

INCOME TAX - Schedule E - receipt by four employees of units in unit trust - whether paying company should have deducted income tax - appeal allowed - ICTA 1988 s 203; Income Tax (Employments) Regulations 1973 SI 1973 No. 334
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THE SPECIAL COMMISSIONERS

MICHAEL BLACK (1)

STEPHEN BROWN (2)

GREGORY GREEN (3)

MALCOLM WHITE (4) Appellant: use right arrow to move to starting point after this box Appellants

- and -

(H M INSPECTOR OF TAXES) Respondent

SPECIAL COMMISSIONER : DR A N BRICE Chairman's name: use right arrow to move to starting point after this box

Sitting in London on 5 and 6 April 2000

Mr Hugh McKay of Counsel, instructed by The Taylors Partnership, Chartered Accountants, for the Appellants

Mr Timothy Brennan of Counsel, instructed by the Solicitor of Inland Revenue, for the Respondent

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ANONYMISED DECISION

The appeals

1. Mr Michael Black, Mr Stephen Brown, Mr Gregory Green and Mr Malcolm White (the Appellants) appeal against assessments to income tax under Schedule E in the following years and amounts:

1989-90 1990-91

Mr Black £370,000 -

Mr Brown - £100,000

Mr Green £250,000 £100,000

Mr White £250,000 £100,000

2. The assessments also include other emoluments not in issue in the appeal. The parties requested a decision in principle leaving the amounts of the assessments to be determined at a later date.

The legislation

3. The relevant parts of section 203 of the Income and Corporation Taxes Act 1988 (the 1988 Act) provide:

"203 Pay as you earn

On the making of any payment of, or on account of, any income assessable to income tax under Schedule E, income tax shall, subject to and in accordance with regulations made by the Board under this section, be deducted or repaid by the person making the payment,"

4. At the relevant time the regulations referred to in section 203 were the Income Tax (Employments) Regulations 1973 SI 1973 No. 334 (the 1973 Regulations).

The agreed question for determination

5. The amounts appealed against were received by the Appellants in the form of units in a unit trust provided to them by their employer. It was agreed that the amounts were taxable under Schedule E as emoluments from employment.

6, The agreed question for determination in the appeal was whether the employer ought to have deducted income tax under section 203 of the 1988 Act and the 1973 Regulations before providing the units to the Appellants.

The evidence

7. A bundle of documents was produced by the Appellants. Oral evidence on behalf of the Appellants was given by each of the Appellants and also by Mr John Smith, an employee of Group from 1 April 1987 and a director of Developments from early 1989 to 1996. Each of the witnesses produced a witness statement which was read at the hearing.

8. A separate bundle of documents was produced by the Inland Revenue.

9 This appeal concerns events from about 1983 to 1990. The documentary evidence was not complete and, understandably, the memory of the witnesses was not complete either. The burden of proof is on the Appellants and the standard of proof is the balance of probabilities.

The facts

10. From the evidence before me I find the following facts.

1983 - Group

11. Group was established by Mr A B Jones in November 1983 as a property development company. Mr Jones was described in evidence which I accept as the only shareholder and the chief executive. Initially the registered office of Group

was at the address of Mr Jones's house. In 1986 Group was trading from an address in London.

12. Group had a number of subsidiary companies of which the most significant for the purposes of this appeal was Developments. Developments was a wholly-owned subsidiary of Group. It acquired development sites, obtained planning permissions, built new premises, and then let or sold them to institutional investors, often on a pre-funded basis with a profit payable to Developments on completion or letting. Although other subsidiaries were formed for joint ventures with other investors or developers, or as single purpose vehicles for specific projects, Developments carried out 90% of Group's development business.

13. Group was the holding and administrative company and did not itself undertake direct property investment or development functions. Group paid all the corporate overheads of companies in the group, including salaries, and then recovered proportionate contributions from the subsidiaries.

1983-1987 - The four Appellants join Group

14. The first of the four Appellants to join Group was Mr White who was first employed on 1 January 1984. The terms of Mr White's employment were contained in a letter dated 8 November 1983 from Mr Jones asking him to become the development director in another company which was an 80% subsidiary of Group. The letter suggested that Mr White's initial salary should be £16,500 per annum "plus an agreed profit sharing formula which you and I can discuss and agree prior to your taking up the appointment". The salary offered to Mr White was below that which he then enjoyed. However, Mr White accepted the offer in writing on 15 November 1983 "subject to our agreeing a satisfactory profit sharing formula in due course".

15. The second of the Appellants to join Group was Mr Green who joined in early 1984 in return for a fixed fee of £25,000 per annum. Mr Green did not regard this sum as sufficient to reward his efforts but expected further rewards in the future. In early 1985 Mr Green became a salaried member of the staff of Group.

16. Meanwhile, in 1985 Mr White was appointed a director of Developments and other subsidiary companies.

17. The third of the four Appellants to join Group was Mr Black who was first employed by Group on 1 October 1985. One of Mr Black's major reasons for joining Group was the promise of a stake in the company.

18. Sometime in 1986 Mr Green was head-hunted by a rival firm. He informed Mr Jones of this. On 4 August 1986 Mr Jones wrote to Mr Green to confirm that his salary would be reviewed at the end of the calendar year and that, subject to Board ratification, Mr Green would be invited to join a share option scheme which was then being finalised for Mr White and Mr Black.

19. On 22 September 1986 Group entered into service agreements with each of Mr White and Mr Black under which Group engaged their services as directors of Developments. The service agreements were for the term of three years. Under the agreements each of Mr Black and Mr White agreed to serve Developments as a director and to perform the duties assigned to him by the directors of Group. Group agreed to pay a salary of £30,000 per annum, the amount of the salary to be reviewed annually by the board of Group.

20. On the same day (22 September 1986) Group entered into option agreements with each of Mr White and Mr Black and on 25 September 1986 Group entered into an option agreement with Mr Green.

21. Mr Black's option agreement recited that Group had established the Group Executive Share Option Scheme 1986 under which Group was able to grant options over its ordinary shares to directors or employees in full-time service. The agreement gave Mr Black an option to subscribe for 40 ordinary shares of 10 pence each in Group at the price of £2,500 for each share. The option could only be exercised after a period of three years and before the expiry of ten years from the date of the option agreement. Clause 4 provided that the option should lapse if the shares of the company were traded on the Stock Exchange or on the Unlisted Securities Market and clause 5 provided that Mr Black's right to exercise the option terminated if he ceased to be an eligible executive. Clause 11 provided that Group would make available sufficient of its authorised but unissued share capital to meet the requirements of the option. The option agreement was signed by Mr Jones on behalf of Group and also by Mr Black.

22. Mr Green's option agreement was in similar form except that it was in respect of 10 ordinary shares rather than 40. It was signed by Mr Jones on behalf of Group and by Mr Green. Mr White's option agreement was in substantially the same form as the agreement with Mr Black. Mr White described his agreement as giving him the right to subscribe for 4% of the capital of Group at an exercise price of £100,000.

23. The last of the four Appellants to join Group was Mr Brown who joined in February 1987. On 12 February 1987 Mr Orange, as secretary and finance director of Group, wrote to Mr Brown. He referred to a letter from Mr Jones of 10 February and confirmed Mr Brown's appointment as development surveyor at a commencing salary of £19,000. The letter stated:

"It is our intention to reward the executives, including yourself, in line with the anticipated profitable growth of Group."

1987 - Group sells 50% of its shares to ABC

24. In about March 1987 it was intended to sell 50% of the shares of Group to ABC. ABC's investment in Group was intended to build up the profits of Group with a view to flotation. Mr Jones commenced discussions with Mr White, Mr Green and Mr Black about amendments to their option agreements. Together those three had options to subscribe for 9% of the authorised share capital of Group (4%, 1% and 4%). ABC wanted the agreements amended because, if they were exercised, they would give the holders of the options the balance of control of the company. On 13 March 1987 amendments to the option agreements between Group and Mr White, Mr Green and Mr Black were agreed. As a result of the amendments the options would only be exercisable on flotation. However, the amendments were stated to be conditional upon the approval of the Inland Revenue. I accept the oral evidence of Mr White that the approval of the Inland Revenue was not forthcoming.

25. In May 1987 ABC acquired 50 per cent of the issued share capital of Group for about £10M, thus valuing Group at £20M. The share options held by the three directors (Mr White, Mr Green and Mr Black) of 9% were thus, on that basis, worth a little less than £2M.

26. On notepaper in use in March 1988 the directors of Group were shown as: Mr Jones (Chairman and Chief Executive), two other directors, the Chief Executive of ABC, and Mr Orange as Secretary. I accept the oral evidence of Mr White and Mr Brown that, even after the acquisition by ABC of 50% of the issued shares of Group, Mr Jones retained the majority voting power on the board of Group.

27. In October 1987 Mr Orange convened a meeting of the directors of Developments, who were then Mr White, Mr Green and Mr Black, to discuss a corporate plan for Group to cover the two years up to autumn 1989 when Group intended to seek a full listing on the London Stock Exchange.

28. On 23 March 1988 Mr Jones wrote to Mr Brown confirming that his salary would be increased to £25,000. The letter concluded with a manuscript note from Mr Jones which read:

"I have been particularly impressed by your performance and you/we should see the results from your hard work over the next period."

29. Shortly after this increase in salary Mr Brown was appointed as a director of Developments. He also accepted a share option agreement similar to that entered into with Mr Black but of 2% of Group's authorised share capital. The option could only be exercised in limited ways but principally when Group was floated.

1989-90 - The emoluments

30. Early in 1989 Mr White, Mr Green and Mr Black entered into discussions with Mr Jones for some profit-sharing arrangement to reward them for the contributions they had made to the profitability of Group during the previous six years. In the summer of 1989 Mr Brown and Mr Smith went to see Mr Jones at his home and subsequently Mr Brown's salary was increased to £60,000.00. Eventually it was decided that each of Mr White, Mr Green and Mr Black would receive a payment reflecting the growth in the value of Group since its inception. Group was then valued at about £32.5M based on annual profits of £6M. Of this, £1M was to be set aside to reward these three directors. Each of Mr White and Mr Green would get £333,333.33. Of this, £83,333 would be paid to each as consideration for amending their share option agreements and a separate bonus of £250,000 would be paid. The sums of £83,333 were eventually paid to each of Mr White and Mr Green in money.

1989 - Group becomes Plc

31. On a date unknown but before September 1989 Group became Plc. Its offices were at another address in London. The directors included Mr Jones, as Chairman and Chief Executive; the senior partner of Plc's solicitors as Deputy Chairman; the Chief Executive of ABC; with Mr Orange as Secretary. The senior partner was described in evidence as a trustee of Mr Jones's family trusts.

1989-90 - The emoluments of Mr White and Mr Green

32. On 11 September 1989 Mr White sent a memorandum to Mr Orange returning his amended share option documentation duly signed. The memorandum asked for all monies due under the agreements, namely £333,333.33, to be transferred to Mr White's bank account that week and Mr White asked to be informed when that had been done. On 12 September 1989 Plc and Mr Green agreed further amendments to his option agreement of 25 September 1986.

33. At some time in September 1989 Mr Orange decided that Plc could achieve substantial savings of national insurance contributions if the bonuses of £250,000 were paid in the form of units in an authorised unit trust. The recipients (Mr White and Mr Green) were told that Plc would purchase units in a unit trust, transfer them to the recipients who could then sell or retain the units as they wished. The recipients were told that this arrangement would have advantages for Plc and no disadvantages for the recipients. The recipients agreed to accept their bonuses in this way.

34. On 12 September 1989 Plc purchased 472,590 units in Kleinwort Benson Gilt Yield Trusts for the sum of £500,000.

35. On a date in September 1989 a meeting of the board of directors of Plc took place. Copies of the minutes of the meeting as supplied to the Inland Revenue by Plc indicated that the meeting took place on 14 September 1989. That date was also mentioned in the letter from Plc's advisers to the Inland Revenue of 15 April 1991 referred to later in this decision. The date of 14 September 1989 is also consistent with the reference in the minute to "units to be transferred out of the company's name" which units were only acquired on 12 September 1989. It is also consistent with the date of 14 September 1989 on a copy of the letter from Mr White to the directors of Plc referred to below. On the other hand, there were also copies of letters from Mr White and Mr Green to the directors of Plc in exactly the same form but with the date of 8 September. Also, Mr White gave oral evidence that the board of Plc met quarterly and that it was unlikely that it met on 14 September 1989 because his diary indicated other events as taking place on that day. However, I bear in mind that Mr White was not a director of Plc until 28 June 1990. Accordingly I find that, on the balance of probabilities, the board of Plc met on 14 September 1989.

36. The minute recorded that those present were Mr Jones as chairman, another director of Group, the Chief Executive of ABC and the senior partner with Mr Orange as secretary in attendance. It read:

"The following gross bonuses in respect of the year to 31st March, 1990 were approved by the Board.

M WHITE £250,000

G GREEN £250,000

It was decided that the payment of these bonuses should be conditional upon each individual accepting payment in the form of units in an approved unit trust, to be transferred out of the company's name."

37. The minute was signed by Mr Jones as Chairman.

38 On 14 September 1989 each of Mr White and Mr Green signed a letter prepared by Mr Orange and addressed to the directors of Plc. I accept the evidence of Mr Green that Mr Orange presented the letter to him and asked him to sign it. The letters read:

"At the directors' meeting earlier today, bonuses of £250,000 were voted to me in respect of the year to 31 March, 1990.

I now write to confirm that I am prepared to accept the bonus to be paid in the form of units in a approved unit trust. I should be grateful if you would kindly arrange for the units to be transferred into my name."

39. On 14 September 1989 236,295 units were transferred into the name of Mr White and the same number of units was transferred into the name of Mr Green.

40. On 19 September 1989 Kleinwort Benson sent Mr Green a contract note in respect of the sale of units in Kleinwort Benson Gilt Yield Trust for £249,527.52 and that amount was credited to Mr Green's account on 19 September 1989. On or about 21 September 1989 the units transferred to Mr White were registered in his name and seven days later Mr White signed a letter prepared by Mr Orange requesting Messrs Kleinwort Benson to sell his units.

41 In his tax return for the year ending on 5 April 1990 Mr White declared the share option payment of £83,333.00 upon which capital gains tax was subsequently levied and paid. Later the capital gains tax assessment was vacated and replaced by an assessment to income tax under Schedule E. The £250,000 was declared by Group on Mr White's Form P11D as a benefit.

1989-90 - The emoluments of Mr Black

42 Mr Black's service agreement with Group, which was signed on 22 September 1986, expired after three years. At about the beginning of 1989 Mr Black formed the view that he did not wish to extend his service contract and instead wished to agree a bonus payment in respect of his contribution to Group's profits since 1986. On 15 September 1989 Mr Jones, as Chairman of Plc, wrote to Mr Black. The letter said that the service agreement with Mr Black would not be renewed and that any directorships with Group companies would terminate. It also said that Mr Black would not be entitled to share option arrangements. The letter continued:

"However, in the light of your valued employment with us, I would make the following suggestion:

1) You will receive a bonus for your work for this year equivalent to £370,000. ..."

43. The letter went on to mention an additional consultancy fee of £40,000, payable on 10 April 1990, for consultations on the jobs which Mr Black was handling and also the transfer of two company cars free of charge. The letter continued;

"The above payments are subject to agreeing with you a smooth handover of your current workload which we will shortly review together."

44. The letter concluded by asking Mr Black to sign a copy of the letter to confirm his agreement to the terms proposed in it. Mr Black did sign a copy of the letter and returned it to Mr Jones.

45. On 20 September 1989 Plc purchased 350,379 units in Kleinwort Benson Gilt Yield Trust for £370,000.00. Plc supplied the Inland Revenue with a copy of the minutes of a meeting of the board of directors of Plc. The date of the meeting had been altered in manuscript to read 21st September 1989. The minute recorded

the presence of the same directors and secretary as had been present at the meeting on 14 September 1989 and read:

"The following gross bonus in respect of the year to 31st March, 1990 was approved by the Board.

M BLACK £370,000

It was decided that the payment of this bonus should be conditional upon acceptance of payment in the form of units in an approved unit trust, to be transferred out of the company's name."

46. The minute was signed by Mr Jones as Chairman.

47. On or about 21 September 1989 Mr Orange explained to Mr Black that it would assist the company in avoiding national insurance contributions if he were to sign various documents taking the bonus in the form of unit trusts. He was told that it would not affect his personal position. On 21 September 1989 Mr Black signed a letter addressed to the Directors of Plc. The letter read:

"At the directors' meeting earlier today, a bonus of £370,000 was voted to me in respect of the year to 31 March. 1990.

I now write to confirm that I am prepared to accept the bonus to be paid in the form of units in a approved unit trust. I should be grateful if you would kindly arrange for the units to be transferred into my name."

48. On 21 September 1989 the 350,379 units were transferred to Mr Black. Mr Black left the company on 22 September 1989 and he sold the units on 17 October 1989 for £372,102.50.

1990-91 - The emoluments - Mr. White, Mr Green and Mr Brown

49. In late October 1989 Mr Jones was diagnosed with a heart condition and had a by-pass operation. He was away from work until January 1990. Mr White, Mr Green and Mr Brown with Mr Smith looked after the company while Mr Jones was away. The company did well and survived the recession in the property market which occurred at the end of 1989 and the beginning of 1990. On 16 January 1990 a meeting of the board of directors of Developments was held following which Mr White, Mr Green and Mr Brown with Mr Smith put forward a profit sharing arrangement to Mr Jones.

50. On 18 January 1990 Mr Jones sent a memorandum to each of the directors of Developments. At that time there were five directors of Developments, namely Mr Smith, Mr Orange, Mr Brown, Mr Green and Mr White. The memorandum was in terse terms and indicated that it was not the role of the directors of Developments to fix the remuneration packages of the directors. The directors of Developments had been asked to make recommendations for consideration by the board of Plc. After discussions with each of the directors of Developments Mr Jones would put a package to the board of Plc for formal approval.

51. On 6 February 1990 Mr Jones sent a memorandum to each of the five directors of Developments with copies to the senior partner and the Chief Executive of ABC. That memorandum began:

"With reference to our exchange of memoranda dated 16th and 18th January, 1990 and our subsequent meeting, I confirm:

1) For the financial year ending March 1990, £500,000 will be paid into the Directors' Profit Share Pool subject to the £7 million forecast being achieved. This sum to reduce by £10,000 in respect of each £100,000 shortfall to the target. It will be payable on 30 June 1990 or on receipt of audited accounts, whichever is later."

52. The memorandum went on to propose that each of Mr Smith, Mr Brown and Mr White should receive 22.5% of the pool, that Mr Green should receive 15%, and that Mr Orange should receive 17.5%, unless Mr Jones were formally notified of an alternative division by 14 February 1990. The memorandum gave no indication that the payments would not be made in cash.

53. On 14 February 1990 all five recipients of the memorandum of 6 February wrote to Mr Jones to say that they were all agreed that the proposed directors' profit share should be divided equally between them.

54. On 25 June 1990 Plc purchased 491,643 units in Kleinwort Benson Gilt Yield Trust for the sum of £500,000.00. On 27 June 1990 a meeting of the board of directors of Plc took place. The directors present were Mr Jones, the senior partner and the Chief Executive of ABC with Mr Orange as secretary in attendance. The minute read:

"The following gross bonuses in respect of the year to 31st March 1991 were approved by the Board due to the personal contribution of those listed to the company's profitability:

M WHITE £100,000

G GREEN £100,000

S BROWN £100,000

It was decided that ... payment of these bonuses should be conditional on each individual accepting payment in the form of units in an approved unit trust, to be transferred out of the company's name."

55. The minute was signed by Mr Jones as Chairman.

56. On 27 June 1990 each of Mr White and Mr Brown, and most probably Mr Green, signed a standard letter given to them by Mr Orange. The letter was addressed to the directors of Plc and read:

"I understand that at the directors' meeting earlier today, a bonus of £100,000 was voted to me in respect of the year to 31st March 1991.

I now write to confirm that I am prepared to accept payment of the bonus in the form of units in an authorised unit trust. I should be grateful if you would kindly arrange for the units to be transferred into my name."

57. On 28 June 1990 Mr White was appointed a director of Plc.

58. On 2 July 1990 Kleinwort Benson Unit Trusts wrote to each of Mr White and Mr Green and sent each a contract note dated 29 June 1990 indicating that the recipient had sold his units in Kleinwort Benson Gilt Yield Trust for £99,705.61. The letter informed each recipient that that amount had been transferred into his bank account. On 11 July 1990 Kleinwort Benson Unit Trusts wrote to Mr Brown and sent him a Unit Certificate dated 29 June 1990 certifying that Mr Brown was the registered holder of 98,329 units in a Gilt Yield Trust; the same letter informed Mr Brown that the amount of £98,329.00 had that day been transferred into his bank account.

The events subsequent to the transfer of the unit trusts

59. On 15 April 1991 the advisers of Plc wrote to the Inland Revenue. They said that 472,590 units were acquired by the company on 12 September 1989 and that the bonus was voted on 14 September 1989 and was conditional on it being satisfied in the form of units in an authorised unit trust. Additional units had been acquired on 20 September 1989 and on 25 June 1990 and payments had been voted on 21 September 1989 and 27 June 1990. On 17 July 1991 Notices of Determination under Regulation 29 of the 1973 Regulations were served by the Inland Revenue on Plc but were later withdrawn.

60. During the summer of 1990 Mr Orange told Mr Green that he (Mr Green) was liable for tax on the sum of £333,333.33 received in September 1989 and that if he did not pay it he would be liable for penalties and interest as well. In October 1990 Mr Green paid the sum of £132,280 to the Inland Revenue as that was the amount which he calculated was his liability. In July 1991 the Inland Revenue asked Mr Green how the payment which he had made should be allocated. Mr Green then asked for a repayment which he received. In June 1994 Mr Green was informed that the Inland Revenue had withdrawn the Notices of Determination under Regulation 29 which had been served on Plc and that he was to be assessed for the Schedule E tax. Mr Green paid the amounts due and submitted protective appeals.

61. On 19 November 1991 Mr Brown wrote to his tax advisers and said that an amount of £100,000 was transferred to him as unit trusts the previous year and that he understood that "the tax of the payment was or is to be paid for by Group, i.e. the £100,000 was a net transfer. On 24 June 1992 Mr Orange wrote to Mr Brown in connection with the arrangements for the termination of Mr Brown's employment with Plc. The letter referred to the bonus of £100,000 and stated that, as the bonus was provided in the form of a benefit in kind, Plc had not paid national insurance contributions or PAYE and that Mr Brown was personally liable to account for income tax on the benefit provided which had been recorded in his Form P11D for 1990/91. The letter continued by saying that if Plc were required to pay the tax it would seek reimbursement from Mr Brown of a maximum of £40,000. The letter concluded by asking Mr Brown to sign a copy of the letter to confirm his agreement to pay Plc any tax determined on the bonus. Mr Brown did not so sign.

62. On 19 October 1993 the then company secretary of Group, wrote to Mr White about the arrangements for the termination of his employment. The letter referred to the bonuses of £250,000 and £100,000 which had been provided and accepted as a benefit in kind. The letter asked Mr White to confirm that he would pay a sum equivalent to the tax if Group had to pay it. Mr White refused to so confirm. In November 1993 Mr White resigned as a director and was offered an ex gratia payment of £10,000.00 and some commissions if he signed letters confirming the termination of his share option agreements and providing an

indemnity for tax payments due in respect of the bonuses received. Mr White refused to sign those letters.

The law - the areas of agreement

63. There was a substantial amount of agreement by the parties on the law.

64. First it was agreed that, in section 203 of the 1988 Act, the words "payment of, or on account of, any income" were not limited to payments of cash. The words could include other transfers of valuable consideration, for example, payments by cheque, or by credit to a bank account, or by transfer of some other chose in action. *Garforth v Newsmith Stainless Limited* [1979] STC 129 was an example of the broader meaning of the word "payment".

65. Secondly, it was agreed that Regulation 2 of the 1973 Regulations defined the word "emoluments" as meaning the full amount of any income to be taken into account in assessing liability under Schedule E. Thus, the term "emoluments" encompassed the cash equivalent of benefits in kind. However, not every provision of a benefit in kind attracted the operation of section 203 because section 203 was not applicable to benefits in kind not involving "payments" by an employer. For example, the making of a company car available to an employee was not a "payment" and, although the cash equivalent was taxed, the cash equivalent was not "paid". Thus the provision of some benefits taxable under Schedule E as emoluments did not amount to the "payment" of those emoluments.

66. Thirdly, it was agreed that, for the purposes of section 203 and of the 1973 Regulations, "payment" was the transfer of money or of money's worth where quantified in money (e.g. cheque or bank credit). It was therefore critical to identify when, if at all, the recipient's entitlement to the payment of money arose. If, prior to the transfer of assets (such as units in unit trusts) the recipient had no legal entitlement to payment of money, the transfer of the assets would amount to the provision of a benefit in kind and the relevant cash equivalent would be a deemed emolument, for example under section 154 of the Taxes Act. However, such a transfer could not amount to the "payment" of that emolument. It was only if there were a pre-existing legal entitlement to money (or money's worth quantified in an amount of money) that satisfaction of that entitlement constituted "payment" for the purposes of section 203. In the absence of legal entitlement, taxability arose on the receipt of the asset following *Wilkins v Rogerson* 39 TC 344 at 352 and 354..

67. Fourthly, it was agreed that an employer could only be required to comply with section 203 and deduct income tax from payments of emoluments where it could be demonstrated that a legal entitlement arose in the hands of the employee to actual payment of a monetary amount. It was not enough to show that the employee wanted cash; preferred cash; expected to receive cash; or that an award was discussed in terms of cash prior to it being made formally by way of some other benefit.

68. Finally, it was also agreed that the four Appellants were not directors of Group or Plc at any material time. That was significant because the voting of bonuses by the board of Plc, whenever it occurred, did not result in any binding legal obligation to pay such bonuses. Accordingly, the Appellants had to establish, in respect of each bonus, that the award of units in a unit trust was made in satisfaction of a legally binding entitlement to money or money's worth quantified in money. The Appellants had to show a binding contractual promise to pay an

amount of money, supported by consideration moving from the promisee, and entered into by someone on behalf of the company who had authority unconditionally to bind the company to such a contractual promise. Mere discussion, hope or expectation that the company would make a payment in due course was insufficient. In order for section 203 to apply each recipient must have been entitled to sue for an ascertained amount of money and to have had his entitlement to that amount discharged by the transfer of an asset the value of which was quantified as that amount.

The arguments of the Appellants

69. For the Appellants Mr McKay argued that the evidence proved that, on the balance of probabilities, Mr Jones had actual authority or, alternatively, had apparent (or ostensible) authority to bind Plc and in exercise of that authority had entered into agreements to pay money to the Appellants. He cited *Bowstead & Reynolds on Agency* paragraph 8-013 at page 366; *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Limited* [1964] 2 QB 480; and *Inland Revenue Commissioners v Ufitec Group Ltd* [1977] 3 All ER 924 and referred to section 36 of the Companies Act 1985. Specifically, the memorandum of 18 January 1990 indicated that Mr Jones had either actual or ostensible authority to bind Group.

70. Mr McKay went on to argue that the evidence, including the minutes of the board meetings, proved that there were agreements by Plc to pay sums of money to the Appellants, which agreements were satisfied by the transfer of units in unit trusts of a like amount. Specifically, in September 1989 Mr White and Mr Green had share options and an expectation of realising value on a flotation; also the company had increased from nothing to £32M and Mr White and Mr Green had only been rewarded by modest salaries. There was always an expectation that the value of Group would be shared at some stage. Accordingly, some alternative means of extracting value for Mr White and Mr Green had had to be found. They were in the same position as Mr Black except that he left Plc and they remained. Turning to Mr Black's bonus, the letter of 15 September 1989 from Mr Jones to Mr Black recorded an agreement to pay a sum of money and there was no mention in that letter of unit trusts. Also, there was no need for a board meeting to vote for the bonus as the deal had already been done before Mr Black signed the letter of 21 September 1989 accepting that the bonus might be paid in the form of units in an approved unit trust. Also, the evidence was that the bonus was not conditional on a smooth handover as that had already taken place. Turning to the exchange of memoranda in February 1990 Mr McKay argued that "no strings were attached" to the agreement to pay the bonuses and Mr Brown had spent the money immediately because he regarded the deal as having been done.

71. Finally, Mr McKay argued that, as the obligation to deduct tax was that of Plc, it followed that the amounts received by the Appellants were received net of tax.

The arguments of the Inland Revenue

72. For the Inland Revenue Mr Brennan argued that the Appellants had not been entitled to sue for an ascertained amount of money; accordingly what they got was benefits in kind and they were liable to pay Schedule E tax on the relevant cash equivalent as on any other benefits in kind.

73. Specifically, Mr Brennan argued that there was no evidence that Mr Jones had actual authority to enter into contracts for tax-paid bonuses. Ostensible authority would only apply if there was a holding out by someone with actual authority

(namely the board) that Mr Jones had ostensible authority to bind the board. He relied upon *Freeman v Lockyer* at pages 502 to 505 and argued that Mr Jones had not been held out by the board as having authority to enter into lump sum agreements (tax paid). Mr Jones did not control the company because ABC had 50% of the shares and the holders of the options had the right to subscribe for more. Even if Mr Jones controlled the board he would have been unwise to ignore the interests of ABC. The documentation supported the view that major matters of remuneration were reserved to the board.

74. Mr Brennan concluded that all the evidence pointed to the conclusion that the bonuses were discretionary and that the entitlement arose only on their receipt. Specifically, the agreement with Mr Black on 15 September 1989 was conditional on a smooth handover. As far as the 1990 bonuses were concerned Mr Brennan argued that the memoranda of 6 and 14 February 1990 did not give rise to a contractual commitment. The company was not obliged to pay the Appellants out of the pool and there was no entitlement until receipt. On all occasions the Appellants had agreed to accept their bonuses in the form of unit trusts so what they got was benefits in kind and they were liable to pay the tax.

Reasons for Decision

75. The arguments of the parties raised the following questions:

(1) did Mr Jones have authority to bind Group and Plc?; and

(2) does the evidence establish that each Appellant had a pre-existing entitlement to money (or money's worth quantified in an amount of money)?.

(1) - Did Mr Jones have authority to bind Group and Plc?

76. The first question is whether Mr Jones had had actual or ostensible authority to bind Group and Plc. Although all the bonuses were paid by Plc, negotiations for the 1989 bonuses most probably started before Group became Plc. In considering whether Mr Jones had authority to bind Group or Plc a reference is first made to the relevant facts.

77. Mr Jones established Group in 1983 when he was described as the only shareholder and chief executive. He recruited Mr White in 1984 and later the other Appellants. Although Mr Brown's letter of appointment was signed by Mr Orange, it referred to an earlier letter from Mr Jones and the letter to Mr Brown of 23 March 1988 about an increase in salary was signed by Mr Jones. Mr Jones had the discussions with Mr Green in 1986 when Mr Green was head-hunted. He signed the option agreements in September 1986 on behalf of Group. He commenced discussions with the option holders in 1987 at the time of the sale of shares to ABC. After the sale of the shares to ABC Mr Jones was described as Chairman and Chief Executive of Group. After Group became Plc Mr Jones remained as Chairman and Chief Executive. The discussions about the 1989 bonuses began early in 1989 and were conducted with Mr Jones. Mr Black's discussions about his leaving arrangements were conducted with Mr Jones. The negotiations about the 1990 bonuses were conducted with Mr Jones.

78. Some of the documentary evidence indicates that matters for remuneration were for decision by the board of Group or Plc and that the Appellants were aware of that. The service agreements with Mr White and Mr Black of September 1986 indicated that the amount of salary would be reviewed annually by the board of Group. All the bonuses were minuted as having been voted by the board of Plc.

Mr Jones's memorandum of 18 January 1990 indicated that it was the not role of the board of Developments to make decisions about remuneration and that Mr Jones would put a package to the board of Plc "for formal approval". Thus the documentary evidence leads to the conclusion that it was the board of Group or Plc which formally approved the remuneration of the Appellants but that leaves open the question as to whether Mr Jones had ostensible authority to negotiate agreements with the Appellants as the director did in Ufitec. In this connection the oral evidence of the witnesses is relevant.

79. The evidence of Mr White was that Mr Jones was somewhat autocratic and that "what he said went". He was never over-ruled by the board of Group who were mainly non-executive directors. That position continued after the sale of the shares to ABC and also after Group became Plc. Decisions about salary were made by Mr Jones who, however, "hid behind the board for unwelcome decisions". I accept that evidence. The evidence of Mr Green was that "Mr Jones was Group". Even after Group became Plc, and Mr Jones had advisers on the board, he continued to have the reins in his hands on all issues. Mr Jones controlled the company and never relinquished total control. Mr Jones always said the right thing and could be quite convincing; he was able to convince people that they could rely on him. I accept that evidence. I also accept that Mr Jones relied upon the senior partner for advice on property dealing and would not make a move on such matters without consulting the senior partner.

80. In the light of that evidence the authorities cited by the parties can be considered to see what principles they establish.

81. Bowstead & Reynolds at paragraph 8-013 states that where a person, by words or conduct, represents or permits it to be represented that another person has authority to act on his behalf, he is bound by the act of that other person with respect to anyone dealing with him as an agent on the faith of any such representation, to the same extent as if such other person had the authority that he was represented to have, even though he had no such actual authority.

82 In Freeman & Lockyer (1964) one of the directors of a company instructed a firm of architects to undertake certain work. The articles of association of the company provided that a managing director might be appointed but none was appointed. The Court of Appeal held that, although the director had no actual authority to instruct the architects, he had ostensible authority as he acted throughout on behalf of the board. His act in engaging the architects was within the ambit of the authority of a managing director and the architects did not have to inquire whether he was properly appointed. At page 502 Diplock L J said:

"An 'apparent' or 'ostensible' authority ... is a legal relationship between the principal and the contractor created by a representation, made by the principal to the contractor, intended to be and in fact acted upon by the contractor, that the agent has authority to enter on behalf of the principal into a contract of a kind within the scope of the 'apparent' authority, so as to render the principal liable to perform any obligations imposed upon him by such contract. To the relationship so created the agent is a stranger. He need not be (although he generally is) aware of the existence of the representation but he must not purport to make the agreement as principal himself. The representation, when acted upon by the contractor by entering into a contract with the agent, operates as an estoppel, preventing the principal from asserting that he is not bound by the contract. It is irrelevant whether the agent had actual authority to enter into the contract."

83 At page 506 Diplock LJ set out the four conditions which had to be satisfied. These were: that a representation that the agent had authority to enter into the contract was made to the contractor; that the representation was made by a person who had actual authority to manage the business of the company; that the contractor was induced by such representation to enter into the contract; and that the company was not deprived by its memorandum or articles of association of the capacity to enter into the contract or to delegate authority to enter into the contract to the agent.

84 From that authority I derive the following principles with reference to the facts of this appeal. For Mr Jones to have ostensible authority to bind Group or Plc there must have been a representation by Group or Plc that Mr Jones had authority to bind them; that representation must have been made by a person with the actual authority of Group or Plc; the Appellants must have been induced by Mr Jones's representations to enter into the contracts; and Group or Plc must have the capacity to enter into the contracts with the Appellants. It is also relevant that the agent (Mr Jones) must not have purported to make the agreements as principal himself. Also, if the act of a director (Mr Jones) is within the ambit of his authority it is not necessary to inquire whether he had actual authority.

85 In *Ufitec* (1997) liability for stamp duty depended upon whether an agreement had been signed within two years of the company's incorporation. That depended upon whether the chairman and majority shareholder had authority to sign the agreement. May J held that, although the chairman might not have had actual authority to enter into the agreement, he had ostensible authority to do so; the board of the company, by its conduct in permitting him to conduct the negotiations, had represented that he had authority to enter into the agreement and the company was estopped from denying that he had the requisite authority.

86. Applying those principles to the facts of the present appeal I find that the boards of Group and Plc, by their conduct in permitting Mr Jones to undertake negotiations and correspondence on all matters relating to recruitment and remuneration, represented that he had authority to enter into agreements for remuneration. The Appellants relied on the fact that Mr Jones had such authority and entered into agreements with him. Group and Plc had the capacity to enter into such agreements. Mr Jones did not purport to make the agreements as principal himself. And the acts were within the ambit of his authority as Chairman and Chief Executive. It is also significant that the acts of Mr Jones were in fact subsequently ratified by the board of Plc.

87. I therefore conclude that Mr Jones had ostensible authority to bind Group and Plc.

(2) Does the evidence establish that each Appellant had a pre-existing entitlement to money (or money's worth quantified in an amount of money)?

88. The second question is whether the evidence establishes that each Appellant had a pre-existing entitlement to money (or money's worth quantified in an amount of money).

89. It is convenient to consider separately :

(a) the receipt by Mr White and Mr Green of the bonuses of £250,000 each in September 1989;

(b) the receipt by Mr Black of the bonus of £370,000 in September 1989; and

(c) the receipt by Mr White, Mr Green and Mr Brown of the bonuses of £100,000 each in June 1990.

90. However there is one argument of Mr McKay which is general to them all and that concerns the expectation of each recipient to a share in the profits. The exchange of letters in 1983 prior to Mr White's joining Group were expressly subject to a future agreement of a satisfactory profit sharing formula. Mr Green gave evidence, which I accept, that there was an expectation which was almost a right that the employees would share in the growth of the company. Mr Black joined Group because he had the promise of a stake in the company. The letters to Mr Brown of 12 February 1987 and 23 March 1988 indicated that there would be rewards in line with profitable growth. I accept the evidence of Mr Smith that he and the four Appellants contributed to the growth in Group but that this was not immediately recognised by Mr Jones who frequently made promises which he did not keep. On the other hand all four Appellants were given share option agreements, three in 1986 and Mr Brown in 1988.

91 I accept that on recruitment and later each of the Appellants was given some expectation of a future share in profits but, on the evidence before me, I find that such expectations were not sufficiently specific to constitute an entitlement. Even Mr White, whose engagement was subject to a future agreement of a satisfactory profit sharing formula, had no specific entitlement until such formula was agreed.

92. In the light of that conclusion the evidence as to each of the bonuses can be considered.

(a) Mr White's and Mr Green's bonuses of £250,000 in September 1989

93. The evidence establishes that discussions about rewards for Mr White, Mr Black and Mr Green commenced early in 1989 and continued through the first few months of 1989. Some time before September an amount of £1M had been allocated to reward these three employees. Each of Mr White and Mr Green were to receive £333,333.33 being £83,333.33 for agreeing to amend their share option agreements and £250,000 as a bonus. Mr White wrote his memorandum to Mr Orange on 11 September 1989 with the amended share documentation and a request that the whole sum of £333,333.33 be paid into his bank account. Mr Orange told the recipients that they would receive the bonuses in the form of units in a unit trust and they agreed to this. The units were purchased on 12 September and the board of Plc met on 14 September and the bonuses were voted conditional upon acceptance as units in units trusts. These were accepted by the recipients. The units were transferred to them; they sold the units and the money was paid into their bank accounts. The sums of £83,333.33 were paid in cash.

94. In evidence which I accept Mr White said that the agreement to pay his bonus was not said to be subject to the approval of the board. If he had known at the time that the arrangement would have resulted in his having a significant tax liability he would not have agreed to it and would have insisted on receiving cash; if he had not been paid the amount agreed he would have left the company and sued for the money due. Mr White's memorandum of 11 September 1989 supports the conclusion that Mr White considered that he was entitled to the whole sum. In evidence which I accept Mr Green confirmed that the agreement to pay his bonus was not said to be subject to the approval of the board; he

considered that a commitment had been made and that, if the money had not been paid, he would probably have taken steps to recover it.

95. It is also relevant that the allocation of the sums of £333,333.33 to Mr White and Mr McNicholas must have been made before Mr White wrote his memorandum of 11 September 1989.

96. On the evidence before me I conclude that Mr White and Mr Green did have a pre-existing entitlement to be paid the bonuses of £250,000 before the board meeting of 14 September 1989.

(b) - Mr Black's bonus of £370,000 in September 1989

97. The evidence establishes that at the beginning of 1989 Mr Black and Mr Jones entered into discussions about the arrangements for the termination of Mr Black's employment and the heads of agreement were contained in Mr Jones's letter of 15 September 1989. A copy of that letter was signed as an agreement by Mr Black. In evidence which I accept Mr Black said that he regarded the letter of 15 September 1989 as a contract between himself and Plc and if he had not been paid the bonus he would have sued Plc. At that stage he expected the whole bonus to be paid in cash. At the date of the letter all his remaining work had been done.

98. Mr Black left the company on 22 September 1989 when his three year service agreement expired. It was always known that the service agreement had three years to run and the date upon which it would expire. Mr Black did not want to renew it. It is therefore entirely credible that he negotiated the terms of his departure well in advance. It is extremely unlikely that the final agreement would have been left until the board meeting of 21 September 1989 which was the day before his departure.

99. On the evidence before me I conclude that Mr Black did have a pre-existing entitlement to be paid his bonus before the board meeting of 21 September 1989.

(c) Mr White's, Mr Green's and Mr Brown's bonuses of £100,000 each in June 1990

100 The evidence establishes that there was an exchange of memoranda in February 1990 between Mr Jones and Mr White, Mr Green and Mr Brown. The sum of £500,000 was to be paid into a directors' profit share pool subject to the £7M forecast being achieved. There was no indication that the payments would not be in cash. Copies of the memorandum were sent to the senior partner and the Chief Executive of ABC, the other directors of Plc.

101. I accept the evidence of Mr White that the recipients had been promised a share in profits which took a long time to settle. When it was settled it was a commitment as far as he was concerned. After the memorandum had been signed he went to spend the money as he was confident that it would be paid. He and the other recipients understood and expected that the bonus was to be a cash bonus. They had a deal with Mr Jones. Mr White regarded the exchange of memoranda as a binding agreement between himself and the company on which he could have sued. I accept the evidence of Mr Green that, when he signed the memorandum of 14 February 1990, he did not believe that any other approval to the payment of the profit pool was required. I accept the evidence of Mr Brown that, if he had not received the £100,000, he would have sued the company

because on the strength of the memorandum from Mr Jones he had obtained a big overdraft from his bank for a large purchase.

102. I also accept the evidence of Mr White and Mr Smith that at the time that the profit pool was proposed there was no prospect of a shortfall and the profit figure was certain to exceed £7M; the £7M forecast had already nearly been achieved and, because of the way in which Developments worked, it was possible to tell a year in advance what the level of profit would be. The condition of the £7M profit had been satisfied.

103. On the evidence before me I conclude that Mr White, Mr Green and Mr Brown did have a pre-existing entitlement to be paid their bonuses in cash before the board meeting of 27 June 1990.

Conclusions

104 Those conclusions mean that the decision on the agreed question for determination in the appeal as argued by the parties is that Plc ought to have deducted income tax under section 203 of the 1988 Act and the 1973 Regulations before providing the units to the Appellants. That means that I do not have to decide whether the recipients were entitled to receive their bonuses net of tax. However, as I heard evidence on this point I record my views

105. Mr White's evidence was that the 1989 bonus of £250,000 was to be net of tax and national insurance contributions. Both the £83,333 and the £250,000 were net payments. The amount of the payments was agreed after seven or eight months of negotiations which started at higher levels. Mr Green's evidence was that his understanding was that he would receive the 1989 bonus net after deduction of tax.

106. The 1989 bonus payments to Mr White and Mr Green were part of a total agreement which included the payments of £83,333.33 for amending their share option agreements. Those payments were accepted as gross payments and Mr White at least paid tax on the £83,333.33. Also, whatever the recipients may have understood, the documentary evidence does not support the view that the payments were to be of such an amount as, after the deduction of income tax, would amount to what was received. In my view, Mr White and Mr Green were entitled to £250,000 each and, if tax had been deducted by Plc under section 203 when the bonuses were paid, then the recipients could not have demanded more.

107. The 1989 bonus payment to Mr Black was also part of a total agreement reached upon his departure from Plc. In evidence Mr Black said that he expected it to be net of tax; his understanding at the time was that, as had been the case throughout his employment with Group, the bonus would be paid as part of his income and the company would deal with any tax issues. However, income tax is normally deducted when payments are made and there was no documentary evidence to support the view that Plc had agreed to pay the £370,000 net of tax. In my view Mr Black was entitled to £370,000 and, if tax had been deducted by Plc when the bonus was paid, he could not have demanded more.

108. Turning to the 1990 bonuses of £100,000 paid to Mr White, Mr Green and Mr Brown, in evidence Mr White disputed the word "gross" in the board minute of 27 June 1990 and said that the payments were to be net so that each recipient should have £100,000 in his possession after tax. Mr Smith also gave evidence that he thought that this bonus was net of tax. However, the documentary evidence does not support that view. The directors' profit pool was £500,000 and

each of the five was to get £100,000. There is no mention that tax would be paid in addition. In my view each of the three recipients was entitled to £100,000 and, if tax had been deducted by Plc, they could not have demanded more. In reaching this view I have not relied upon the inclusion of the word "gross" in the board minute. My views would have been the same if that word had not appeared.

109. This decision has been given on the questions raised by the arguments of the parties. However, in my view it would have been possible to approach the appeal from another direction with the same result. Section 203 applies to all payments of emoluments; the word "payments" is not restricted to payments in cash; the word "emoluments" includes perquisites or profits; the words "perquisites or profits" include anything that can be turned into money (whereas anything that cannot be turned into money is a benefit in kind strictly so called); the units in the unit trusts could be, and were, turned into money and so they were perquisites or profits; and perquisites or profits can be paid (although benefits in kind cannot be paid). It follows that the units were emoluments and that they were paid. For that reason also section 203 applies.

Decision

110. My decision on the agreed question for determination in the appeal is that Plc ought to have deducted income tax under section 203 of the 1988 Act and the 1973 Regulations before providing the units to the Appellants.

111. Accordingly, the appeal is allowed.

112 As requested by the parties this is a decision in principle. If it is not possible for the amounts of the assessments to be agreed then either party has liberty to apply for a further hearing at which the amounts of the assessments will be determined.

Chairman's name: use right arrow to move to starting point

DR A N BRICE

SPECIAL COMMISSIONER

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