was that the appellant certainly did not work for B and his attendance was as representing M as opposed to B. He did not think that the appellant worked for M. This fits in with the other evidence and I accept it.

B was not mentioned in the notes of appellant's first interview in January 1990 with the Inspector Mr O R Wright, from whom I also heard evidence. The appellant's former accountant claimed in the later interview with the Inspector, Mr C Kelly in November 1991, who also gave evidence, that B was mentioned in the interview with Mr Wright. Mr Wright said that his father had worked for B and it would be a familiar

name to him and likely to be included in the notes if it had been mentioned. I find that B was not mentioned in the first interview. The existence of the liaison meetings were not known to the Inspector until later.

The third question concerns other receipts of the appellant for the year 1985/86. I was given a list of payments into his bank account. I did not hear any evidence which suggests that the appellant carried on any business in the UK during this period, although he was a director of two companies later. The money paid to the appellant came from his father. So far as assets in Iran are concerned, the appellant had a building plot on which he started to build a house but this was taken over at the time of the revolution and it was sold about 1990. There is a reference to assets in Iran in his statement of assets of 30 June 1998 which refers to this, although in an interview in January 1990 with Mr Wright he stated that his only property was the expectation of a share in his father's estate. The appellant has no other assets in Iran. I was shown evidence of bank statements of accounts operated by the appellant's brother, F3 showing that £190,721.76 came into the UK and was then transferred to a deposit account in Jersey. This money apparently came from Kuwait. From this account \$100,000 was paid to the appellant to enable him to start a limited company in the UK, T in 1987.

Is the appellant a shadow director of Goostrey Properties?

Section 33 of the Finance Act 1977 taxes an employee on the benefit of accommodation provided by reason of his employment. It is accepted that the appellant is not a director or employee of Goostrey Properties Limited and so the only way in which he might be taxed is if he is a shadow director (I shall return to the question whether this is right in law). Section 33 incorporates the definition of director contained in s.72(8). For this purpose "'Director' includes any person in accordance with whose directions or instructions the directors of the company (defined as above) are accustomed to act." I shall call such a person a shadow director. The full definition of director is set out later in this decision and the reference to "defined as above" is to the directors properly so called and to certain other people occupying a similar position. This definition requires that directions or instructions are given and are accustomed to be acted upon. In determining this question I am asked to look at the year 1987/88 during the which the second property, Archery House, was occupied by the appellant.

Since the properties were financed by A, as I have found, it is not likely that the appellant would have given directions or instructions to the directors. A family friend, A, who was in the good position of having money in England invested some money in a house and allowed the appellant to occupy it rent-free. The appellant would not in these circumstances have told A or directors of A's company what to do. To A the house was an investment which did not produce any income but might produce a capital gain. I doubt whether A's generosity would extend to selling the house to the appellant at cost but the question has not arisen. The odd feature is that A's death has made no difference to the appellant's position. One explanation is that in fact A had been reimbursed by the appellant's father in Iran, another is that A's relatives are content to have an investment in a house in England which is looked after by the appellant and may ultimately produce a gain for them outside Iran. I need not speculate about this.

There is no evidence that the appellant gave any instructions to anyone in connection with the house or the company Goostrey Properties Limited and I would not in the circumstances expected him to have done so. He may not even have known the name of the purchasing company at the time of the first purchase because why would the solicitors have given it to him for insurance purposes. He did approach the estate agent in connection with the sale of the Goostrey property but did not take part in any of the financial negotiations. In relation to entering into the licence to occupy it is clear that Goostrey Properties Limited was giving the appellant instructions that entering into the licence was required before he occupied the property. The highest one can put it is that the directors fall in with his wishes in buying the Goostrey property, in selling it and buying Archery House, but falling in with someone's wishes is very different from complying with their directions or instructions. I therefore find as a fact that the appellant was not a shadow director of the Goostrey Properties Limited and allow the appeal against the assessment on the benefit.

Does section 33 of the Finance Act 1977 apply to tax a shadow director?

Having decided that the appellant is not a shadow director, the question of construction of section 33 of the Finance Act 1977 does not arise (the year in question is 1987/88 before the 1988 consolidation). Mr McKay urged me to express a view on it, being a point which had long been in dispute between practitioners and the Revenue, while Mr Wilbey preferred that I did not. I have decided to do so as it was fully argued and in view of the general interest in the question.

Section 33 of the Finance Act 1977 provides that:

(1) ... where living accommodation is provided for a person in any period by reason of his employment, and is not otherwise made the subject of any charge to him by way of income tax, he is to be treated for Schedule E purposes as being in receipt of emoluments of an amount equal to the value to him of the accommodation for the period ...

Section 33(8) provides that a number of what it calls interpretative provisions from the Finance Act 1976 including "employment" and "director" are to apply as if section 33 were included in sections 60 to 71 of the 1976 Act. I shall therefore start by looking at the meaning of "employment" in those sections of the 1976 Act. Those sections contain four charging provisions depending on a person's employment in a director's or higher-paid employment (sections 61, 64, 66, 67) and one charging provision, section 68 depending on a person's employment "(whether or not director's or higher-paid)". If section 33 had been included in the Finance Act 1976 it would be the only section applying to employment without any qualification.

"Director's or higher-paid employment" is defined in s.69(1), which was redrafted in the Finance Act 1977 at the same time as s.33 was enacted, to mean:

"(a) subject to subsection (5) below [containing an exclusion for certain full-time working directors] employment as a director of a

company; or

(b) employment with emoluments at the rate of [originally] £5,000 a year or more."

The other relevant provisions are the definitions of "employment" and "director" as follows:

"Section 72(2) 'Employment' means an office or employment whose emoluments fall to be assessed under Schedule E; and related expressions are to be construed accordingly."

"Section 72(8) 'Director' means -

(a) in relation to a company whose affairs are managed by a board of directors or similar body, a member of that board or similar body;

(b) in relation to a company whose affairs are managed by a single director or similar person, that director or person; and

(c) in relation to a company whose affairs are managed by the members themselves, a member of the company,

and includes any person in accordance with whose directions or instructions the directors of the company (defined as above) are accustomed to act."

Combining the definitions into s.69(1), "director's or higher-paid employment" means:

(a) [ignoring the exclusion for certain full-time working directors] an office or employment whose emoluments fall to be assessed under Schedule E as a director of a company [which includes in paragraph (c) a member of a company whose affairs are managed by the members themselves, and in the concluding words shadow directors, neither of whom have an office or employment as normally understood]; or

(b) an office or employment whose emoluments fall to be assessed under Schedule E with emoluments at the rate of [originally] £5,000 a year or more.

Starting with paragraph (b), which is easier to understand, it seems to me that the purpose of the definition of "employment" is first to add offices and secondly to

provide the territorial limitation to the charge, that only those offices and employments which are liable to tax under Schedule E are included, that is, that most of the world's offices and employments held by non-residents of the UK working wholly abroad are, as one would expect, excluded. Paragraph (a) has a similar function for directors and the only way to make sense of it is to assume that those within the extended definition of director who do not actually hold an office or employment are treated as if they did, because otherwise the extended definition of director would never have any effect. The distinction between director's employment and employment has little effect in the Finance Act 1976 because on the only occasion where both expressions are not used together in a charging provision, s.68, that section applies whether or not the employment is director's or higher-paid.

There are a number of exceptions in s.62 from the general charge on those in director's or higher-paid employment which are drafted in terms of employees or employment without mentioning directors: sections 62(3), 62(4), 62(7) and 65. From the context I assume that these are intended to apply both to director's and other employments. The original section 62(5), relating to representative accommodation, repealed by the Finance Act 1977, contained an exception, applying where the employee is a director, to the exception in subsection (4) which applies to employees. This supports the view that the exception in subsection (4) applies to director's employment because otherwise the exception to it would be wider in scope than the exception itself.

In section 33 of the Finance Act 1977 the expression "by reason of employment" incorporates the definition of "employment" but not the Finance Act 1976 meaning of the whole expression (which is not incorporated by reference) because s.33(7) contains its own definition of "by reason of employment". Accordingly, the effect of the incorporation of the definition of "employment" is to include offices to and to provide the territorial limitation. There is no mention of directors in the charging provision in subsection (1) and there is no reason to incorporate shadow directors by implying that they hold an office and are therefore included within the definition of employment. According to section 33(8) we are to apply the interpretative provisions as if s.33 is included in the relevant sections of the Finance Act 1976. If it had been so included it would have stood out as the only charging section applying to employments without qualification. In my view it is possible to treat directors, such as shadow directors, who do not actually hold an office or employment only if director's employment is specifically referred to, which it is in all the charging sections in the Finance Act 1976, including s.68 applying whether or not the employment is director's or higher-paid. It is not possible to imply in s.33 words such as "whether or not the employment is director's employment" when they are used in s.68 of the Finance Act 1976 and not in s.33. On this basis I conclude therefore that director's employment is not included in s.33.

There is one argument to the contrary, that since directors are mentioned in s.33(5) excluding them from the exemption in subsection (4) for representative occupation, the charge itself must necessarily apply to director's employment. This provision has some similarity to the original sections 62(4) and (5) of the Finance Act 1976 but that was an exception from the general charge on those in director's or higher-paid employment. If one approaches the matter by applying the definition of employment as if s.33 had been included in the Finance Act 1976 the charging provision of s.33

does not apply to director's employment. I do not think that the context is strong enough to say that director's employment is included in the charge merely because directors are mentioned in the exception in subsection (5) to the exception to the charge in subsection (4). It would be an odd method of construction to rely on an exception to an exception to enlarge the width of a charging provision which on its own did not include director's employment. The result is that the exception cannot be wider than the charge and it seems to me that, for example, a member of a non-profit-making company who is a director within paragraph (c) of the definition of "director" may be within the exclusion in s.33(5) but this has no effect as he is not within the charge anyway. I conclude that since s.33 is drafted in terms of employments without reference to director's employment, a shadow director is not included in the charge.

I should mention in passing that in the predecessor to s.33, s.185 of the Taxes Act 1970, Parliament did expressly provide in subsection (4) that any director within the same extended definition was treated as holding an office. The draftsman must have had that section before him when drafting s.33 and presumably he considered that the point was adequately covered in the Finance Act 1976, which I agree it was, though less elegantly, and he failed to see that the effect of notionally incorporating the section into that Act did not have the effect of incorporating the extended definition of director in all references to employment. I do not think that I should imply that the draftsman had achieved what he presumably intended.

Mr McKay contended secondly that in relation to shadow directors s.33 was circular and logically impossible: the section applies to those employees whose emoluments fall to be assessed under Schedule E, but the section itself deems him to be in receipt of emoluments for Schedule E purposes. Assuming for the purposes of testing this proposition, that the section otherwise applies to a shadow director with no actual emoluments, he contends that one could not include the deemed emoluments to satisfy the section. As we have seen, the definition of employment has the effect of providing a territorial limitation; if the employment is within that limitation, s.33 deems there to be Schedule E emoluments unrelated to any Case of Schedule E. If one could use the deemed emoluments under the section to complete the circle in the definition of employee and make the section apply, there would be no territorial limitation to the section and all employees in the world provided with living accommodation would be caught. This cannot have been intended. This seems to me to be a compelling reason why one cannot use the deemed emoluments to make the section apply. The deemed emoluments expressly count in determining the then £5,000 limit by virtue of the amended s.69(2) but this arises only when one has decided that they are chargeable.

In summary, I do not think that s.33 applies to a shadow director or a director who does not actually hold an office or employment, such as a paragraph (c) director for two reasons: first, because such a person is not within the meaning of "employee" in Finance Act 1976 into which s.33 is notionally incorporated; and secondly, because one cannot use the emoluments deemed to arise under the section to create a Schedule E emolument to satisfy the territorial limitation in the definition of "employee".

Is the appellant taxable on certain payments made to him through M?

I am asked to look at the year 1986/87. Payments were made of £12,000 between 20

July 1984 and 19 July 1985 which would be the basis year if there was a trade which started on 20 July 1983, the date of the first payment of which I have seen a record. In fact, the payments may have started before that and the basis period may therefore be different but I am only asked to decide the question in principle. The Inspector claims tax on these payments under Cases I or II of Schedule D.

In relation to Case I, the question is whether the appellant is carrying on a trade of providing services to M for which payment is made through B. His attendance at liaison meetings was occasional and, as I have found, unpaid. His actions were much more in keeping with a wish to do a good turn to his former employer, M, whose chairman and possibly owner, A, had been generous to him, than the carrying on of a trade by the appellant. The significant point, it seems to me, is that C, a senior employee of B, was unaware of the payments, but he was aware of the appellant's attendance at meetings. His view was that the appellant was not working for M. I regard C's evidence as important coming from an independent party who knew the commercial relationships. I was also expecting him, from the note of the meeting with him, to say the opposite, and I was looking carefully at any evidence which might have shown that the appellant's evidence was untrue. In the light of his evidence the note of meeting with C is misleading. I am sure it was not deliberately so but the Inspector may have read too much of what he wanted to hear into what was said. I find that these payments do not represent payment of the work done at the liaison meetings, or any other work done for M. They are not taxable under Case I.

I can understand the Inspector's concern about these payments, particularly when B was not mentioned in the interview with Mr Wright. On the other hand, if the appellant was trying to protect those in Iran he would have been careful not to mention B as this would immediately involve M and the other individuals in Iran connected with it, including his father and A. Since B were effectively only acting as bankers and since the appellant's attendance at the liaison meetings was only occasional and he was not paid for them, they can not have seemed important to him.

The alternative claim is that they are taxable under Case III which it is common ground would require that the payments were made under a legal obligation. Mr Wilbey said that a company like B would not have made the payments without an obligation to do so. Having accepted the appellant's evidence that the payments originated from his father, it follows that there was no obligation on M (or B) to make them. The alternative claim under Case III also fails.

Is the appellant taxable on other moneys paid to him?

I have accepted the appellant's claim that the source of the payments are family money and not taxable income of the appellant. It is helpful to have bank statements of an account in the brother's F3's name which indicates that substantial sums of family money were available outside Iran. The Inspector claims tax under Case I or Case V of Schedule D on payments to the appellant. There is no evidence of any trade carried on in the UK and I reject the claim under Case I. In relation to Case V there is no evidence that the appellant owned any possessions in Iran (or elsewhere) and I also reject the claim under Case V.

It was suggested by Mr Wilbey that as the appellant had not declared commissions

mentioned in the accounts for 1990/91 of a UK company, R, of which the appellant is a director, his evidence was unreliable. As I read the notes in those accounts the money should have been paid to the appellant's UK company T. I heard evidence from Mr P Gordon Smith of the appellant's accountants that in the end the commission was accounted for in T but in the following year. It seems to me that this is evidence of a muddle and not something which suggests that the appellant was not telling the truth in the earlier period with which I am concerned.

This has been a difficult case as it was hampered by the lack of hard evidence on many points. I certainly do not criticise either Mr Kelly or his predecessor Mr Wright for not accepting the story presented to them without more concrete evidence. They both appeared to me to be taking an open-minded approach to their investigation but were sceptical about stories about money arrived from Iran. We still do not have much concrete evidence but, having had the benefit of seeing all the witnesses, I accept the explanations given to me, all of which are completely consistent with each other. I am satisfied that throughout the appellant told the truth but he was inhibited from telling the whole truth because of fear of the consequences to those in Iran, including his relatives, and on occasions because he did not always know the whole story himself, probably for the same reason.

I therefore allow the appeal against assessments on the appellant as occupier of Archery House for 1987/88, under Schedule D for 1986/87 in respect of the payments made through B, and under Schedule D for 1985/86 in respect of the other receipts.

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7 April 1994