

Bonus Payment in kind – Whether employee "made good"  
to employer tax due – FA 1994 s.144A (c)

THE SPECIAL COMMISSIONERS

KENNETH S FERGUSON, THOMAS H FERGUSON, Appellants

DAVID H FERGUSON

- and -

THE COMMISSIONERS OF INLAND REVENUE Respondents

Special Commissioner: MR T G COUTTS QC

Sitting in Edinburgh on 17 October 2000

Mr Colin Tyre QC, for the Appellants

Mr D Wishart of the Inland Revenue Solicitor's Office  
(Scotland), for the Respondents

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DECISION

INTRODUCTORY

facts in one were to be treated as the facts in the others. Accordingly the Commissioner heard evidence from the appellant Mr Kenneth Ferguson out of the three the Appellants, from Mrs Douglas, their Bookkeeper, and from Mr Michael Blythe, C.A., as expert witness. For the Crown Mr Wishart led Mr E Fairley, C.A. as expert witness. A Statement of Agreed Facts had been prepared and was before the Commissioner.

The question to be determined was able to be stated shortly and it was whether the Appellants had "made good" to the Company of which they were Directors the sum of income tax chargeable under PAYE in respect of payments to them by the Company of a bonus in the form of a tradable asset.

FINDINGS IN FACT

From the Statement of Agreed Facts and the evidence heard the following facts are found to have been established;

1. The Appellants are Directors of Fernan (Sundries) Limited, (hereafter referred to as "the Company").
2. With a view to avoiding the payment of National Insurance Contributions on bonus payments the Company resolved at a meeting of Directors to purchase 782.526 ounces of rhodium metal on 21 December 1995.
3. On 22 September 1995 the Company sent an order to Union CAL Limited to purchase that amount of rhodium.
4. The Company resolved to award varying amounts of rhodium to each of the Appellants representing a bonus in respect of the Company's accounting year ended 31 December 1994.
5. The metal was held in a bonded warehouse in Rotterdam.
6. The Company on 25 September 1995 instructed Union CAL Limited to transfer the ownership of the rhodium to the Appellants.
7. The Appellants immediately instructed the sale of the amounts of rhodium allocated to them.
8. On 26 September 1995 the proceeds from the sale were paid to the Appellants. The proceeds were then credited to the Company's current account with the Clydesdale Bank.
9. The receipt of this sum was subsequently entered in the books of the Company by Mrs Douglas by way of debit to the bank account and credit to the Directors loan account.
10. Mrs Douglas did this when dealing with the reconciliation necessary in her journal entries by creating an entry on 21 October 1995 bearing a date 30 September 1995. Mr Kenneth Ferguson oversaw these adjustments and corrected them. They had been created by Mrs Douglas to indicate both credits and debits on the Directors loan account and a correction was made on 26 October 1995 to reflect the fact that the sum shown as drawn from the Bank was removed from the debits shown on Directors loan account. Accordingly insofar as funds were placed by the Appellants in the Company bank account they were not allocated to any specific account in the Company books until the said dates.
11. Various errors were made thereafter in relation to these sums by Mrs Douglas by the Appellant, Mr Kenneth Ferguson, and by the Auditors and Accountants of the Company who produced a balance sheet which was accepted before the Commissioner as erroneous. That balance sheet had been signed as true and accurate by the

Directors of the Company on 30 April 1996.

12. The Appellants each all along intended that the Company would be put in funds to make the payment of PAYE to the Revenue which they knew required to be made in relation to this form of payment of a bonus.

13. Mr Kenneth Ferguson was erroneously advised prior to the metal transaction taking place that the tax would be payable on 16 April 1996. He took no steps other than annotating the Directors loan account with the sums which he anticipated were due to be paid on that date. He took no steps to isolate any sum in the books of the Company as outstanding to the Revenue.

14. Mrs Douglas utilised the Directors loan account as a home for unusual transactions pending clarification. This use of a Directors loan account is common and acceptable practice.

15. The Auditors and Accountants failed to note the fact that the Directors loan account did contain a sum due to the Revenue and the Company accounts for the year in question showed a sum in Directors loan account which was enhanced by the unpaid tax and a sum in the entry for taxes due which understated the tax liabilities.

16. The Company accounts, accordingly, did not show a true and fair picture although the net effect in relation to the total sum due unto creditors was accurately conveyed.

17. The due tax was paid in April 1996 by the somewhat unusual method of three cheques being sent by the Appellants to the Revenue in relation to the amounts which they were due. These cheques were Company cheques.

## THE LAW

18. The applicable law was not in issue. It was that the Company was due to make payment at the end of the month following the payment to the Directors of the bonus of the appropriate amount of PAYE to the Commissioners. Since the payment was made by way of tradable assets Section 144 A of the Taxes Act 1988 as amended applied. By paragraph 1 of that Section:

In any case where,

"(a) an employer is treated as having made a payment of income of an employee which is assessable to income tax under Schedule E

(c) and the employee does not before the end of the period

of 30 days from the date on which the employer is treated as making that payment, make good the due amount to the employer, the due amount shall be treated as income of the employee which arises on the date mentioned in paragraph (c) above and is assessable to income under Schedule ."

Accordingly in relation to the transfer to the Appellants of rhodium they were required before 25 October 1995 make good the due amount of tax to the employer failing which it would be assessable on the employee.

#### THE ASSESSMENT

19. Because of the state of the Company books the Commissioners made an assessment on the Appellants of the tax due in relation to the rhodium transaction. They had, be it noted, received payment of an equivalent amount from the Company albeit in the subsequent tax year.

#### CONTENTIONS FOR THE APPELLANTS

(i) that, when the proceeds of the sale of the rhodium became available, it was his understanding that a sum would be used to pay the PAYE liability when it fell due and the balance would be credited to his loan account;

(ii) when the company received the free proceeds of sale on 26 September 1995, the full amount was incorrectly credited to the Appellant's loan account;

(iii) that, as the free proceeds of sale were paid to the company in the first instance on 26 September 1995, the Appellant did in fact make good the tax due under the PAYE regulations within 30 days of the payment of the rhodium; and

(iv) the amount of tax due in respect of the payment of the rhodium is not assessable on him in terms of section 144A(1).

#### CONTENTIONS BY THE COMMISSIONERS

(i) that the Appellant and not the company was entitled to the free proceeds of sale of the rhodium on 26 September 1995;

(ii) that, by crediting the full amount of the proceeds of sale of the rhodium to the Appellant's loan account on 26 September 1996, the company did in fact make payment of the full amount to the Appellant on that day;

(iii) that, as no deduction was made from the Appellant's loan account in respect of the tax due on the payment until

15 April 1996, the Appellant did not make good the tax due to the company within thirty days from the date on which payment was made to him on 25 September 1995 in terms of section 144A(1)(c) of ICTA 1988; and

(iv) the amount of tax in respect of the payment, namely £19,948 is assessable under Schedule E as the income of the Appellant for the year 1995/96 in terms of section 144A(1).

#### APPELLANTS ARGUMENT ON THE FACTS

20. In the events which happened the Company made the unilateral mistake with regard to its internal accounting treatment of the sum which they had received from the Appellants. However the fact was that the Company was put in funds and that mistake of the Company's does not prevent the Appellant from being treated as having made good the tax due on his benefit.

#### ARGUMENT FOR THE COMMISSIONERS

21. The sums having been placed in the Directors loan account such sums were unreservedly at the disposal of the Directors and the Company had no claim upon them until the matter was rectified. The timescale within which one should look at

the transaction was between 26 September and 25 October 1995. On the facts the Company did not have made good the amount of tax.

#### DECISION

22. The Commissioners had no hesitation in accepting as reliable and credible the evidence given by Mr Kenneth

Ferguson and Mrs Douglas. The net effect of their evidence was that there had been a mistake in the treatment of funds of which the Company had been put in possession by each of the Appellants following the scheme to avoid paying National Insurance Contributions. The matter was considerably complicated and muddled by the erroneous advice given to and accepted by the Appellants as to the due date of payment of tax. It can readily be accepted, and I do accept, that had Mr Ferguson known that the Company required to make the payment in October he would have seen that payment was made and would not have assented to the correction made to the Company's banking balances or the entries in the Directors loan account. No doubt he should have isolated in the loan account more specifically the tax due but the matter was not surreptitious or clandestine. It was known to all the Directors and accordingly to the Company that the funds which were in the Directors loan account were not theirs to dispose of but were in truth the Company's and that they were merely being held there pending the due date of payment of tax erroneously thought to be April 1996. While perhaps in theory, monies in the Directors loan account were available to be drawn on by the Directors, I have no hesitation in finding that this, in this particular case, would not and indeed could not have happened. It follows that on the evidence I find that the Appellants did make good the tax due in terms of 144A(1)(c) and that the assessments upon them should be reduced by the appropriate amounts.

23. Before passing from the matter finally it is recorded that this entire event took place because of inaccurate accounting and inappropriate advice. Although the true facts have now emerged at the hearing the Commissioners were entitled to rely upon the state of the audited accounts signed by the appellants in conducting their affairs. It perhaps followed from that that no suggestion was made at the hearing of any expenses being due. Such a suggestion would be inappropriate. Each party will bear their own costs.

24. I accordingly direct that the assessments on the appellants for the year 1995/96 be reduced as follows:

- (1) David W Ferguson by £19,948
- (2) Kenneth S Ferguson by £44,666
- (3) Thomas H Ferguson by £31,382

SPECIAL COMMISSIONER

T G COUTTS QC

Date of Release: 14<sup>th</sup> November 2000

SC 3004-6/2000