Corporation tax - whether value contributed to Employee Benefit Trusts was deductible for corporation tax purposes - whether director was chargeable to income tax on benefits made available to him - if there was a PAYE liability on the companies, whether that could be traced to the director under Regulation 72 - whether the corporation tax deduction (if allowable on general principles) was denied by paragraph 1 Schedule 24 FA 2003 in the event that the benefits were not taxable as emoluments or earnings of the director - Corporation tax appeal dismissed - Income tax appeal allowed

FIRST-TIER TRIBUNAL **Reference nos: TC/2010/05154**
TC/2010/05275
TC/2011/00564
TC/2011/00566

TAX CHAMBER

SCOTTS ATLANTIC MANAGEMENT LIMITED
(in members' voluntary liquidation)

SCOTTS FILM MANAGEMENT LIMITED

-and-

JOHN DRYBURGH (in bankruptcy)

Appellants

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS
Respondents

Tribunal: JUDGE HOWARD M. NOWLAN
GILL HUNTER

Sitting in public at 45 Bedford Square in London on 18 – 22 February and 1 March 2003 and at Field House, Breams Buildings in London on 18 and 20 March 2013
Andrew Thornhill QC and Edward Waldegrave, counsel on behalf of the Appellants
James Sheehan, counsel, on behalf of Mr. Dryburgh's trustee in bankruptcy
Richard Coleman QC, James McClelland and David Yates, counsel on behalf of the Respondents

DECISION

Introduction

1. These Appeals involved another case raising the question of whether companies contributing substantial value into Employee Benefit Trusts ("EBTs") could sustain their claims for corporation tax deductions for the cost of funding those benefits, and whether the companies (and indirectly the directors) could simultaneously establish that there were no Pay As You Earn ("PAYE") liabilities in respect of the benefits provided to the directors.

2. Earlier cases have established that on appropriate facts those two objectives can be achieved, albeit that in addition to the general rules governing when corporation tax deductions are due, companies implementing these schemes have for some time had to avoid the impact of one of the various provisions that have been in force from time to time that have specifically sought to deny corporation tax deductions whenever the directors or employees enjoying the benefits have escaped income tax and PAYE and National Insurance Contribution ("NIC") liabilities and deductions.

3. These Appeals raised the question of whether the particular mechanics involved in making the contributions to the EBTs succeeded in escaping the corporation tax disallowance specifically provided for by paragraph 1 Schedule 24 Finance Act 2003 ("paragraph 1 Schedule 24"). In addition to that issue, however, there are numerous other points that we have to decide. These include:

- contentions by HMRC that corporation tax deductions should be denied on various fundamental grounds, distinct from the specific provision in paragraph 1 Schedule 24, some of these relating to HMRC's claim as to the real reason for the making of the contributions in this case, and some attributable to the specific mechanics adopted in the effort to avoid the application of paragraph 1 Schedule 24;
- contentions by HMRC that PAYE should have been deducted because the extraordinary delays that occurred in vesting the contributed funds directly into the hands of the EBTs, and consequently leaving them in the hands of companies in which the two principal intended EBT beneficiaries were actually the directors, meant (according to HMRC's claim) that the funds in those companies were "unreservedly at the disposal of the directors", such that the directors should be treated as having been entitled to the relevant moneys and as having received "payment" for income tax and PAYE purposes; and
- claims by HMRC that a considerable number of mistakes had been made in implementing the schemes, and that these mistakes undermined the Appellants' various contentions.

4. Both Appellant companies, Scotts Atlantic Management Limited ("SA") and Scotts Film Management Limited ("FM") made contributions into EBTs. SA contributed £7,636,000 indirectly into one EBT ("SA EBT") in transactions effected on 5 to 7 April 2004; FM contributed £250,000 indirectly into its first EBT ("FM EBT") around 15 December 2003 and £1,039,000 indirectly into its second EBT ("FM 2004/5 EBT") on 1 November 2004. At these various dates, none of the assets were directly held by the EBTs and it was approximately six years before the assets

were directly contributed into the trusts themselves. Ignoring the detail, the vast majority of the amounts contributed were lent to the two main shareholders/directors in roughly equal proportions. Some of these loans even pre-dated the contributions into the EBTs; some were made almost immediately the contributions were made, and others were made when contributed assets became "free and available" to be lent.

The format of this Decision

5. Since the Appeals involved three different EBTs, complex facts in relation to the way that one of the EBTs was funded, and the Appeals also involved numerous individual claimed failings in the implementation of the schemes, it is relatively difficult to explain the facts and the issues clearly. In view of this, we will now summarise the matters that we will address, and the order of dealing with them. We will thus deal with:

- a short summary of the background facts, albeit that this will be amplified in relation to each point in respect of which a decision needs to be made when we summarise the respective contentions of the parties concerning the particular point;
- an indication of the most fundamental point in contention between the parties, giving some initial facts which we consider to be relatively incontestable in relation to that fundamental dispute between the parties;
- an indication of other cases involving some at least of the same parties as the Appellants in these present Appeals, and the relationship between those cases and the present Appeals;
- the terms of paragraph 1 Schedule 24, and the steps that the Appellant companies implemented with a view to avoiding the corporation tax disallowance designed to result from funding EBTs and simultaneously eliminating PAYE tax and NIC liabilities (the summary of steps at this point ignoring the actual detail and just postulating ideal facts without implementation defects);
- the detailed manner in which the scheme was implemented by SA on 5 to 7 April 2004, and the various detailed points of challenge in relation to that implementation;
- the detailed manner in which FM funded two separate EBTs in, respectively, December 2003 and November 2004, again indicating a particular point of challenge in relation to the December 2003 transactions; and
- the basic facts in relation to the delays in vesting the assets contributed into various Newcos into the direct ownership of the three EBTs, and the facts material, therefore, to HMRC's claim that the directors' powers of control over the moneys at that interim stage sustained HMRC's contention that the moneys in the Newcos were "unreservedly at the disposal of the directors".

6. We will then comment generally on the evidence, particularly that given by Mr. Dryburgh.

7. We will then deal with each point of contention between the parties, expanding on the facts as required, summarising the contentions of the parties, and giving our decision on each point in turn. Some of the points will be rendered irrelevant by

conclusions on other matters, but since there may be an appeal against our decision on any of the individual points, we will deal with every point.

The background facts in outline

8. In this section we will summarise the background facts, and those relevant to the trading in the years 2003 and 2004.

9. Mr. Dryburgh, born in 1953, had trained as an accountant, and had been a tax partner dealing mainly with private clients at Messrs Rutherford Manson Dowds, and Deloitte & Touche, with which the former firm merged.

10. In 2000, Mr. Dryburgh presumably resigned from Deloitte & Touche and set up various companies, and others at later dates, the name of all of them commencing with the name "Scotts". The detailed names then referred either to "Private Clients", "Film" and "Media" Management, or "Atlantic".

11. We certainly understand from the facts summarised in a Scottish case to which we will refer below, that in 2001 the various Scotts companies were trading quite successfully, and generally conducting the various strands of tax advisory business that we are more directly concerned with in the 2003 to 2004 period to which these present Appeals relate. The facts that emerged in the Scottish case were that one of the earlier companies paid dividends to a then minority (30%) shareholder; it then made substantial contributions to an EBT for the benefit of the majority 70% shareholder, Mr. Dryburgh, and it then transferred the assets and liabilities of its business to another Scotts company. The present significance of the Scottish case is that, on the one hand, as the Respondents point out, the liquidator of the 2001 company was making claims against Mr. Dryburgh to the effect that he had wrongly stripped the company of assets, such that it was unable to satisfy its creditors, and the Respondents claim that facts of that nature indicate that the earlier case was a blueprint for what happened in relation to SA and FM (SA in particular) in the present case. On the other hand, it is instructive to note that the EBT scheme implemented to pass the profits attributable to Mr. Dryburgh to EBT trusts on behalf of Mr. Dryburgh also had many of the attributes of the schemes implemented by SA and FM. The scheme in that earlier case was certainly implemented after at least general tax advice on EBT matters from Mr. Andrew Thornhill Q.C. ("Mr. Thornhill"); it admittedly involved only EBT payments to the one director/shareholder and not the minority shareholder; but the detailed steps of the earlier scheme designed to circumvent the then provision designed to disallow the contributions to the contributing company when computing its taxable profits for corporation tax purposes, were identical to the steps adopted by SA and FM in the present case.

12. By 2003 to 2004, there were several active Scotts companies, but the two that we are concerned with were SA and FM. By 2003, it seems that the person who had held the 30% shareholding referred to in the previous paragraph was no longer involved, but Mr. Dryburgh had then been joined by a Mr. Andrew Somper ("Mr. Somper"). Mr. Dryburgh and Mr. Somper each owned 50% of the shares of Scotts Atlantic LLP, and it was that LLP that owned the two companies with which we are now concerned, SA and FM. We were told that SA and FM had both been formed in 2002.

13. It was not relevant for us to obtain a detailed understanding of the trades of these two companies. So far as was material, we understood that both SA and FM organised partnerships, almost certainly composed of high-income earning individuals, to undertake roles in acquiring interests in, or otherwise financing, films. The trades of those two companies involved seeking out and acquiring films or distribution rights to films, promoting lease-back or other financing roles in relation to those films to the high net worth individuals just referred to, and then undertaking and providing all the documentation both in relation to the structure of the partnerships, and of course the transaction documentation with the film producers, distributors etc. The companies were also responsible for providing accounting and tax filing advice to the partners.

14. The main distinction between the roles of the two companies, SA and FM, was that FM concentrated entirely on qualifying British Films, and that SA was involved principally with European and US films and particularly with US film producers.

15. Nothing now revolves directly around the degree to which the financing arrangements achieved tax advantages for the relevant individual partners in the film partnerships. It is just worth mentioning, however, that HMRC commenced their Skeleton Argument with the proposition that these present Appeals involved tax avoidance steps to avoid the normal tax implications of distributing profits, the profits themselves derived from making tax avoidance schemes available to SA's and FM's clients. We were also told that all the partnership schemes had been challenged by HMRC but that for six years nothing further had been heard from HMRC in relation to those challenges. The only passing significance of these underlying points, and indeed of the outcome of the earlier Scottish case to which we will refer below, is that there was a relatively fierce dispute between the parties.

16. It was strenuously asserted, both in evidence and in submissions on behalf of the Appellants that the trades of the two companies relied on the expertise of the companies' directors and employees, and that the companies' gross income consisted entirely of fee and similar income. There was no sense in which the companies' profits derived from any material capital employed in the trades, and no sense in which the gross receipts were anything but the return for the tax planning ideas, administrative services, and the provision of contacts and opportunities known to the directors that could be of value to potential clients.

17. Mr. Dryburgh's evidence was that the two "key players" in the Scotts businesses, and particularly the businesses of SA and FM, were Mr. Dryburgh himself and Mr. Somper. Their contributions differed. Mr. Dryburgh was the tax specialist who knew how to structure film financing deals and how to assemble partnerships of high-income earning individuals interested in participating in such deals. Mr. Somper, by contrast, was the person with the contacts in the UK, US and European film industries, and thus the person able to access the type of films that individuals in the various partnerships would wish to acquire or finance. We gained the impression, which HMRC did not seek to undermine, that the businesses would not have been viable and SA and FM would not have made the profits that they made without both Mr. Dryburgh and Mr. Somper playing their respective roles.

18. While Mr. Dryburgh and Mr. Somper were the key players, without whom it was said that the business would not have been viable, there were other employees. The only two to whom we need to make specific reference in this Decision were a Mr. Richard Charles ("Mr. Charles") and a lady named Ms. Nazeera Moola ("Ms. Moola"). Mr. Charles' role had been on the marketing side. We accept Mr. Dryburgh's evidence when he said that Mr. Charles could be "weak on detail", and that at times he was criticised (see below) for somewhat sharp practice, but nevertheless he was an extremely good marketing man. Ms Moola, by contrast, seems to have been virtually the opposite. She had been a solicitor in private practice with Richards Butler. Her role was to deal with all the required legal documentation principally for the client partnerships but also for the Scotts companies. On leaving the Scotts companies, she had joined Lazards, and was now working in South Africa, from where she gave evidence to us by video link. She seemed, both on Mr. Dryburgh's evidence and from our own observation, to have been a first-rate lawyer.

19. Whilst Mr. Charles was an excellent marketing man, and Ms. Moola performed an efficient role that probably saved the companies vastly higher amounts than her salary in enabling the companies to avoid outside law firms' professional charges, it was claimed by Mr. Dryburgh, and generally supported by other evidence to which we will refer, that the contributions of Mr. Charles and Ms. Moola were of a different order to the contributions of Mr. Dryburgh and Mr. Somper. It was Mr. Dryburgh and Mr. Somper who were the "rain-makers", without either of whom the businesses would not have been viable. Mr. Charles and Ms.Moola both made valuable contributions, but both could have been replaced.

20. Two or three other employees were referred to by name but their contributions appeared to have been less important and we were never told what their functions were.

21. We were not given a full picture of the other Scotts companies that were operating in the period 2003 to 2004. It certainly appeared that SA and FM were by far the most active companies in this period, but others were operating. The trades may also have related to film financing, or alternatively to more general tax-based advice to clients. We were certainly told that one at least of the companies gave advice to Scotts' own clients about EBT schemes, and it was clear that on a number of occasions (not just in relation to the schemes implemented by SA and FM which we will deal with below) Mr. Dryburgh had sought the advice of Turcan Connell, the Scottish law firm that the Scotts companies used, and the advice of Mr. Thornhill in relation both to EBT schemes and other tax matters. We were told that Mr. Dryburgh had sought advice from Mr. Thornhill on roughly five occasions a year, and that he was doing this both when working as a partner in Deloitte & Touche, and whilst running the Scotts companies.

22. We will need in due course to consider the issue of which companies employed Mr. Charles and Ms. Moola in slightly more detail, but at this stage it is sufficient to record that it may not always have been entirely clear by whom Mr. Charles and Ms. Moola were employed. Mr. Charles had certainly been employed by one of the other Scotts companies until December 2003, and we will need to consider below the fact that he was made a director of SA in a very artificial manner in early 2004, backdated to February 2004, and indeed on the odd basis that he was only appointed

for a fixed term of six months. Ms. Moola gave video evidence to us and by 2013 she had very understandably forgotten by which company she was strictly employed, and which company had paid her salary. She said that she had rendered legal services to several of the Scotts companies, and that looking back she could be no more specific than to say that she had been employed "by Scotts". Her recollection, however, was that she was appointed Company Secretary of SA. That was not verified but it seemed entirely likely.

The fundamental points in dispute

23. Mr. Thornhill commenced his case on behalf of the various Appellants by claiming that the evidence would show that the business model, or rather the "earnings distribution model" of the two companies, SA and FM, was that they were operating as companies, but essentially aiming to pay out the vast majority of their profits to, or for the benefit of, the directors and employees, rather as if they were partnerships. The profits earned by the companies derived entirely from the ideas, contacts and services possessed and provided by the employees, and in particular Mr. Dryburgh and Mr. Somper, and it was therefore perfectly realistic for the key employees to be paid remuneration in one form or another equal to the great majority of the profits, i.e. the profits prior to the deductions for the very payments and contributions made to and on behalf of those directors and employees.

24. The claim, in other words, was that SA and FM were operating in what Mr. Thornhill claimed was the fairly familiar manner for "corporate-partnerships". The claim was initially advanced on the basis that the "quasi-partnership" should be taken to include Mr. Dryburgh, Mr. Somper, Mr. Charles and Ms. Moola. We always expected that it would be unrealistic to regard the "quasi-partnership" notion as extending to all four individuals, and our expectation was that if the "quasi-partnership" notion was established in the present case at all, the realistic summary would be that the "quasi-partnership" was composed of the two "rain-makers". Mr. Charles and Ms. Moola were highly valued employees to whom it might be appropriate to pay more conventional bonuses in one form or another but they were not members of the inner circle in the way that Mr. Dryburgh and Mr. Somper were.

25. Our aim at this stage is not to analyse, or confirm or dispute the above claim. We simply record that that was Mr. Thornhill's starting point. In his opening submissions he then proceeded to treat the above analysis of SA's and FM's profit sharing model as a given, and he explained that most of the dispute would revolve around the points of interpretation under paragraph 1 Schedule 24. In other words the Appeals would revolve around whether the companies' corporation tax deductions for contributions to EBTs could be sustained, notwithstanding the claim that no directors or employees were suffering tax or PAYE deductions and NIC contributions in respect of the benefits provided, and notwithstanding the plain statutory intention of paragraph 1 Schedule 24 that in this situation the corporation tax deduction for the contributions should be disallowed.

26. There is no doubt that the points in relation to paragraph 1 Schedule 24 are highly significant in this case. This, however, is not because HMRC's principal contentions relate to the application of that particular statutory provision at all. In a sense the prime relevance of the planning in relation to the steps designed by the

Appellants to avoid the application of paragraph 1 Schedule 24 is not the issue of whether those steps achieved their purpose (though naturally that is one of the points that we must decide). The main relevance of those steps is that they did govern the whole manner in which the EBT schemes were implemented. They therefore occasioned several of the general grounds on which HMRC sought to challenge the corporation tax deductibility of the payments, and they also occasioned what we can fairly describe as a string of implementation errors in effecting the schemes, that might indeed have undermined the intended tax planning objectives. The point that we make at this stage, therefore, is that the trick devised in the effort to circumvent the application of paragraph 1 Schedule 24 governed the whole way in which the schemes had to be implemented, and it is largely for that reason that the detailed steps need to be understood.

27. HMRC's main contentions in this case were that for various fundamental reasons, SA and FM failed to sustain their deductions for corporation tax purposes even before paragraph 1 Schedule 24 was considered. This was on the principal ground that corporation tax deductions are only available for revenue expenses incurred wholly and exclusively for the purposes of the trade, and that that could not be established in the present case. There were no contractual obligations on either SA or FM to pay any bonuses or EBT contributions to the directors or employees. In several of the cases involving EBT contributions where corporation tax deductions had been available, there had been an "expected practice" of paying bonuses or EBT contributions, and such bonuses or contributions were thus required in order to incentivise employees to remain in employment and to continue generating profits for the companies. It was claimed that there had been no such "past practice" in this case, and that by February 2004 it looked as if a legislative change would have undermined the tax-based film schemes being promoted, particularly in the case of the non-British films dealt with by SA. Indeed in the period commencing 1 April 2004, SA had no gross turnover, so that the claim that it was necessary to make EBT contributions to incentivise people to continue to work to generate the profits was wholly absent because the line of business had actually ceased.

28. HMRC therefore contended that the real purpose of the making of the EBT contributions was just to avoid corporation tax, or to strip the companies of their assets, and that neither of these purposes was wholly or even remotely a legitimate revenue expense of the trade. It was also contended that since the vast majority of the benefits passed to the people who were anyway the ultimate shareholders, an improper deduction was being claimed for payments that really ought to have been dividends. There was a distribution of profit, not an expense in earning profit, and worse still a distribution of all the assets that left both companies, certainly SA, quite unable to pay any remaining liabilities, including corporation tax should it emerge that the contributions were non-deductible such that the companies were left with corporation tax liabilities.

29. It was therefore on this ground, and other fundamental grounds, that HMRC principally contested these Appeals.

The implications of the different HMRC contentions in this case; the relationship with other pending litigation, and the significance of the Scottish case

30. HMRC's primary argument in this case was that all the corporation tax deductions for the contributions to the EBTs should be disallowed. HMRC made it clear that were they to sustain that claim they would actually drop their fallback contention that the directors received income from which PAYE tax should have been deducted. This was not entirely on a concessionary basis but on the rather extraordinary approach that because the contributions should be disallowed because the contributions were designed to provide benefits to the directors in tax-free form, simply so as to eliminate the corporation tax liabilities, or to strip the companies of assets, if HMRC won the disallowance point, it would follow that there would be no tax to charge on the tax-free benefits.

31. It was, however, clear that if HMRC failed in their claim that the corporation tax deductions were non-deductible, then HMRC did assert that as soon as the contributions went into the Newcos used in the EBT schemes, of which notably Mr Dryburgh and Mr. Somper were the directors, then Schedule E tax or employment income tax should have been charged, and tax deducted under the PAYE machinery on the ground that the moneys in the three Newcos were unreservedly at the disposal of the directors. Not only would it then be contended that PAYE tax should have been deducted but Notices had been served under Regulation 72(5) of the PAYE Regulations indicating that HMRC had grounds to believe that the directors knew that they had received payments from which PAYE tax had not been deducted as it should have been deducted, whereupon the tax could then be recovered directly from the directors. Mr. Somper had ceased to be UK resident so that no attempt had been made to recover the PAYE tax from him, but HMRC were pursuing Mr. Dryburgh for the PAYE liability.

32. We made the point during the hearing that there was obviously a possibility that we might conclude that HMRC won both the non-deductibility argument and the PAYE argument, and we asked HMRC how we should deal with the PAYE issue if these were our conclusions. Partially on the reasoning that we ought simply to give our decision on the merits of the various points, and partly also because if we only decided the non-deductibility question (were we to decide that in favour of HMRC), it would manifestly be unsatisfactory to have no decision on the PAYE points, and indeed the multitude of other points in these Appeals, when our decision on the non-deductibility points might be overturned on appeal, we concluded that we should give out decision on all relevant points, disregarding the approach indicated by HMRC in paragraph 30 above.

33. HMRC still confirmed that if they won on both main points, the great likelihood is that they would not seek to collect the PAYE tax. This was in part on the slightly strange basis that such recovery would involve some element of double taxation, but equally it might be influenced by the point made in the following paragraph.

34. We were told that various unsatisfied creditors of the Appellant companies, particularly creditors of SA, were bringing proceedings in the High Court under the Insolvency Act, claiming that the ex-directors of SA had wrongly stripped that company of its net worth, leaving it unable to satisfy its creditors, and that therefore the creditors should be able to make recoveries from the directors. The principal strategy on the part of HMRC in the present Appeals was therefore to win the non-deductibility issue, thereby demonstrating that both SA and FM had substantial

unsatisfied liabilities and then seek to recover those amounts from Mr. Dryburgh, Mr. Somper and various liquidators. One of the particular attractions therefore of winning on the corporation tax point, rather than on the PAYE point, was that while success on the PAYE point might be a pyrrhic victory when Mr. Dryburgh was bankrupt, success on the corporation tax point, followed by success on the case under the Insolvency Act, offered the prospect of being far more likely actually to collect the tax. The distinction in relation to Mr. Somper, now a resident of Israel, was that HMRC might be able to enforce a judgment debt under the Insolvency Act in Israel, whilst obviously private international law made it impossible to enforce a taxation debt for PAYE tax arising in the UK in Israel.

35. We have already mentioned that there was an earlier case, heard in 2011 by Lord Glennie in the Court of Session. This case related to the claims by the liquidator of the Scotts company, Scotts Media Tax Limited, that Mr. Dryburgh had improperly stripped the assets out of the company, leaving it unable to satisfy its creditors. As we have already mentioned, one of the creditors of the relevant company was HMRC, whose claim related to the unsatisfied liability for corporation tax, resulting from the disallowance of the contribution to the EBT made in that case. While it seems that the EBT planning was substantially similar to that in the present case, the facts were otherwise different in that HMRC's principal contention in that case appeared to have been that the cost or loss incurred by the company was a capital loss and not a revenue loss, and secondly that the company refrained from appealing because it was known that the company would anyway not have been able to pay the tax if it lost the appeal. The ground just referred to, advanced again by HMRC in the present case, as one of their slightly secondary contentions, is one that we are going to reject in this case, but that is not presently relevant.

36. The facts in the Scottish case that are presently relevant are first the fact that Mr. Dryburgh had implemented an EBT scheme in 2001, so that the schemes with which we are presently concerned were plainly not the first relevant schemes. Beyond that the relevant points are that Lord Glennie was critical of some of the evidence that had been given by Mr. Dryburgh. He concluded that he could not say that Mr. Dryburgh's evidence had ever been false, but he did say that he had every impression that Mr. Dryburgh would often respond to questions by giving the answer that would have the best effect, whether necessarily the whole truth or not. In terms of conclusions, he also concluded that the corporation tax deductions had correctly been disallowed, more it seems on the grounds that he considered that they had been made for the non-trading purpose of stripping the company of its assets, rather than under any obligation to pay either bonuses, or any equivalent of bonuses. As we understand the outcome of the case, Mr. Dryburgh in fact won the case but on the equivalent of a limitation point, rather than on its true merits. Apparently the liquidator's claims had been made at so late a date that, while Lord Glennie considered them to be sound, the liquidator would only have been able to obtain satisfaction if he had been able to establish fraud on the part of Mr. Dryburgh. Lord Glennie considered that he could not reach a conclusion that Mr. Dryburgh had been fraudulent, and so on the limitation point, Mr. Dryburgh won the case.

37. Insofar as we ought to attach considerable weight to the findings of Lord Glennie, albeit that those findings related to different facts and a quite different case, we should record that in the hearing before us, Mr. Thornhill asked Mr. Dryburgh

whether he considered that Lord Glennie had been slightly unfair in the conclusions that he reached. As we understood his response, Mr. Dryburgh said that he did consider that Lord Glennie had been unfair in that when the liquidated company had been liquidated it had apparently passed both its assets and its liabilities to another Scotts company. At the time that other company had been perfectly solvent. If we understand Mr. Dryburgh's point correctly, if the liquidator and other claimants had been rather quicker in making their claims, they could have pursued this transferee company for their claims against the liquidated company at a time when the transferee company could have met them. At some subsequent point some disaster befell the relevant transferee company, such that whether there was some chain of indemnities or contracts that would have theoretically enabled the liquidated company's liabilities to be recovered from the transferee, by the time the claims were made the transferee also had no net worth. It is not remotely relevant for us to reach any conclusion as to whether Mr. Dryburgh's complaints are justified or not, though we consider it material just to have mentioned them.

38. The final point that we make in relation to the Scottish case is a perfectly obvious one from the dates that we have already given. In other words, the events that were material in that case all occurred in 2001, before SA and FM had even been formed. The hearing in Scotland took place in 2011, many years after all the events in the present case. Accordingly when the transactions in this case were implemented, none of the observations or conclusion made and reached by Lord Glennie could have influenced the parties.

The terms of paragraph 1 Schedule 24, FA 2003 and the mechanism designed to avoid the corporation tax disallowance under that paragraph

39. The mechanism to avoid the corporation tax disallowance for contributions to EBTs when the contributions would otherwise have been deductible, and when the contributions would have occasioned no income tax liabilities on beneficiaries, or PAYE liabilities for the contributors, relied on a fine technical point of interpretation.

40. Sub-paragraphs 1(1) and 1(2) of the Schedule read as follows at the relevant times:

> ***"1. Restriction on deductions***
>
> *(1) This Schedule applies where –*
>
> *(a) a calculation is required to be made for tax purposes of a person's profits for any period, and*
> *(b) a deduction would (but for this Schedule) be allowed for that period in respect of employee benefit contributions made, or to be made, by that person ("the employer").*
>
> *But it does not apply to a deduction of a kind mentioned in paragraph 8.*
> *(2) For the purposes of this Schedule an employer makes an "employee benefit contribution" if –*

(a) he pays money or transfers an asset to another person ("the third party"), and
(b) the third party is entitled or required, under the terms of an employee benefit scheme, to hold or use the money or asset for or in connection with the provision of benefits to employees of the employer.

(3) The deduction in respect of employee benefit contributions mentioned in sub-paragraph (1) is allowed only to the extent that –

(a) during the period in question or within nine months from the end of it -
(i) qualifying benefits are provided out of the contributions, or
(ii) qualifying expenses are paid out of the contributions,

or

(b) where the making of the contributions is itself the provision of qualifying benefits, the contributions are made during that period or within those nine months."

41. Ignoring various details that we will mention below (but reflecting the one detail that for some reason two EBTs were used in the steps of each of the three schemes adopted by SA and FM - one by SA and two by FM), the steps undertaken to avoid the application of the disallowance provided for by the above provisions were as follows:

- the employer company, intending to make contributions of, say, £1 million into an EBT would first form a new UK company ("Newco");
- the employer company would then form two EBTs, EBT1 and EBT2 with, say, Guernsey trustees;
- the employer would then subscribe a few shares, say 100 1p shares in Newco for a premium of £999,999, such that those shares would be worth £1 million (with the result at this point that the employer would own a 100% subsidiary, worth £1 million);
- Newco would then grant an option, exercisable within 10 years, to EBT1 to subscribe 10,000 1 p shares at par (i.e. for £100), the effect of which grant would be to procure that the value of the 100 shares in Newco held by the employer company would drop to 1% of £1 million, i.e. £10,000, and the option would be worth £990,000;
- the employer company would then sell the 100 shares to EBT 2, at their heavily diminished, but now correct, value of £10,000; and
- EBT2 would countersign the option agreement, committing to ensure that no share issues or distributions would dilute the value of the option.

Whether the option was then exercised immediately, or whether the value was left in the option, the value would be held almost entirely by EBT1, reinforced by the terms of the non-dilution covenants given by EBT2, albeit that until the exercise of the option, shareholder control would rest with EBT2.

42. The basis on which these steps were said to circumvent the obvious intent of paragraph 1 Schedule 24 was that the particular step that occasioned the loss or cost for which the employer would claim a corporation tax deduction was the step at which Newco itself granted the option to EBT1. The prior step at which the employer company subscribed the few shares (that we generally referred to in the hearing, and that we will refer to in this Decision as "the trivial shares") involved no loss or cost because at that point the trivial shares were actually held by the employer company. It was at the next step, when the employer company procured that Newco itself granted the highly valuable subscription option to EBT1, and the value flooded out of the trivial shares and into the option, that the employer company would suffer its loss for which the tax deduction would be sought. Once the option had been granted the trivial shares were worth only the vastly reduced amount, whether the option had been exercised or not, so that the sale of those shares to EBT2 for the price reflecting their diminished value (seemingly an optional step as regards "costs" and value shifting) was not a transfer that involved any cost or loss to the employer company.

43. Having thus identified that the step that involved the loss or the cost for which the corporation tax deduction would be claimed, the argument in relation to paragraph 1 Schedule 24 was that deductions were only denied "in respect of employee benefit contributions", and "employee benefit contributions" were defined narrowly to mean "payments of money or transfers of assets" by the employer company to another person. Since the step that occasioned the loss or cost, and for which the corporation tax deduction was claimed, was the grant by Newco of the option to EBT1, and that step involved no payment of cash or even transfer of assets by any company, and certainly not by the relevant employer company, the corporation tax deduction was being claimed for a step that could not fall within the definition of "employee benefit contributions". There was of course a payment of cash by the employer and a transfer of the trivial shares by the employer but neither of those steps involved any cost or loss, and thus any cost for which the corporation tax deduction was claimed.

44. In due course, one of the obvious questions that we will have to address is whether this fine technical distinction can survive an interpretation of paragraph 1 that might better reflect the fairly obvious general purpose of Parliament that steps of the type described above were hardly meant to escape the disallowance provided for by the legislation.

The detail of the manner in which the contributions made by SA were actually made

45. The steps summarised in paragraph 41 above were considerably simplified, and we must now record the actual steps. The particular significance of the actual steps is that they led to at least four claims by HMRC in the case of the contributions to SA's EBT that deductions should be denied on further detailed grounds.

46. We should first mention a point about terminology, and about the parties chosen in the three actual schemes. Whenever we refer to EBT1, that reference will be to the particular EBT that received the grant of the option, and therefore the EBT by which the substantial value was held. EBT2 is always thus a reference to the EBT

that held the trivial shares. Furthermore when EBT1 was the EBT designed to receive the option, and the vast bulk of the value in relation to SA's scheme, the terms of the trust deed for EBT1 correctly provided that the beneficiaries of that trust were the directors and employees **of SA** in the year to 30 April 2004, and not the employees of the other company. The slightly confusing factor is then that in the case of SA's EBT trust, the relatively "dummy" EBT that served the function of acquiring and holding the trivial shares of the relevant Newco (i.e. EBT2) was the EBT destined to be the holder of the option, and thus ultimately the substantial value of the other company's (i.e. FM's) first EBT (i.e. EBT1 so far as the first FM scheme was concerned). And the same applied in the other schemes, i.e. the schemes adopted by FM. Accordingly in those schemes (there were in fact two different schemes), the role of EBT1 was taken by EBTs formed by FM for each of its two schemes. And it was SA's EBT (i.e. EBT1 so far as SA was concerned) that held the trivial shares of the relevant Newcos used in both of the FM schemes.

47. Dealing with the contributions made to SA, and ultimately to the relevant EBT1 for SA, namely Saltire Trustees (Overseas) Limited, as trustees of the Scotts Atlantic Employee Benefit Trust ("SA EBT"), the facts were as follows:

- The relevant Newco in relation to the SA contributions was a UK company called Scotts Atlantic Investments Ltd ("SAIL"), which was incorporated on 19 September 2003. Significantly, Mr. Dryburgh and Mr. Somper were the directors of SAIL.
- The SA EBT was formed on 15 December 2003, the defined beneficiaries being the directors and employees of SA for the period ended 30 April 2004.
- Prior to the implementation of any of the other steps mentioned in paragraph 41 above, other than the first two (i.e. the formation of SAIL, and the creation of the SA EBT), SA had entered into a number of transactions with SAIL. On two occasions in March 2004 and on 2 April, SA had lent cash (£4,630,500 in total) to SAIL, and SAIL had advanced the vast amount lent to it on those three occasions to Mr. Dryburgh and to Mr. Somper. The three loans made to Mr. Dryburgh were for £2,100,080 and the three to Mr. Somper were for £1,900,000. We assume that at this stage SA held the only issued shares in SAIL, those perhaps just being the subscribers' shares. Since SAIL had assets equal to its liabilities to SA at this stage, SAIL had no net worth at this point.
- Beyond the loans mentioned at the previous bullet point, it appears that SA had also assigned 7 deposits, the principal amount of which was £1,730,608, plus accrued interest on those deposits, to SAIL at some point presumably in March 2004, or at least before 5 April 2004. Two complications must be mentioned in relation to these deposits. Firstly, they had been charged to Barclays Bank or possibly directly to film production companies, to secure various liabilities in some way related to the earlier transactions undertaken by SA. The other point is that implicitly (though we were not shown any document that achieved this result) SAIL became indebted to SA in the amount of £1,730,608 in return for the acquisition of the charged deposits. It seems slightly strange to us that SAIL became indebted for that full amount, since we were told not only that the deposits were charged to third parties, but that it might take 10 years for the possible claims of those third parties to be clarified, and hopefully to be discharged without recourse to the deposits.

- It follows from the two previous bullet points, therefore that SAIL had assets worth £6,361,108 (ignoring any reduction in value in relation to the charged deposits to reflect the chargee's potential claims), and that SAIL owed SA a similar £6,361,108.
- On 5 April 2004, the Directors of SA (Mr. Dryburgh, Mr. Somper and two others) held a meeting at which they referred to the formation of SAIL and the fact that Mr. Dryburgh and Mr. Somper were the directors of SAIL; they then resolved that SA would subscribe £7,636,000 for the small number of shares in SAIL that we have referred to as the trivial shares, and then they resolved that Mr. Dryburgh and Mr. Somper, as directors of SAIL, would procure SAIL to issue the "swamping" option to SA EBT to subscribe the very substantial number of shares in SAIL at par. At the same time as the grant of the option, the badly-worded minute resolved that SAIL would sell the trivial shares in SAIL to the EBT that had been formed (see below) to rank as the EBT for FM. Obviously what was meant was that SA, not SAIL, would sell those shares and, as a bullet point below indicates, that is what happened. The SA minutes concluded by resolving that the option would be granted "as a means of providing benefits for the benefit of employees in the year to 30 April 2004".
- Whilst the above minutes did not clarify how the subscription moneys were to be provided (but simply referred to a subscription for £7,636,000), it was claimed in argument that the amount subscribed consisted of the following four elements:

  1. either the release of the debt of £4,630,500 owing by SAIL to SA referred to above, or an entitlement on the part of SAIL to an equivalent amount that would be set-off against that debt;
  2. a similar notion in relation to the £1,730,608 apparently owing by SAIL to SA, resulting from the transfer of the 7 charged deposits;
  3. a transfer on 5th April of four further charged deposits, the principal amount of which was £1,034,892, and
  4. £240,000 in cash, paid on 5th April.

  We were not shown any actual subscription agreement, but we were shown a bank statement that indicated that the £240,000 was paid on 5 April 2004 and a letter to Barclays Bank of the same date dealing with the assignment of the charged deposits mentioned at 3 above.
- On 6 April, the Option Agreement was entered into between SAIL, SA EBT (i.e. the grantee) and the EBT for FM, that EBT being a party in order to grant the "anti-dilution" rights to SA EBT. We should mention the critical point that while SAIL was a company registered in Scotland, the Option Agreement was said to be governed by the law of England and Wales, and that no consideration was given for the grant of the option.
- On 7 April the trivial shares in SAIL were transferred to FM's EBT for its December 2003 transactions (referred to below as FM EBT).

48. We mentioned in paragraph 45 that the detailed steps that we have now summarised led to three contentions by HMRC that to some greater or lesser extent, implementation errors in these steps undermined the Appellants' contentions in relation to paragraph 1 Schedule 24 even if we decided that the Appellants'

interpretation was justified when the transactions were implemented correctly. The fourth claimed error related to the different issue of whether, quite apart from the paragraph 1 Schedule 24 issues, PAYE liabilities could be recovered. The four HMRC contentions were as follows:

1. the absence of consideration meant that the option was void. This led naturally to a dispute as to whether Scottish or English law governed the issue of whether consideration was required when SAIL was a Scottish registered company, but the agreement was governed by English law. Regardless of the fact that the option was actually exercised after a very long delay, HMRC's claim was naturally that if the option was void for lack of consideration, it would not have diminished the value of the trivial shares, so that the loss would then have arisen when those shares (with undiminished or somewhat undiminished value) were transferred to SA EBT at a very considerable under-value. It would then inevitably follow that that under-value transfer would have been a "transfer of assets", and an "employee benefit contribution" to which the loss or cost would have been attributable, and then on any interpretation paragraph 1 Schedule 24 would have denied the corporation tax deduction.

2. The minutes of the Board meeting on 5 April 2004 certainly made it clear that the intention was to subscribe the trivial shares in SAIL for £7,636,000, but the minutes initially shown to us made no mention of the mechanics for effecting the set-off against existing loans. This led HMRC to question whether the value had been properly contributed, or whether the liabilities owing from SAIL to SA in respect of the loans mentioned at the third and fourth bullet points of paragraph 47 above had been discharged.

   Mr. Dryburgh initially said that there may have been no documentation in relation to the set-off because it was obvious that the subscription at the amount of £7,636,000 involved the set-off, and that in due course the accounts of both companies reflected this obvious reality.

   On a later day in the hearing, Mr. Dryburgh said that he had made a search at home, and found other minutes that dealt with the set-off issue, which he had now copied so that the parties and the Tribunal could see the terms of the minutes that he had just found.

   It eventually transpired that these "set-off minutes" had almost certainly been generated in 2013 and not 2004. Two points arise therefore. One is the issue of whether the subscription did contribute the whole value of £7,636,000 into SAIL on account of the lack of genuine contemporary documentation in relation to the set-off point. That is the point we are addressing at this stage. The other point is the fact that Mr. Dryburgh admitted that he had lied to the Tribunal and almost certainly generated the minutes in relation to the set-off that were produced during the hearing. We will deal separately with that issue when discussing the credibility of Mr. Dryburgh as a witness below.

3. The third detailed contention in relation to the capitalisation of SAIL was that if (as was the case) the charged deposits were securing obligations to third

parties and the deposits might have had to be applied in discharging those liabilities during a 10-year period, it was difficult to see why SAIL was initially said to have incurred an obligation to pay the full face value of those deposits acquired prior to 5 April 2004, when the deposits were assigned to it. It was equally difficult to see that the full premium, ostensibly put at £7,636,000, had been contributed to SAIL when £2,765,500 of the value contributed consisted of "fettered assets" that might not be available to SAIL. Finally, it was difficult to see how it was said on 6 April 2004, that on the grant by SAIL of the option, the full cost of £7,636,000 was incurred as a cost to SA of remunerating the directors, when £2,795,500 (i.e. the total principal amount of the deposits) might actually end up being applied for some quite different purpose.

4. The fourth point was a timing point, and this is the point relevant to the PAYE liability as distinct from the corporation tax deductibility issues. HMRC conceded that they were out of time in assessing either FM or Mr. Dryburgh on any employee benefits in relation to the first contributions made into the FM EBT. This was because HMRC's basic PAYE contention was that the liability for PAYE tax arose at the point when the contributions (i.e. share subscriptions at a premium) were made by the employer companies into the Newcos (FMIL in the case of the first contributions made by FM in December 2003) and by the time that HMRC wished to raise assessments they were out of time to make assessments for the year 2003/2004, i.e. for those in respect of the December 2003 contributions to FMIL.

   The point of present significance is that if (as HMRC contended) the trigger point for benefits becoming chargeable in respect of SA's contributions was the point at which funds were contributed absolutely into SAIL, i.e. when the premium was injected, then the board minute summarised above indicated that that contribution had also occurred in the tax year 2003/2004, and HMRC would again be out of time to make the assessments, provided that the subscription had actually been made on 5 April.

   HMRC pointed out that the only evidence that we saw was a board minute resolving to subscribe the shares, and not the actual subscription agreement. We were shown the bank statement in relation to the subscription of £240,000 in cash, plainly made on 5 April, and the directions to Barclays Bank, also dated 5 April 2004, in relation to the contribution of the four additional charged deposits (both of which we mentioned at items 3 and 4 in the seventh bullet point in paragraph 47 above), but nothing in respect of the residue of the value to be contributed (i.e. by far the majority of the amount ostensibly contributed).

   HMRC's claim, therefore, was that the evidence did not establish that the full premium had been contributed in the tax year 2003/2004, or indeed that the actual subscription, as distinct from the SA board resolution to make it, had been made in that earlier tax year. It obviously follows that if the actual subscription at the £7.6 million premium did occur on 5 April 2004, and we agree with HMRC that that is the point at which the employment income liability arises, then the PAYE claims would be out of time not only for the

December 2003 transactions, but for by far the most substantial contributions as well, in other words those made on 5th April 2004.

The detail of the manner in which the contributions made by FM were actually made

49. As we have already indicated, FM made contributions into Newcos on two different occasions and created separate EBTs for each contribution. The facts in relation to the two sets of transactions involving FM were somewhat simpler than those described above in relation to SA. As with the SA transactions, the steps involved the same subscription of shares in the Newcos, namely Scotts Film Management Investments Limited ("FMIL"), for the contributions made around the date 15 December 2003, and NCS Investments Limited ("NCSIL") for the contributions made on 1 November 2004. The contributions made on these occasions were the somewhat simpler contributions of cash (£250,000 for the transaction in December 2003 and £1,039,000 for the transaction in November 2004), and as we explained when summarising the steps in outline, it was again arranged that the valuable option would be granted to the intended EBT for each contribution (in other words, separate EBTs for the December 2003 transactions and the November 2004 transactions) while the trivial shares were transferred, after the grant or ostensible grant of the options, to the EBT for the other company, SA, i.e. to SA EBT. While separate EBTs were created for each of the two FM contributions, the trustees of each EBT were the same trustees, namely Turcan Connell Trustees (Guernsey) Limited. We will refer to FM's first EBT for the December 2003 contributions as FM EBT, and the separate EBT for the November 2004 contributions as FM (2004/5) EBT.

50. We should mention that the Newco for the mid-December 2003 contributions into FM's first EBT was formed on the same day as the Newco used in the SA transactions, namely 19 September 2003, and that Mr. Dryburgh and Mr. Somper were again the directors.

51. There are two points that we need to highlight in relation to the two sets of transactions involving FM. In the SA transaction, the directors of SA had resolved that at the appropriate point they would procure that SAIL would grant the valuable option to SA EBT and, subject to the question about consideration, it was indeed SAIL that granted the option. By contrast in the FM cases, while both initial FM board minutes referred to the fact that the directors of the respective Newcos, Mr. Dryburgh and Mr. Somper, would procure that the Newcos would grant the valuable options to the appropriate EBTs, the actual grants of options were made not by the Newcos at all, but by the two relevant directors. Neither Newco was actually a party to the option agreements. The rather curious terms of the option agreements thus recited that the directors were the directors of the respective Newcos; they then recited that *"the Directors have agreed to grant an option to the Subscriber to subscribe"* the relevant "swamping" shares, and the operative clause of the agreement simply provided that *"the Subscriber shall have the right to subscribe for the Option shares" etc.* A later clause provided that the options would be exercised by the issue of a notice to the relevant Newco.

52. No particular point was made in relation to this rather curious manner in which the option was actually granted by the directors and not by the Newcos at all. It was suggested by the Appellants that when the directors were the directors of the respective Newcos, and when the Newcos could only act through their directors, the grant of options by the directors amounted in effect to grants by the companies. HMRC certainly drew our attention to this point, but made relatively little of it. For our part, we are at a complete loss to understand why the SA transaction and the grant of the option in the SA case was effected in one manner, while a different approach was adopted in the two FM transactions. We also note the curious point that had some adviser concluded that one or other approach was to be preferred, it is then difficult to understand why the direct grant of the option in the SAIL case was made by SAIL, whilst the grants by the directors in the two FM transactions preceded in one case, and followed in the other, the SAIL transaction. For our part, without attaching undue significance to the point, we obviously accept that companies can only act through the actions of their directors, but when a subscription option is to be granted over the shares in a company, we would expect the company to be the grantor, the company plainly to be a party to the transaction in question, and the document or deed to be executed by the company, albeit acting though its authorised directors.

53. It was the second point in relation to one of the FM grants of options that attracted attention, and in respect of which HMRC contended again that an implementation error had been made. This point only arose in the first of the two FM transactions. The relevant point was that although the option grant in the FM case in December 2003 was a transaction governed on this occasion by Scottish law, such that absence of consideration was irrelevant, it emerged that the Option Agreement had been signed in London on 16 December, but had only been signed by the trustees of the two EBTs in Guernsey on 22 December 2003. It will be recalled that the reason why two EBTs were involved was that one was the grantee of the option, namely Turcan Connell Trustees (Guernsey) Limited as trustees of FM EBT, whilst the other EBT was SA EBT, signing the option as the holder (or intended holder) of the trivial shares of the relevant Newco, i.e. FMIL, in order to give the “anti-dilution” covenants. The trivial shares had been transferred to SA EBT on 17 December, such that when the two EBTs executed the option agreement on 22 December, the trivial shares were already held by SA EBT.

54. The contention advanced by HMRC was that since the two EBTs were intended signatories to the option agreement, the option agreement should not be considered to be effective when only the directors had signed it on 16 December, and that it should not be considered to be a binding agreement until 22 December when the two EBTs had signed it. And since the trivial shares had already been transferred to SA EBT on 17 December, at a time when their value had not been diminished by the option agreement, there was (as with the “no consideration” contention in relation to the SA transfer of the trivial shares in SAIL) an under-value sale of the trivial shares, such that the key argument for avoiding the disallowance of the deduction intended by paragraph 1 Schedule 24 was undermined.

55. We were given evidence in relation to Scottish law, the essence of which appeared to be that a grant of an option without receipt of consideration and without signature by the grantee was a perfectly valid grant, regardless indeed of whether the

grantee knew that it was the beneficiary of the option. If, however, the right construction of the events was that there was simply an offer of an option, then that offer only resulted in the grant when the offer was accepted. And the fact that this particular agreement had to be signed by the grantee indicated that since there was no other purpose for requiring the grantee to execute the agreement, we should treat the case as one involving “offer and acceptance”, with the acceptance thus being signified after the critical time at which the trivial shares were sold.

56. Without considering the right analysis of this situation at this point, we will add two points. First, whilst there was some relevance to the execution of the agreement by SA EBT, in that it had to reinforce the value of the option by giving the “anti-dilution” covenants, we could find no single obligation assumed by the intended grantee of the option, FM EBT. Whether this indicates that it was simply another implementation mistake to provide for signature by FM EBT, or whether this indicates that the only coherent remaining purpose for FM EBT to sign the document was to signify its acceptance of the grant, so supporting the “offer and acceptance” analysis, we must obviously consider in due course. Another factor is whether the plain fact that SA EBT needed to sign (in order to add the “non-dilution” covenants to the grant of the option), and had not signed until 22 December, may also be significant. Finally, once the option agreement had been signed by the directors and apparently posted immediately to Guernsey, the proposition that the trivial shares had not been materially reduced in value might of itself be distinctly questionable. Would a willing buyer in other words, aware of the circumstances and of the fact that the intended grantee would be almost bound to sign the agreement as it did, and aware that it would either have been impossible, or possibly merely highly unlikely that the directors would preclude SA EBT and FM EBT from signing, to have given any material consideration for the trivial shares? Arguably therefore, the trivial shares might have been materially reduced in value, regardless of whether we prefer the “offer and acceptance” analysis to the “grant at the outset” analysis.

The various loans advanced by SAIL, FMIL and NCSIL

57. We summarised above the loans that had been made to and by SAIL even prior to the main activation of SAIL in the transactions on 5, 6 and 7 April 2004.

58. Similar loans were made out of the £250,000 contributed into FMIL in the December 2003 transactions initiated by FM, out of the additional cash of £240,000 injected into SAIL on 5 April 2004 and out of the £1,039,000 contributed into NCSIL in November 2004.

59. It is unnecessary to give all the detail about these loans, and indeed the detail of yet further loans that were made by SAIL when the charges over some of the blocked deposits were released (the first – in relation to deposits of £600,000, in September 2005, the balance of the blocked deposits when the charges were released in September 2006). It is sufficient to make the following general points:

- All of the loans were made by the three respective Newcos, Mr. Dryburgh and Mr. Somper being and remaining the directors at all relevant times.
- We were shown exchanges of letters between the directors and the trustees of one or other of the EBTs under which the directors generally indicated to the

trustees their intention to make loans, and the trustees invariably approved the proposed loans. There was a slight anomaly in that because none of the options had been exercised (at least until November 2005), to subscribe the "swamping" shares, the only actual holder of shares in the various Newcos happened to be the wrong EBT in the sense that it was the EBT that held the only issued shares at the time, in other words the relatively worthless shares. It followed that the trust approving loans, for instance, by SAIL, was usually (though not always) not SA EBT, but FM EBT. Since the two Guernsey trust companies had identical directors, no particular criticism was made of this detail.

- The terms of the loans made were generally that no security was requested from the borrowers, and the interest rate was set at the rate required to establish that there were no employee benefits inherent in the borrowers borrowing money on interest-free or low-interest terms.
- We were told that until HMRC commenced their enquiries, interest was never demanded by the various Newcos that had lent, notwithstanding that they were taxable, as UK companies, on an accruals basis on the interest receivable. We understand that the relevant tax was duly paid, but that interest was not paid, albeit that it presumably accrued and accumulated.
- Whilst the vast majority of the loans were made to Mr. Dryburgh and Mr. Somper, SAIL obtained approval from the trustees (on this occasion in fact from the trustees of the SA EBT – perhaps the more appropriate trustee even though the option had not been exercised) to lend £215,466 to Mr. Charles and £30,000 to Ms. Moola. We will refer below to the facts surrounding these loans, particularly the one made to Mr. Charles.

The letters written to potential beneficiaries on the creation of the EBTs

60. When each of the sets of contributions had been made into the three Newcos, the shares subscribed at a premium, the options granted and the trivial shares transferred to the relevant EBT 2s, on each occasion a letter was sent to the four intended beneficiaries, Mr. Dryburgh, Mr. Somper, Mr. Charles and Ms. Moola, informing them of the creation of the relevant EBT. The one sent following the first contributions (i.e. those by FM in December 2003) was in the following terms:

> *"As a progressive employer, Scotts Film Management Limited is continually seeking ways to incentivise and retain its quality workforce.*
>
> *An Employee Benefit Trust ("EBT") has been established, which has the potential to benefit the company's employees who have contributed to the success of the company in the year to 30th April 2004.*
>
> *Scotts Film Management Limited has secured the grant of an option in favour of the EBT Trustees over shares in SFM Investments Limited, a subsidiary of Scotts Film Management Limited, which it has capitalised.*
>
> *The Option will be held in a discretionary trust, which is controlled by independent trustees who have no association or connection with the company or its directors.*

Whilst the final decision on how the EBT funds are applied rests solely with the independent trustees, senior personnel will recommend the provision of financial benefits to those who, in their opinion, have contributed most to the company's success in the year to 30th April 2004. As is common with most EBTs no employee has any right to benefit nor are the trustees obliged to pay monies out every year. They will only do so at their discretion.

The EBT does not form part of the contractual arrangements between Scotts Film Management Limited and its employees and Scotts Film Management Limited is under no obligation to make or to continue to make contributions to the EBT.

I hope this new initiative will be welcomed and if you have any questions then please contact me."

The basic facts in relation to the delays in vesting the assets contributed into the various Newcos into the direct ownership of the three EBTs, and the events and transactions that occurred in the period between 5 April 2004 and the end of 2010

61. HMRC claimed that the occasion on which the liability to PAYE tax arose, based on the notion that earnings were put at the unfettered disposal of the directors, was when the contributions were made into the various Newcos. Since those made in December 2003 were out of time by the time HMRC were making their assessments, no PAYE claims were asserted in relation to the benefits derived from the first FM transactions. Since, however, the timing points for equivalent possible PAYE liabilities all occurred in the case of the other contributions in the tax year 2004/2005 (unless indeed the very major contributions into SAIL were also made on 5 April 2004 and were all out of time as well), the significance of events spanning up to the year 2010 is relatively limited. While we will now summarise the key events that occurred, we will give particular emphasis to events concerning the solvency of SA, since that is material to the asset stripping contention. We will also concentrate on any facts (though there are few) that might indicate why there were such delays in effecting the various simple steps that eventually took until 2010 to complete. The significance of the delays, and any evidence summarised in the next section concerning those delays is principally geared to whether it indicates that assets and control were left in the hands of the Newcos, and their directors, because of a reluctance by Mr. Dryburgh and Mr. Somper to allow control over the allocation of employee benefits to pass out of their hands. Whether as a legal matter that feature would be particularly decisive in relation to PAYE liability we will also have to consider.

62. The various events that occurred between 5 April 2004 and the end of 2010 were as follows, bolt type periodically indicating the particular topic or subject matter:-

1. An event that occurred on 5 April 2004 was that SAIL entered into an **indemnity agreement**, indemnifying SA against certain liabilities in relation to various film transactions. Having considered the short terms of the indemnity, the indemnity itself provided for no cap on the liabilities indemnified, but we were told that the indemnity liabilities were all potentially

funded by the transfer to SAIL of the "charged deposits". We have no particular reason to doubt that evidence. The reasons we mention the grant of this indemnity are two-fold and very related and indeed largely speculative. Nothing was made of this thought during the hearing but it does seem possible that Mr. Dryburgh and Mr. Somper, the directors of SAIL, were more interested in retaining some control over the affairs of SAIL in order to manage possible liability claims in respect of the indemnified matters, rather than because of anything to do with allocation of employee benefits. The matching point is that the trustees might have been perfectly content to exercise discretions as between various different employee beneficiaries, but less attracted to dealing with indemnity liabilities and potential control over the application of charged deposits if satisfaction of historic trading claims was being passed directly into the hands of the trusts. We accept that that is largely speculation on our part. We do however note that Mr. Hartley (whose role we mention below) recorded in a note on 22 June 2006 the information given to him by Mr. Dryburgh that *"Final transaction expected in September this year. Expect all moneys to be unencumbered by October 2006".* This seems to confirm the point, which purely as regards the actual calculation of the funds over which appointments might be made to sub-trusts is perfectly obvious, that the existence of the deposits, and their release, was significant. Whether this feature occasioned the delays in effecting all the steps of vesting the assets into the EBTs is more speculative.

2. There was considerable dispute as to whether SA's various contributions had stripped the company of all its assets, and whether thus there was a repeat of the type of **asset-stripping operation** that Lord Glennie had so criticised in relation to the 2001 transactions.

According to the accounts of SA for the period ending 30 April 2004, the very major contributions made into SAIL did leave SA with considerable losses. These losses led to extensive cross-examination of Mr. Dryburgh as to whether the contributions occasioned these losses and so were exceptionable. In response Mr. Dryburgh contended that the losses had not been anticipated, but resulted from an utterly unexpected claim, and an unjustified claim, for £1 million from a US individual named Hoffman, in which he was claiming unpaid commissions.

It was extremely difficult to verify from the 2004 and the 2005 accounts of SA whether those accounts reflected the ultimate settlement of this claim in November 2004. We were told that it was eventually settled for approximately £538,000, and we were also told that the reason why the Scotts companies had had to meet the claim rather than fight it was that Hoffman had some leverage over the affairs of the other company, FM, that made it impossible or unwise to fight the claim on its merits. We then note the rather extraordinary fact that on 4 November 2004, SAIL (i.e. SA's Newco that was fundamentally meant to be holding assets for the benefit of the EBT that had the right to acquire SAIL) lent FM £538,975. Whether this loan funded the settlement amount paid to Hoffman, and paid on this supposition by FM and not SA at all, was never clarified. We were told that this loan carried interest and was repaid in due course.

All that we can say in relation to the deficit in SA, resulting from the £7.6 million contributions made into SAIL, and effectively passed to the EBT, is that it was not proved that the SA deficit resulted from the Hoffman claim, and the very major contribution was thus a highly material factor in leaving SA short of assets.

3. A point vigorously disputed between HMRC's counsel and Mr. Dryburgh was the issue of whether by February 2004, a UK legislative change had virtually undermined the business model of SA, such that it was obvious that **its business would really cease** at the end of the accounting period ending 30th April 2004. The significance of this was that insofar as the claim for the corporation tax deduction was based in part on the claim that it was critical to keep valued staff in order to enable the company to make future profits, this rationale obviously dropped away so far as SA was concerned if SA's whole business model was undermined.

Mr. Dryburgh demonstrated to us that some efforts were being made to research some US investment plan relating to undervalued cinema assets, and we accept that SA hoped to continue trading with that new line of business. In the event, this came to nothing.

The more material exchanges in cross-examination revolved around Mr. Dryburgh's claim that SA must have had continuing operations because it made profits of roughly £400,000 in the following accounting period. We accept HMRC's claim that this evidence was misleading. There may have been such profits, but the accounts showed turnover of Nil in the following period, and while we were unclear quite how the profit arose it appeared to have something to do either with a refund of professional fees, or a write-off of a provision in relation to such fees.

Our summary of this point is that there was no trading in the period commencing 1 May 2004 in SA; arguments that the EBT contributions were made for trading purposes geared to encouraging employees to continue working and making profits in the particular company were extremely weak, and that HMRC's counsel did fairly criticise Mr. Dryburgh for having sought to suggest that trading profits were made in the relevant next period.

4. We should also record that **FM's business** appears not to have been particularly active after the various contributions were made into its EBTs. We were certainly told that by 2007 the "leaseback business" had basically finished, and as regards solvency and net worth, we were told that if FM had a corporation tax liability on account of the disallowance of its EBT contributions, it would not be able to pay the tax.

5. In September 2005 the charges over £600,000 of the previously **charged deposits were released**.

6. In November and December 2005, all three EBTs **exercised their options** to subscribe the "swamping" shares in their respective Newcos. It

was strenuously argued by and on behalf of Mr. Dryburgh that once this had occurred it was inevitable that all the later steps for eventually vesting the Newcos' assets directly into the hands of the EBT trustees would be effected, and that HMRC were wrong in their contrary contention that those later steps were all occasioned simply by the start of enquiries into the transactions by HMRC.

7. On 7 February 2006, the Appellants received the first letter from HMRC that indicated that HMRC were beginning enquiries into the EBT transactions.

8. On 14 February 2006 **the three Newcos were placed in liquidation**.

9. Further letters were sent by HMRC on 21 and 22 March 2006, pursuing the enquiries.

10. On 27 March 2006 Mr. Dryburgh wrote to Turcan Connell, asking them to commence the steps for appointing the EBT assets to sub-trusts. On 28 March the liquidator(s) of the Newcos **assigned the various loans** to directors and employees to the respective EBT trustees. A decision had also been taken to request the services of a partner in Reed Smith (formerly Richards Butler), namely Mr. Hartley who had been known to Ms. Moola when she worked for Richards Butler. Mr. Hartley was requested to perform the role of advising the EBT trustees in relation to the exercise of their discretions in allocating benefits amongst the various potential beneficiaries in all three EBTs.

11. There is a certain amount of doubt, and we understand a further dispute between HMRC and the Newcos and presumably their liquidator in relation to the following matter. The points in dispute have some relevance to our present Appeals, but it is fortunately unnecessary to resolve the doubt that does clearly exist.

The point relates to the fact that, following the assignment of the loans by the Newcos to the EBTs, HMRC made assessments under section 419 Taxes Act 1988 on the basis that some at least of the loans to directors (possibly all of them) were subject to the 25% tax charge in respect of **loans to participators in close companies.** That tax had not been paid and has still not been paid. It appears that the various interested parties sought to repay the original loans to the Newcos by temporary borrowings from Barclays and by drawing down replacement loans directly from the EBT trustees, on the reasoning that the 25% tax charge was always reversed if and when the loans were repaid. At some point HMRC appeared to have believed that the loans had thus been repaid and whilst we have no information as to whether interest was owed to HMRC in respect of the period when the loans had subsisted, it was at least thought that the original loans had been repaid.

When, however, HMRC later learnt that the loans had been assigned by the Newcos to the EBT trustees prior to the repayment and re-advance exercise, it appears that HMRC may have raised, or may still be raising, the contention that the s. 419 charges have not been vacated. Presumably the analysis is that since the loans had been assigned, when they were ostensibly repaid, all that really happened was that the Newcos passed through the repayment amounts to the assignees of the loans, i.e. the EBT trustees. Accordingly the analysis was that the original loans were repaid to the EBTs (the assignees), and replacement advances made by EBTs, but that the loans made by the Newcos had never been repaid to those companies themselves.

The present relevance of the above is partly that there is a further dispute between HMRC and the Newcos, and doubtless the liquidator of the Newcos and the parties that have indemnified the liquidator. More relevantly in the context of the present Appeals, the Appellants make the point that they cannot have simultaneously received earnings or emoluments for PAYE purposes in accordance with HMRC's fallback PAYE contention, if simultaneously they are being assessed under sections dealing with loans to participators.

We should make the further and distinct point that we were told that Mr. Dryburgh gave some security in support of the replacement loans that were made to him by the trustees.

12. During the various exchanges in relation to the points just dealt with in 10 above, an intra office note was sent by one of his partners at Reed Smith on 29 March 2006 to brief Mr. Hartley in relation to the role that the trustees wanted him to perform.

13. On 3rd May 2006 SA itself was placed in Members' Voluntary Liquidation.

14. In September 2006 **the charges over the remaining "charged deposits"** (in other words the great majority of the original deposits) were released.

15. In October 2006, HMRC made various assessments, based on the analysis that the EBT contributions made by SA and FM were not deductible for corporation tax purposes.

16. In February 2007, s. 419 assessments were made upon the Newcos in respect of the loans to participators. We repeat that we are not concerned in these Appeals with those assessments.

17. In April 2007, Mr. Dryburgh learnt that Mr. Somper and Mr. Charles (as we understand it Mr. Charles actually having left employment by Scotts companies back in May 2004) had set up a competing business, using the contacts of the Scotts companies. Mr. Dryburgh only gathered this from the fact that parties negotiating with Mr. Somper and Mr. Charles rang Scotts and spoke to Mr. Dryburgh, ignorant of the fact that Scotts had nothing to do with whatever proposals were being put to them.

18. On 21 December 2007, Mr. Dryburgh e-mailed the trustees of one of the EBT trusts asking whether they would be prepared to lend approximately £100,000 back to FM because FM was now having to attend to all the

administrative work in relation to past transactions, and particularly after the departure of Mr. Somper, this was proving onerous. We understand that the trustees, almost certainly on advice from Mr. Hartley of Reed Smith, ignored this request and that no loan was advanced.

19. On 19 August 2008 Mr. Hartley of Reed Smith sent a letter confirming Reed Smith's instructions to advise the trustees in relation to sub-appointments and the allocation of funds between the various sub-trusts.

20. In August 2008 Reed Smith made their recommendations. These recommendations were based initially on a review produced by Mr. Dryburgh in which in one document for each EBT he summarised the respective contributions of the various potential beneficiaries. In a separate schedule, Mr. Dryburgh then gave his suggested figures for the proposed sub-appointments and allocations. The figures corresponded broadly to the loans already made. The suggested allocations indicated the figures that Mr. Dryburgh considered appropriate for Mr. Charles and Ms. Moola. Ms. Moola was certainly shown the review document, but not the schedule, though she did know what was proposed in her case. Mr. Somper had seen both the review and the schedules of figures.

21. In summarising Mr. Hartley's evidence below, we will deal with the issues of why it took so long for Mr. Hartley to consider matters when he had first been involved back in 2006. We will also summarise the cross-checking that Mr. Hartley undertook in seeking to confirm that Mr. Dryburgh's suggested allocations were in the right range. It is sufficient to say for present purposes that Mr. Hartley's recommendations were precisely in line with the figures suggested by Mr. Dryburgh.

22. For reasons that are again not entirely clear, the sub-appointments and allocations of benefits in the form of loans were not made until December 2010. When they were made, they corresponded precisely to the figures in Mr. Dryburgh's initial review and schedule, and thus to Mr. Hartley's formal recommendations. They were also said to be backdated to the year 2008.

The evidence

63. Evidence was given by Mr. Dryburgh; by Mr. Donald Simpson of Turcan Connell, the Scottish law firm that had advised the Scotts companies in relation to the transactions and whose trustee companies in Guernsey acted as the trustees for all three EBTs; by Ms. Moola (by video link from South Africa); by Mr. Alasdair McLaren, no longer involved with Turcan Connell but head of Turcan Connell's Guernsey trust business until either 2006 or 2007, and by Mr. Simon Hartley of Reed Smith. A Witness Statement had been provided by Mr. Somper, but he was not prepared to attend the hearing or be cross-examined and relatively little attention was therefore paid to the Witness Statement.

64. We will record some of the evidence given by Mr. Dryburgh, and the evidence (not expert evidence since Mr. Simpson had advised in relation to the transactions) in relation to Scottish law given by Mr. Simpson in discrete paragraphs. We learnt

little from the remaining evidence, and since much of it involved one recollection by one party and another by Mr. Dryburgh, we will deal with that in composite form.

Mr. Dryburgh's evidence

65. Mr. Dryburgh gave evidence, and was cross-examined, for several days. There is no doubt that HMRC regarded him as a potentially untrustworthy witness, and we are certainly going to have to confirm that in several respects that expectation was very clearly confirmed. Prior to summarising those matters that emerged from his evidence that have not been included in the summary of the facts given above, we will make two observations.

66. We first record that it was obvious that Mr. Dryburgh was an impressive and a highly intelligent and disciplined man. It was not remotely surprising that he had been a partner in Deloitte & Touche, or that he had built up a business that had at least at times been highly successful. He answered every question put to him over a very extensive period in the witness box coolly and almost always without hesitation. Many years had elapsed between the date of the events being considered and the hearing itself, and whilst lack of recollection on a few matters was, and certainly remains, rather troubling, there were other occasions where the fact that he had forgotten minor details was entirely understandable.

67. The related point that we wish to record is that it is obvious that Mr. Dryburgh was under intense pressure. He had fairly recently been involved with the Scottish litigation. We were certainly aware that there was some urgency to complete the tax litigation so that he could then face the litigation under the Insolvency Act. There was even reference to "nine disputes", though we know nothing of the detail of that or whether the figure given was literally correct. Whilst we consider that his occasional challenges that he was being "hounded" by HMRC were unjustified on the evidence that we saw, and whilst we also understood HMRC's explanation when they said that their failure to assess Mr. Somper for equivalent liability for PAYE tax in respect of benefits was obviously based on the fact that Mr. Somper was out of the jurisdiction, we certainly sympathised with Mr. Dryburgh's feeling of grievance. On his perception Mr. Somper and, to a much lesser degree, Mr. Charles, had taken the benefits of the once successful operation of companies that were initially formed by Mr. Dryburgh himself, and are now trading together, Mr. Somper remaining a director of some of the Scotts companies at the time of commencing that business. The feature that others have taken and retained the benefits, whilst leaving Mr. Dryburgh with countless claims and presumably some "after-care" administration for clients who will have respected and trusted him, in other words "the job of trying to clear up the wreckage", does deserve some recognition.

68. Having said that, there is no doubt that Mr. Dryburgh not only lied to the Tribunal in a material way, but he appeared also to have fabricated evidence, forged documents and thrown away a memory stick in order to destroy evidence. He admitted to those lies in a further Witness Statement, and in our view he compounded the lies when apologising for them in the Witness Statement, by advancing a further more material lie.

69. The context in which this occurred related to the mechanics required to effect the subscription by SA of the trivial shares in SAIL for £7,636,000, and to the feature (explained in the third and fourth bullet points in paragraph 47 above, and again at items 1 and 2 of the seventh bullet point of that paragraph) that £6,361,108 of the subscription amount involved dealing in some way with the fact that various moneys and charged deposits were already held by SAIL, and that SAIL owed £6,361,108 to SA. It followed that the subscription was going to require some sort of set-off in order to eliminate those debts owing to SA and ensure that the whole capital value of £7,636,000 was in the hands of SAIL. HMRC raised two related points in relation to this. They first said that a set-off required contractual acquiescence by both parties, and that there was no evidence that SAIL had agreed to anything in relation to any such set-off. Secondly they said that whilst a Board Minute of SA had been produced (the one mentioned in the sixth bullet point of paragraph 47 above), no subscription agreement had been produced. This raised the question of whether the set-off had actually occurred at all (i.e. whether SAIL really still owed the very substantial amount to SA), and the timing point of whether the actual subscription had occurred on 5 April 2004 (as opposed to a day or two later), possibly relevant to whether PAYE claims were out of time or not.

70. All that we knew on the basis of the documents provided was that other elements of the claimed subscription by SA were furnished on 5th April. The bank statement demonstrated that the £240,000 had been paid on 5th April, and the letter to Barclays Bank dealing with the four further charged deposits was also dated 5th April. We also knew that on 7th April SA sold the trivial shares, implicitly held by them, to SA EBT, and on the same date, SAIL acknowledged that transfer.

71. We might mention in passing that HMRC's contention was slightly inaccurate in that the subscription could have been effected without any notion of set-off simply by SA subscribing the trivial shares on the basis that it would (i) pay £240,000; (ii) assign the four charged deposits, and then (iii) simply release SAIL's debts to SA in respect of the £6,361,198, all in return for the issue of the shares. Nobody addressed that. Mr. Dryburgh's initial claim about the set-off was that when the Board Minute referred to a contribution of £7,636,000 in return for the trivial shares, and no specific reference was made to any set-off, the feature of the set-off was just obvious, and of course it was confirmed by the accounts of both companies.

72. On a later date in the hearing, Mr. Dryburgh revealed that he had found a further couple of Board Minutes that indeed dealt with the set-off, one of SA and one of SAIL. They were both dated 5th April, and they appeared to evidence contractual agreement in relation to the set-off and the implicit feature (since SAIL was resolving to agree to the set-off) that the set-off occurred on 5th April. In due course, Mr. Dryburgh purported to hand up several copies of the Board Minutes, and the claimed 2004 originals that he said that he had found in his desk at home.

73. Mr. Dryburgh was then subjected to fairly intense questioning by HMRC's counsel along the lines that the purported originals and the copies appeared to be in different typeface and format to other plainly genuine 2004 documents, and that the shiny good quality paper on which both the claimed originals and the copies of the newly-produced set-off minutes were printed appeared to be identical. HMRC were obviously suggesting that the originals and then the copies had been produced

recently. The claimed originals had been signed by Mr. Dryburgh. Mr. Dryburgh continued to claim that the originals had been found in his desk and that they did date from 2004.

74. When the hearing resumed on 1 March, Mr. Dryburgh handed up a Witness Statement in which he made a fulsome apology of deep regret for having lied, and he confessed that he had in fact printed out the originals in his counsels' chambers (plainly unknown to either counsel), then signed them, and then asked the clerks to produce several copies of the then signed board minutes. The claim, then, was that the purported minutes did still date from 2004 in that he said that he had found a memory stick at home that had had the relevant minutes on it; that he had brought that into the counsels' chambers, printed the "originals" off from the memory stick, signed them, and then obtained the copies. HMRC pointedly suggested that the admission of the lies and the apologies resulted not from a sudden pang of conscience, but from the fact that HMRC had taken away the supposed originals and the copies on 22 February, and in the intervening period between 22 February and 1 March HMRC would almost certainly have had the paper examined by experts, as indeed it appeared that they had done.

75. We will now ignore the detail, but HMRC continued with the contentions that the claimed "originals" did not date from 2004, because the typeface, setout etc. of the documents differed from those different minutes that plainly did date from 2004. HMRC's counsel eventually asked whether HMRC could see the memory stick, whereupon Mr. Dryburgh said that he had thrown both the memory stick and the biro with which he had signed the so-called originals, into a bin on the walk between counsels' chambers and the Tribunal. His suggested reason for having thrown it away was that it would have revealed that the documents on the memory stick had not been signed.

76. We do not believe that evidence. We agree with HMRC that if the memory stick and its content did date from 2004, retention of the memory stick would have been decisive evidence to confirm the genuine nature of the minutes produced, and we also agree that if the memory stick did date from 2004 it would have been obvious that the text on it would not have been signed in any event. Accordingly, the ostensible ground for disposing of the memory stick did not make sense, and we infer that it was in fact destroyed because it would have indicated that the documents on the memory stick had been generated in 2013. Without troubling to refer to other points about setout, and rogue apostrophes etc. we also agree that all the documents produced by Mr. Dryburgh appeared to be in quite different format to other obviously genuine minutes and documents dating from 2004. Our conclusion is that whilst admitting to one lie, and apologising profusely for it, Mr. Dryburgh included a further rather more material lie in the Witness Statement produced and in the evidence that he continued to give.

77. We rather confused HMRC's counsel in the hearing by indicating that this fraudulent evidence related to points about the set-off which we would have been inclined to accept on the basis of the point mentioned in the final sentence of paragraph 71 above. This was meant simply to be an observation that it was unfortunate for Mr. Dryburgh that he had fabricated evidence when it was probably irrelevant that the written evidence was not available. We believe that HMRC's

counsel eventually understood and almost agreed with the proposition that the set-off (though arguably not its timing) might well have been established without any production of further minutes. None of this slight misunderstanding was meant to relate to the seriousness of the fact that evidence was plainly fabricated, and the memory stick destroyed.

78. In summarising the general evidence below, we will refer to various matters, properly drawn to our attention by HMRC where Mr. Dryburgh was reticent in conceding points that were obvious, albeit slightly or materially prejudicial to his case, and other points where there was some doubt about his evidence. The most important point to note now, however, is that in relation to by far the most important point of evidence, namely whether it was always agreed or implicit between Mr. Dryburgh and Mr. Somper throughout the accounting period ending 30 April 2004 that SA would be operated on the basis that SA would pay out bonuses or EBT contributions to Mr. Dryburgh and Mr. Somper (after an appropriate bonus to Nazeera, and the relevant payment to Mr. Charles) of virtually the totality of SA's profits, we cannot rely on Mr. Dryburgh's evidence. We must in other words look only to objective indications if we are to reach and sustain a conclusion that that was the implicit agreement between Mr. Dryburgh and Mr. Somper and SA and FM throughout the period in question.

Summary of other material evidence, and in particular points of dispute or doubt

79. There were several topics where we were left in doubt as to what the true position had been, and where to some degree there was conflict between the evidence of Mr. Dryburgh and other witnesses.

The lack of explanation for the 6-year delay in vesting the assets directly in the hands of the trustees of the EBTs

80. One such significant topic was why it was that such a very long period subsisted between the making of the contributions into the Newcos, and the final distributions into the EBTs, which only occurred at the very end of the year 2010.

81. Mr. Dryburgh initially explained the delays by suggesting that Mr. McLaren, who had been in charge of Turcan Connell's Guernsey operation and their "in house" trust companies at the outset, had been extremely efficient, but regrettably he left and was replaced by a lady who was highly regarded as a trust lawyer, but fairly inefficient at administration. Matters had therefore drifted. This explanation was undermined when it became quite plain that Mr. McLaren had remained in charge of the Turcan Connell trust operation for two or three years after the initial transactions in 2004. Mr. Dryburgh might have just forgotten this because later documents were going to undermine the claim, though it was odd to account for the delays in this manner.

82. On the same basic topic there was then dispute between Mr. Dryburgh on the one hand, and Mr. McLaren, and to an extent Mr. Hartley, in that Mr. Dryburgh was claiming that the Guernsey trustees were always just "lazy", whilst both Mr. McLaren, and to some extent Mr. Hartley, were indicating that their delays in acting were attributable to the fact that they only expected to attend to trust matters when

requested to do so by the settlors or beneficiaries, and that nobody prompted them to do anything.

83. Whilst we are inclined to adopt the suggestions given by Mr. Mclaren and Mr. Hartley, just referred to, we nevertheless ended up finding this feature unsatisfactory, and cannot volunteer a firm suggestion as to why there were such delays.

84. We might add, however, that we found HMRC's suggestion relatively implausible. HMRC's suggestion was that whilst the basic EBT planning would have required funds to be passed to the EBT trustees, and for allocation and provision of benefits to be dealt with under the discretions exercised by the trustees, HMRC claimed that Mr. Dryburgh must have found it unacceptable to relinquish control over the assets in the various Newcos (of which he and Mr. Somper were directors), and more materially the ability to govern who would receive benefits, to the trustees. We consider this to be singularly unlikely. First we note that as a tax specialist, Mr. Dryburgh would have attached importance, in sustaining the tax planning, to vesting the assets in the trustees. Furthermore, whilst Mr. Dryburgh claimed that he was not prompted to hurry matters along by the commencement of HMRC's investigations, the hasty action that did follow the commencement of enquiries (see items 8,10,11 and 12 in particular in paragraph 62 above) did suggest that Mr. Dryburgh considered it important to sustain the tax planning by vesting the assets directly in the trustees, and he immediately sought to initiate such action when he saw that the scheme was to be scrutinised by HMRC. We are far from clear that that was actually particularly vital, but the rapid action after HMRC's first intimation of challenge was significant. We are also very sceptical as to whether Mr. Dryburgh would have feared that he would lose whatever control he wanted if the assets were passed to the trustees. It seems unrealistic to suppose that the trustees would have done anything other than accede to the wishes of Mr. Dryburgh and Mr. Somper, and that it was instead far more likely that Mr. Hartley and the trustees would indeed make recommendations, and exercise discretions, very much as it was realistically assumed that they would do. Of course in the event, that is precisely what happened.

85. The two conclusions that we draw in relation to the six-year delay are as follows. First, we conclude that we were given no satisfactory explanation as to why the delay occurred. Mr. Dryburgh was an efficient professional, and we cannot volunteer a convincing explanation for why he did not drive matters forward, when that was something he was obviously well able to do. We simply do not know the answer to this question.

86. While it is little more than speculation, we consider that a distinctly possible explanation for the delays was not remotely the desire to have control over the allocation of employee benefits, but rather the complicating factor that at least until October 2006 a substantial quantity of the assets in the Newcos (or just in SAIL) were charged in support of quite different liabilities. And to distribute assets in FM and NCSIL, when those in SAIL might have to be left "locked in SAIL" would have emphasised the slightly embarrassing fact that SAIL's assets included some that might be required for other purposes. There are the related points that SAIL was called upon to lend FM £538,975 (mentioned at item 2 of paragraph 62 above) to FM, and that Mr. Dryburgh sought but then failed to procure that Mr. Hartley and the trustees would sanction a further loan back to FM to fund administrative expenses

(mentioned at item 18 of paragraph 62). These are examples of the rather odd point that Mr. Dryburgh might have wanted to reserve some control over the assets in the Newcos, but perversely this was not to secure control over the allocation of employee benefits, but rather to retrieve value from the Newcos for the purposes of the Scotts companies, or simply to retain control over settling the liabilities for which many deposits were charged. The feature that it was specifically mentioned to Mr. Hartley that all the assets should be released from the charges in October 2006 seems to support the thought that the earlier existence of the charges did cause problems. Quite apart from Mr. Dryburgh's personal concerns in relation to having potentially to deal with these liabilities for which the deposits were charged, it seems equally credible that the trustees, engaged to deal essentially with discretions as between potential beneficiaries, might have been reluctant to take distributions of assets within the Newcos, charged to meet quite different potential liabilities.

87. We acknowledge that we cannot confirm that the suspicions mentioned in the previous paragraph are correct, and certainly no-one addressed them.

The issue of whether the business of SA might continue, requiring the continuing loyalty of the employees, in the periods after 30 April 2004

88. On a quite distinct topic there was also extensive cross-examination of Mr. Dryburgh in relation to the issue of whether it was obvious by April 2004, if not even by February 2004, that SA's business was unlikely to progress in the following period. This was potentially relevant to HMRC's contention that the deductibility of EBT contributions was reliant, *inter alia*, on the need to incentivise employees to work in following periods to continue to generate profits. Mr. Dryburgh's claim that the business did continue, and that indeed there were profits in the next period was undermined, when it became clear that the turnover in the period commencing 1 May 2004 had been Nil, and that there was only a profit because of some refund of professional fees or the write-off of a liability that had been provided for such fees.

89. We conclude that Mr. Dryburgh must have known that the business of SA had effectively been brought to an end by whatever law change had been made in February 2004. We accept that we were shown papers relating to a hoped-for line of new business in relation to under-valued cinema assets in the US, and that the research undertaken in relation to that possible venture (albeit that nothing came of it) was almost certainly genuine. In terms of credibility of evidence, however, this does not affect the conclusion that Mr. Dryburgh's claims about the actual continuance of the film business in the period commencing 1 May 2004, and profits in that period, were both misleading and probably meant to be misleading.

Whether the contributions made to the EBTs left SA and FM unable to meet potential liabilities, particularly in relation to corporation tax should the contributions not be deductible in computing profits for corporation tax purposes

90. There was also considerable cross-examination of Mr. Dryburgh in relation to whether the EBT contributions, particularly those made by SA, had been designed to strip SA of assets, so that (rather as Lord Glennie had concluded in the Scottish case) some of the motivation for the making of the contributions was geared to ensuring that even if the claims for tax deductions failed and SA was left with substantial

liabilities for corporation tax, HMRC would be unable to recover the tax because SA would then be insolvent.

91. Mr. Dryburgh suggested that the only reason why SA ended up making losses, and with no net worth, following the making of the contributions was that it faced the unexpected claim for £1 million from Mr. Hoffman which was only made on 30 April 2004, and said to have been unjustified.

92. We summarised the facts in relation to this claim at item 2 of paragraph 62 above, and repeat the conclusion that we were unable to verify that the accounts of SA in either the period ending 30 April 2004 or the following period reflected the amount paid in settlement of that claim. The evidence in relation to this claim, and how it was settled, was all somewhat confusing. Whatever the position, the amount paid in settlement and any amount paid in legal fees did not make the difference between SA retaining sufficient net worth to meet a potential claim in respect of either corporation tax or PAYE and NIC deductions, were those asserted and established.

Nazeera's comments on the set-off documentation

93. We dealt separately above with all Mr. Dryburgh's evidence in relation to the set-off matter. In giving her evidence Ms. Moola said that she could not herself remember producing minutes to deal with the set-off, and she could not remember drafting an actual subscription agreement for the subscription by SA of the trivial shares in SAIL. She did say that she thought that she remembered Mr. Somper mentioning to her the need to deal with the set-off point, and that she felt sure that it would have been attended to. She was unable, however, to say with any conviction that minutes had actually been produced, and she could not remember having produced them. Our conclusion was that written minutes had probably not been produced. If they had been, they were almost certainly not in the terms of the documents that Mr. Dryburgh had printed out from the contentious memory stick.

The quasi-partnership issue

94. An important matter in terms of evidence was whether there was support for Mr. Thornhill's submission that SA and FM operated as "quasi-partnerships" and that the quasi-partners who were to agree on the fair allocation of virtually the whole of the profits of SA and FM between them were Mr. Dryburgh, Mr. Somper, Mr. Charles and Ms. Moola.

95. We should immediately say that in giving our decision below, our analysis will be (and indeed always was) that if the quasi-partnership claim was sustained, then it was a quasi-partnership between Mr. Dryburgh and Mr. Somper. The evidence does, however, have a bearing on the secondary issue of whether Mr. Charles and Ms. Moola should be treated as having participated in any such quasi-partnership notion of profit sharing.

96. Mr. Dryburgh was cross-examined extensively as to why Mr. Charles had been made a director of SA for a fixed period of 6 months almost immediately prior to the steps at which SA contributed the assets into SAIL. Mr. Dryburgh's claim was that Mr. Charles had been employed all along, or certainly since December 2003, by SA,

but that because this was not reflected in a written service agreement, he was formally made a director simply to put it beyond doubt that he was eligible to participate in the provision of benefits under the SA EBT. HMRC contended that Mr. Charles was a singularly odd choice as a director since he had provisionally been censured, and was about to be formally censured, by the SFO, all to the knowledge of Mr. Dryburgh, for some sharp practice in marketing some form of hedging instruments or hedge fund. HMRC's contention was that Mr. Charles was in fact in dispute with the Scotts companies, and that he was made a director of SA simply so that the compensation claim could be settled through the EBT structure. We consider that this contention by HMRC was realistic. Ms. Moola confirmed in her evidence that "Mr. Charles was always in dispute about money", and the impression that we gained was that he was making a claim for some form of commission and not that he was just advancing his case as one of the "four quasi-partners" for a fair share of the profits. The relatively minor significance of this point may just relate to whether when SA made contributions destined for Mr. Charles, some or all of them should be disallowed as representing satisfaction of claims made against other Scotts companies than SA, and thus not properly being deductible expenses of SA itself.

97. Ms. Moola also said that she had never had discussions about profit sharing and did not consider herself to be "one of an inner circle of four" (or indeed three, if we now exclude Mr. Charles). We accept this. If there was a quasi-partnership profit sharing-expectation, that existed between Mr. Dryburgh and Mr. Somper, the two of them nevertheless conceding that Mr. Charles had been an excellent marketing man, and that his claims had anyway got to be settled, and that Ms. Moola certainly deserved a conventional employee bonus.

Mr. Simpson's evidence

98. Mr. Simpson was called to give evidence about Scottish law, and the two points that arose in relation to the supposed option grants by SAIL and the directors of FMIL.

99. Mr. Simpson's evidence was not particularly relevant in relation to the supposed grant of the option by SAIL (i.e. the one said to be governed by the law of England and Wales, where no consideration was given) because he simply made the point that Scottish law had no concept of consideration being required to make a promise or grant, intended to have legal effect, valid. We accept that, though simply note that the private international law issue of whether Scottish law or English law should be applied to the "consideration" issue when the grantor was a Scottish company, and the Option Agreement was said to be governed by English law is not a matter of Scottish law, but a matter of general conflict principles. The parties gave us their submissions on this point.

100. Mr. Simpson also gave evidence in relation to the issue of when the option was granted in the December 2003 transaction involving the grant of the option by Mr. Dryburgh and Mr. Somper, acting as the directors of FMIL. In other words, was there a grant as soon as Mr. Dryburgh and Mr. Somper had executed the agreement on 16 December, or was the grant deferred until the two other parties, the two relevant EBTs, had executed the agreement in Guernsey on 22 December. Were the latter the

case, the consequence would be that the option would not legally have been in force at the time when FM disposed of the trivial shares in FMIL.

101. Mr. Simpson's evidence was not clear-cut. We learnt that under Scottish law, there could be a valid grant, without there being consideration, and regardless of the fact that the grantee might not be aware of the grant, or indeed be in existence. In cross-examination Mr. Simpson conceded that if what appeared to be a grant was in fact an offer and the offer had not been accepted, then there was no binding agreement until the offer had been accepted. We also learnt that the default assumption between "grant" and "offer and acceptance" was the latter, and that in business and commercial transactions, there was a presumption that the offer and acceptance analysis prevailed. There could be an implicit contract not to withdraw an offer, once made, but it was not asserted that in this case there was evidence that there was such an implicit contract. It was nevertheless accepted as a factual matter that the option document, not at that time executed in counter-part, had been posted to Guernsey immediately it was executed in London by Mr. Dryburgh and Mr. Somper.

Our decision

102. As we have indicated, we will now deal with every point which was the subject of contentions during the hearing, regardless of whether any of them (indeed in fact the vast majority of them if the basis of our decision, given in paragraph 147 below, is not over-turned on appeal) are irrelevant.

103. There have been a number of earlier appeals in relation to the present issue of whether contributions can be made to EBTs in such a manner that corporation tax deductions are available, notwithstanding that the provision of benefits from EBTs (possibly or probably in the form of loans) have occasioned no liabilities to PAYE tax and NIC deductions. There is no need to refer to the various earlier cases because these appeals revolve largely around claims that the present facts are far removed from those in the earlier precedents, and they revolve around the proper interpretation of paragraph 1 Schedule 24. The earlier cases do however go some way to supporting the claimed expectation on the part of Mr. Dryburgh that the steps undertaken might very well achieve those dual benefits. In that context, it is also worth remembering that at the time of implementing the schemes, nobody would have detected the errors that it is now claimed may have undermined the schemes. Furthermore the actual basis on which we decide that no corporation tax deduction is appropriate for any of the contributions made by either company in this case was not a ground that was specifically advanced by HMRC in argument. We have no hesitation in basing our decision on the point in question since it was encompassed by the general arguments advanced by HMRC, but the precise articulation of what we consider to be the decisive point was not advanced at all during the hearing.

The quasi-partnership argument

104. Mr. Thornhill's fundamental argument was that in the case of a company whose entire profits were attributable to the skills and work of the directors or employees, it was perfectly in order for the company to pay out the bulk or the entirety of the profits to the directors and employees, and that one would ordinarily expect a corporation tax deduction for such payments. Mr. Thornhill said, and we

certainly agree, that there are a number of businesses, often businesses now conducted by limited companies that had formerly been partnerships of individuals where the invariable practice is to pay out bonuses to directors such that the companies are left with very minor profits and (assuming ordinary salary or taxable bonuses at this point) the profits are taxed in the hands of the directors or the directors and employees.

105. There was no suggestion that corporation tax deductions would be due if the profits of companies employing considerable capital (successful manufacturing companies for instance) were paid out to the directors and the bonuses exceeded the value of the contributions actually made by the directors. The suggestion was simply confined to the businesses where the profits were entirely generated by the skill, knowledge or contacts possessed by the directors. Assuming at this point that the profits were paid out as taxable bonuses, subjected to PAYE and NIC deductions, and that there was either a legal obligation during the period for bonuses to be paid at the end of the period, or a clear expectation that the business model was such that bonuses would be paid, we cannot see any doubt that the bonuses would be deductible. Quite apart from their other reservations, HMRC seemed to doubt the validity of the notion that this was an acceptable business (and "profit-distribution") model in the case of a "people business". We find this strange and wrong, and as Mr. Thornhill suggested, we doubt whether any attempt would have been made to disallow the bonuses, had they been paid out as taxable bonuses, and had this always been the business plan. A notion, for instance, that only half the profits should have been paid as bonus, and the other half taxed and either retained or distributed as dividend would have been quite inexplicable, had the facts been that the profits were all derived from the efforts and skill of the directors, and had the bonus intentions always been clear.

106. The company in the example, just assumed, secures a trading deduction for bonuses paid because the bonuses are expenses incurred wholly and exclusively to earn the profits attributable to the work performed by the directors. There is no question of the corporation tax deduction being denied on the ground that the company has some "duality of purpose" in simultaneously seeking to reduce its corporation tax. The deduction is the intended, natural and entirely proper result of the payment of the bonuses, and no expectation or intention of eliminating the corporation tax liability represents the type of "duality of purpose" that might lead to the disallowance of the payment of the bonuses.

107. In the present case, we accept that the companies' profits were entirely attributable to the efforts of the directors and employees, and in particular that whilst more conventional bonuses might appropriately have been paid to Mr. Charles and Ms. Moola, Mr. Dryburgh and Mr. Somper were the "quasi-partners" without whom the business could not have been undertaken, and it was perfectly appropriate for the "super profits" to be divided between them.

108. We are not concerned by the fact that Mr. Thornhill initially advanced the case on the basis that the companies were effectively "corporate/partnerships" composed of four "quasi-partners". As we will mention below, we consider that the explanation for the making of EBT payments to Mr. Charles was somewhat distinct, and we accept Ms. Moola's evidence to the effect that she was not part of any "inner

circle" the members of which would jointly make the profit-distribution decisions. The "quasi-partnership" was composed of Mr. Dryburgh and Mr. Somper. The fact that they were also indirectly the shareholders, to whom dividends could have been distributed on a 50/50 basis has no bearing on the deductibility of the bonuses if the business model was to distribute bonuses. This is for the reason given in the last sentence of paragraphs 105 and 106 above.

HMRC's various contentions that the corporation tax deductions should be disallowed

109. We will now deal with each contention by HMRC that the deductions should have been disallowed.

Wholly paid to secure a corporation tax deduction

110**.** One of HMRC's principal contentions was that it was almost the dominant objective of the making of contributions to the EBTs or to the EBT Newcos to secure corporation tax deductions, and that since eliminating the tax on the profits was obviously not a legitimate trading expense, the EBT contributions should be disallowed. The basis of our actual decision is not that far removed from this point, but HMRC's own argument on this ground appeared to treat the feature that benefits would flow to directors as altogether incidental, and thus to treat the bonuses as just artificial payments made to eliminate the tax liabilities. Since, on any approach, the dominant motive was to enable benefits to flow to the directors, we find this approach by HMRC to be unrealistic and wrong.

Payments made without legal liability to make them, and in circumstances where there can have been no reality to incentivising directors and employees to work in future periods and to make profits in future periods, justifying the deductions on that second basis

111. There are two distinct points here, only one of which we consider to be appropriate in the present case.

112. In a case where the company itself will retain considerable profits, attributable to its whole business structure, and only part of the profits are directly referable to the efforts of the employees, the company has an obvious motivation to ensure the future generation of its own retained (or "shareholder") profits by treating its employees appropriately and securing their loyalty and future efforts. That logic is however really irrelevant in the present case because where all the profits could legitimately be paid to the two directors in respect of their contributions, and where they would otherwise potentially enjoy retained profits as dividend or accumulating surplus, the notion of incentivising the directors by paying bonuses is really irrelevant. In one form or another they will enjoy the profits of their work, directly or indirectly, and the chosen mechanic for dealing with bonuses and profits is not in reality going to make the directors more inclined to work harder or to remain loyal.

113. In the present type of case, the real test is whether the business model, and the business model throughout the period during which the directors were working, and during which the profits were being earned, was that the directors would receive the

profits as bonus at the end of the period. We accept part of HMRC's contention to the extent that if, in the present case, there had been no practice of paying bonuses, and for instance the profits beyond relatively fixed salaries had always been either retained or paid out as dividend, there might have been some difficulty in claiming a corporation tax deduction at the end of the period if the decision was suddenly taken, after the profits had been generated in the company, to pay them out as bonus. We very much doubt whether a deduction would even then have been questioned if the bonuses were paid in this situation as ordinary taxable bonuses. Theoretically, however, if there had been no entitlement or expectation during the period that the directors would receive the bonuses, then deductions could have been questioned. The bonus payments would have been a chosen mechanism for distributing profits that had initially been earned without any implicit cost, whilst the profits were being generated, of having to pay additional amounts to the directors.

114. For the reasons given in paragraph 112 above, we consider it almost wholly irrelevant to enquire whether the business of SA was going to continue in the period commencing 1 May 2004. We conclude that it was very unlikely that it would continue in anything like the same form, but the notion that Mr. Dryburgh and Mr. Somper would somehow incentivise themselves to work harder in future periods by being generous in paying bonuses for the April 2004 period is obviously unrealistic. Admittedly the incentivisation logic could have applied to bonuses paid to Mr. Charles and Ms. Moola but since the vast majority of the bonuses were paid to Mr. Dryburgh and Mr. Somper, and we will deal with Mr. Charles and Ms. Moola below, we consider that this minor exception to the present point is largely irrelevant.

115. The decisive question in the present case is whether the companies had, throughout the relevant periods, a legal obligation to pay bonuses or EBT contributions to Mr. Dryburgh and Mr. Somper at the end of the various accounting periods of the two companies, or whether the clear business expectation throughout those periods was that EBT contributions would indeed be paid, albeit not strictly under legal obligation.

116. We accept that there were no legal obligations on the part of either company to pay "period end" bonuses or EBT contributions in this case.

117. The reality in the case of companies owned by two individuals is that it will be unusual and unrealistic for there to be written (or actual) legal obligations for the companies to pay discretionary bonuses at the end of accounting periods. We accept, however, that such companies can still have a sound basis for claiming that late bonus or EBT contributions are proper expenses of earning the profits (and thus properly deductible), if the expectation throughout the period is that such contributions will be made.

118. We consider that in this case, those expectations did exist throughout the relevant periods, and that it was always intended that Mr. Dryburgh and Mr. Somper would receive the vast majority of those profits in the form of EBT benefits.

119. We cannot rely wholly, or perhaps at all, on Mr. Dryburgh's evidence to the effect that this was always the intention. It was, however, his evidence. We base our conclusion as to the relevant and critical expectation on the facts that:

- the Newcos, that were incorporated for no purpose other than to play their roles in the eventual contributions, were incorporated 4 ½ months into the accounting periods;
- Mr. Dryburgh had arranged for earlier profits to be paid to himself (admittedly not to the other director) in the 2001 transactions as EBT contributions, also adopting the "paragraph 1 Schedule 24 scheme" and that in December 2003 and April 2004 those arrangements had not been challenged;
- whilst some of Mr. Thornhill's advice in relation to EBT planning had been wholly redacted, earlier notes of conference had not been redacted and it was perfectly obvious that Mr. Dryburgh, as the "tax planner" as between himself and Mr. Somper, was a serial EBT addict;
- the Scotts companies themselves gave EBT planning advice to their own clients; and
- Mr. Dryburgh had frequently sought advice from Mr. Thornhill, Mr. Thornhill being a particular expert in relation to EBT planning.

120. We accept that SA and FM had not made EBT contributions in their one or two earlier accounting periods, but we asked why that had not been the practice and were told that in those periods there were no significant profits to contribute in any event.

121. In relation thus to HMRC's contention that the deductions should be disallowed because they were paid without obligation, and at a time when incentivising anyone in relation to future periods was irrelevant, we conclude on this ground that the implicit understanding throughout the periods that the EBT contributions would be paid renders the payments tax deductible, subject simply to possible further grounds of challenge.

Whether the expenses were incurred by SA and FM not for the purposes of the respective trades of those companies, but for the purposes of the trades of other Scotts companies, such that they should be disallowed on that ground

122. We accept that one company cannot secure a trading deduction for meeting expenses of another company's trade.

123. Our ultimate decision on the corporation tax deductibility issue is actually that on one ground the entire expenses are non-deductible. Since that may be disputed on appeal, we now conclude that the EBT contributions made, and destined for Mr. Charles, should not be deductible because we are far from clear that they were proper expenses of SA, i.e. the company that actually made those contributions. We agree with HMRC that Mr. Charles was made a director of SA artificially simply so that his claim for compensation in respect of certain commissions alleged to be due to him could be satisfied by SA. It may very well be that many of the commissions had been earned (or at least claimed) by Mr. Charles in his capacity as an employee of SA itself, but there was no clear evidence that he had been an employee of SA prior to the date in April 2004 when he was artificially appointed as a director. The agreement under which, on receiving the relevant benefits, he confirmed that he abandoned all claims against Scotts companies certainly listed about six companies, and this,

coupled with the absence of evidence, justifies us in saying that the contributions in respect of Mr. Charles should be disallowed.

124. Ms. Moola appeared to have worked very substantially for SA, of which we believe she was the company secretary, and leaving aside the later ground on which we conclude that all the EBT contributions should be disallowed, we would not have disallowed the EBT contributions made on her behalf under this present contention.

125. So far as Mr. Dryburgh and Mr. Somper were concerned, we are satisfied that by far the most active Scotts companies in 2003 and early 2004 were SA and FM, and we see no ground for treating the two companies as meeting expenses of other companies (i.e. other than SA in the case of SA contributions, and FM in the case of FM contributions) when making EBT contributions largely for these two directors. After all, they had generated the profits, the profits appeared to be respectively in SA and FM, and since it was the generation of those profits that occasioned the implicit business model that those profits would be paid out to them, we see no reason to dispute the deductions on this present ground. We note that whilst they benefited broadly in the ratio 50/50 in overall terms, they received somewhat different loans from the respective Newcos and that this was said to reflect where their greater contributions had been made. We consider this arrangement to be perfectly acceptable.

Were the expenses incurred, under the machinery of the paragraph 1 Schedule 24 scheme, such that SA and FM incurred capital losses, rather than revenue losses, and disallowable on this ground?

126. We consider that this point is wholly wrong.

127. It will be recalled that the essence of the paragraph 1 Schedule 24 scheme was that:

- on day 1, the contributor contributed capital **at a substantial premium** in return for a **low number** of trivial shares of a Newco;
- on day 2 the contributor procured that the Newco, whose trivial shares the contributor owned, granted an option to the appropriate EBT to subscribe **a high number** of the shares of the Newco **at par**, such that the value would flood into the option and out of the trivial shares; and
- on day 3 (in fact an entirely optional step) the trivial shares were disposed of to the "other EBT" for a low amount, reflecting their value following the transfer of value occasioned by the previous step.

128. Mr. Thornhill accepted that under the paragraph 1 Schedule 24 scheme, the two contributor companies, SA and FM, acquired shares in the Newcos and contributed very substantial capital into the companies, and that those Newcos ranked as capital assets. He claimed, however, that the only reason why the contributing companies then suffered losses was that they quite deliberately diverted value into the options granted by the Newco companies themselves, that diversion made entirely to meet bonus expectations of the directors, such that it was a revenue expense. There

was no way in which the capital assets lost value in any respect other than by the deliberate step designed to remunerate directors.

129. Mr. Thornhill argued that the case was similar to one under which, for instance, a trading company might give a surplus capital asset, say a factory or a shop, to a director as remuneration. The obvious consequence of this would be that the asset would be treated by section 17(1)(a) TCG Act, 1992 as having been disposed of for capital gains purposes at market value, the director would be charged to income tax on that value and the company would secure a matching deduction equal to the value of the "remuneration" thereby provided. Exactly the same would apply if instead the company granted a long, rent-free, lease for no consideration to the director. And if, having done that, the near worthless freehold reversion was sold for a greatly diminished amount, that would not change the obvious reality that the company had incurred a revenue expense in remunerating a director when granting the beneficial lease.

130. In the present case, therefore, the appropriate treatment in the hands of the company was that the amount subscribed for the trivial shares would be the cost of those shares for the purposes of the corporation tax computation of the potential capital gains and losses in respect of the shares. The second step involved a very substantial part disposal at market value under the "value shifting" provision of section 29 TCG Act, 1992, and the disposal of the trivial shares constituted the final disposal for the consideration received. Accordingly there would be neither gain nor loss. The provision of the value at step 2 would be occasioned by the deliberate intention to remunerate the directors and would be a revenue expense.

131. HMRC suggested that the fact that the loss in the accounts was treated as arising on the disposal of the trivial shares rendered the loss a capital and not a revenue loss. In fact the accounts made it perfectly clear that the loss was entirely occasioned by the grant of the option by the Newco. In any event the reason why the trivial shares ended up being worthless was simply that the employer company had procured the passing of value that vastly reduced their value, all as the mechanism to remunerate directors, so that on any basis the loss was a revenue loss.

132. Mr. Thornhill's contention was that even though he accepted that the trivial shares in Newco ranked as a capital asset, their reduction in value resulted from a diversion of value that constituted a revenue expense. It is unnecessary for us to make this further point, but we conclude that we can reach the same conclusion for a second reason, namely that the shares in Newco never ranked as a capital asset at all. Their subscription, the value reduction and their disposal were admittedly subjected to calculation under the capital gains provisions but that is because those provisions apply not just to capital assets, but to all assets, with simply carve-outs for costs and consideration receipts taken into account in trading calculations. As to whether the subscription of the trivial shares produced a capital asset in the hands of the employer company, we consider that since it constituted a step (which endured either for one or for two days) in a scheme to remunerate directors, it is highly unrealistic to class it as a capital acquisition by the employer company at all.

133. We agree with Mr. Thornhill that the Tribunal's decision in *Lion Co v. HMRC* [2009] UKFTT 357 (TC) confirms Mr. Thornhill's analysis and does not, as HMRC

contended, support HMRC's contentions. In that case, using example figures, a company acquired a house for say £1 million, incurred expenditure on it of £750,000, and then contended when the house was transferred to a director that the house was worth only £900,000. While it was obvious, and not in contention, that the director should be charged in respect of the value transferred of £900,000 and that the company should secure a deduction for that amount, the company claimed a deduction on revenue account also for the further expenditure of £750,000 on the reasoning that this was all incurred to put the house into the state required for the director. Whilst this example seems to occasion some question about the figures or the attraction of the alterations to the house, we consider it to be perfectly obvious that when the expenditure was on the company's asset, and a deduction was given in any event for the whole of the value passed to the director, the further expenditure of £750,000 was not a revenue expense. Had the example worked in the opposite direction, indeed in the more common direction, with the purchase at £1 million, accompanied by spending by the company of £750,000 occasioning an increase in the value of the house to £2 million (i.e. to more than the costs incurred), it is obvious that the transfer of the house would have left the company with a capital gain of £250,000 (computed under section 17 TCG Act, 1992), a revenue deduction for £2 million (not £1.75 million) and the director with an income tax charge in respect of £2 million.

134. In all these examples the revenue expense in remunerating the director or directors is the value applied in remunerating the director or directors, and the value reduction of the trivial shares at step 2 was a revenue expense because it was the step that occasioned the cost to the companies, and that cost was incurred to remunerate the directors.

The various "duality of purpose" contentions

135. Trading companies only secure trading deductions for expenses "wholly and exclusively" incurred for the trading purposes of the company. While expenses can be split if, for instance, expenditure is incurred on a property, half of which is used for trading purposes, and half of which is not held for any trading purpose, there can be no split where the entire expenditure is incurred for a "dual purpose", one element of which is a trading purpose and simultaneously another a non-trading purpose.

136. This basis for disallowing expenses arises in the present case in three possible contexts. Somewhat perversely we consider that the third context that we will address is the one that results in the disallowance of the entire expenditure in the present case, this being perverse because this is the point that was not specifically articulated by HMRC. We will address the other two aspects first.

The charged deposits

137. The trading deduction claimed by SA was in respect of the entire subscription amount contributed to SAIL of £7,636,000, notwithstanding that of that amount, £2,765,500 was not immediately available to be applied in being distributed to anyone because the charged deposits were securing potential trade liabilities of SA. This feature leads us to conclude that in any event the trade deduction should be disallowed in respect of £2,765,500. As we have already noted, we speculate that the fact that these deposits were not released from the charges until September 2005 and

September 2006, was quite possibly the factor that delayed the liquidation of the Newcos (specifically SAIL) and the transfer of the assets to the EBTs, until the deposits were free and available to be applied in discharging the purposes of the EBTs. In computing the trading deductions, however, our decision is that it cannot be said that the £2,765,500 element of the amounts passed over was wholly and exclusively a revenue expense of remunerating directors, as was claimed in the accounts. It might eventually have been, but when passed out of SA, nobody could say whether this amount would be available to be disbursed for the benefit of directors at all.

138. We have given some thought to whether a full trading deduction should be given for the entire £7,636,000 on the reasoning that either application of the charged deposits would fulfil some trading purposes of SA. We reject this line of thought on various grounds. Firstly the claim in the accounts referred solely to the remuneration point. Secondly, no argument was advanced as to whether any sort of provision for future liabilities might equally have been deductible, and when in the event none of the liabilities actually had to be met, and by the time that emerged to be the outcome it very much seems that SA had ceased trading, numerous points would have had to be debated before we could have conceded a trading expense for the £2,765,000 element on a "legitimate either/or" basis.

139. Our decision is that on this ground, SA forfeits a deduction for the claimed revenue cost of the £2,765,000.

Stripping the companies of assets

140. HMRC's strong contention, partially based on the reasoning and observations of Lord Glennie in the Scottish case, was that part of the motivation for the contributions to the Newcos (particularly SAIL) was to strip SA of assets, so that if the corporation tax deduction claims failed, SA would have no assets with which to meet the resultant liabilities. Since planning to secure the failure to pay tax that might be owed was obviously not a legitimate trading expense, the contributions to the SA EBT (or some part of the contributions) should be disallowed on "duality of purpose" grounds in this regard.

141. There is some support for this proposition.

142. We note firstly that in the Scottish case, where EBT contributions had been made and HMRC challenged them on the "capital argument" ground that we have dismissed above, the contributing company failed to pursue an appeal against the disallowance because it knew that it had no assets so that even if it had lost the appeal it would not have been able to pay the claimed tax.

143. Whilst Lord Glennie concluded that he could not reach a finding of fraud, there is no doubt that he considered that the corporation tax deductions claimed in that case would have been forfeited, not so much as we understand it on the capital ground that HMRC appeared to have advanced, but on the ground that year-end non-contractual contributions to EBTs were anyway non-deductible, and that much of the motivation was to eliminate corporation tax liabilities and strip the company of assets.

144. In the present case it does very much seem that the endeavour (and certainly the result) was to make sufficient contributions into SAIL, such that SA would be left with no material net worth. This included the anyway awkward feature (just dealt with) of having to contribute charged deposits that were at that point not free and available to be applied in being contributed to SA EBT, but the level of the contributions also occasioned accounts losses, and left SA unable to meet claims. We should set against this Mr. Dryburgh's claim that the losses resulted from the Hoffman claim.

145. In view of all the evidence, (particularly the fact that the Hoffman claim was for a sum of far less than the corporation tax liability, if the deduction for the EBT contributions was successfully denied, and because we even failed to see with certainty that it was SA that bore the cost of the Hoffman claim) we are not convinced that SA did not have some element of motivation to pass out every asset that it possibly could so as to leave SA unable to meet tax claims from HMRC if the deductions were successfully challenged. An objective of enabling SA to default on meeting tax liabilities is naturally not a legitimate ground for claiming a deduction. We accordingly decide that to the extent of the rate of corporation tax on the contributions made, there may have been a duality of purpose in making the contributions, i.e. both to benefit directors and to strip SA of assets. On this ground, but not cumulatively with the figure mentioned in paragraph 139 above, should our decision given in paragraph 139 above ultimately be sustained, we consider that the corporation tax deduction should be denied for the element of SA's contribution equal to the rate of corporation tax.

The "Catch 22" point

146. It is clear and cannot be disputed that an objective, on the part of a company, of seeking to eliminate its liability for corporation tax, cannot be a legitimate ground for claiming a trading deduction. In the case of ordinary payments of salary and bonus, we accept Mr. Thornhill's contention that when a company ordinarily makes such payments the feature that it expects to secure a trading deduction for the payments does not occasion any "duality of purpose" concern. In the ordinary way, salary and bonuses are obviously tax deductible, they are meant to be tax deductible, and the expectation that this will be so is not an objective of making the payments.

147. The provisions of paragraph 1 Schedule 24, however, undermine this ordinary expectation. The reality becomes that if no steps are undertaken to oust the application of paragraph 1 Schedule 24, the corporation tax deductions will obviously be denied by that provision. If, however, a highly contrived scheme is implemented to oust the application of paragraph 1 Schedule 24, the reality then becomes that:

- the highly artificial steps of the scheme focus attention on the fact that those steps, which were central to the whole planning in the present case, were entirely designed to achieve a particular objective;
- that purpose was obviously to oust the application of paragraph 1 Schedule 24, which can be paraphrased realistically to be a purpose of achieving the precisely opposite corporation tax treatment for the EBT contributions than the result intended by Parliament; and that

- the deliberate and all-pervading objective of achieving a corporation tax deduction makes it impossible to treat the corporation tax result sought for the contributions as the "ordinary, intended or realistically expected outcome" of making salary, bonus or equivalent payments.

These related factors appear to us wholly to undermine the general argument (in a case such as the present) that when salary or bonuses are paid, the expectation of securing a corporation tax deduction does not constitute any sort of "duality of purpose". SA's and FM's intentions were plainly to secure a far from ordinary tax deduction, one that would not ordinarily be expected, and certainly one that was designed to achieve the very opposite of the result intended by Parliament. On this ground we consider that the resultant "duality of purpose" in making the contributions, via the value-draining scheme, is the very factor that occasions the fatal duality of purpose that results in the denial of the entire deductions claimed by both companies.

148. The curious position thus becomes that if no attempt is made to circumvent paragraph 1 Schedule 24, the deduction is denied. If a contrived scheme is effected to achieve the opposite result, it fails simply because that objective becomes the fatal purpose that creates the duality of purpose that itself undermines the deduction.

149. We accept that HMRC did not advance the precise articulation that seems to us to be the overriding reason why the entire corporation tax deduction should be disallowed to both companies in respect of all the contributions. Since however in a general sense, HMRC had plainly contended that the objective of securing a tax deduction was a relevant motivation (indeed, as contended, even the dominant motive for making the contributions) we have no hesitation in reaching our decision on the corporation tax point on the reasoning in this section of the Decision.

The correct interpretation of paragraph 1 Schedule 24

150. Whilst this point is irrelevant if our decision in the preceding paragraphs is correct and not overturned on appeal, we must still consider the proper interpretation of paragraph 1 Schedule 24.

151. We will deal with this point initially without regard to the claimed errors in the implementation of the schemes, and any effect that they may have had.

152. In paragraphs 42 and 43 above, we summarised the manner in which it was claimed and hoped that the Newco value-shifting scheme would circumvent the application of paragraph 1 Schedule 24. We will not repeat those points here. In deciding whether the scheme, properly implemented, succeeded in achieving its objectives, we take it to be common ground between the parties that we should interpret paragraph 1 Schedule 24 purposively. In this context it is manifest that Parliament would not have intended the obvious statutory purpose of the provisions to be circumvented by the value shifting type operation. As Mr. Thornhill said, had the draftsman noted how it might be claimed that the provisions might be circumvented, he would have said "oops". He might indeed then have noted that the rapidly introduced provision, preceded by a "Treasury announcement" of a future law change, had failed to note a point precisely noted in 1965 by the draftsman of the Finance Act

1965 that for capital gains purposes, grants of options, grants of leases and value shifting operations between one category of shares in a company and other shares or rights in the company were not disposals or "transfers of assets" (i.e. transfers of existing assets or strictly speaking – in the case of value shifting – transfers at all), such that in 1965 specific provisions deemed all three "non-disposal" situation, to constitute disposals.

153. Whilst thus it is obvious that in strict technical terms the drafting of paragraph 1 Schedule 24 was deficient, and that it occasioned the chance that the present scheme might evade the perfectly obvious intention that Parliament would have had, had the value shifting scheme been contemplated, the question for us is whether it is possible to interpret the provisions broadly so as to achieve a result in conformity with common sense and the result that Parliament would have intended, had the present scheme been contemplated.

154. Our decision is that the Newco scheme, operated without errors, would have succeeded in avoiding the application of paragraph 1 Schedule 24 (to no avail of course if our decision in paragraph 147 above is correct). We agree with Mr. Thornhill that the deduction was not allowed *"in respect of employee benefit contributions",* i.e. in respect of any *"[payment] of money or transfers [of assets made by an employer to another person]".* The step for which the deduction was claimed, namely the grant of the option, involved no payment of cash or transfer of any asset. The grant of the option by Newco was not a transfer of a pre-existing asset (the natural meaning of "transfer"), but was furthermore not made by the employer company at all. Mr. Coleman, for HMRC, claimed that the intended result under paragraph 1 Schedule 24 might have been achieved by the scheme had the wording referred to *"obtaining a deduction* ***for*** *payments of cash or transfers of assets by the employer to another person",* but that when the words *"****in respect of****"* in fact appeared rather than the word ***"for"***, this enabled the provision to be interpreted more broadly. Mr. Thornhill said that the meaning of the phrase was identical to the meaning of the word "for".

155. It is a very fine point of interpretation, but we incline to the view that Mr. Thornhill is right. We consider that Mr. Coleman is construing the words *"in respect of"* wrongly. The correct paraphrase of the events in the Newco scheme is not that *"the deduction is claimed* ***for or in respect of*** *a step* (the value shifting step) that is either a payment of cash to a third person, or a transfer of assets by the employer to another person. Instead, the deduction is claimed ***"in respect of*** *a step that is itself implemented* ***in respect of*** *contributions to an employee benefit scheme in a broad manner."* The words *"in respect of"* appear in the wrong place for Mr. Coleman's interpretation to be correct, and we consider that on any permissible basis of interpretation, the statutory wording cannot be interpreted to undermine the present scheme.

The various errors

156. We deal now with the first three claimed errors mentioned in paragraph 48 above, and those mentioned in paragraphs 51 to 56 above.

The absence of consideration for the SAIL grant of option

157. The first claimed error in relation to the SAIL scheme was that because no consideration was given for the grant by SAIL of the vital option ostensibly granted to SA EBT, the option was void, such that when the trivial shares were transferred to FM EBT, those shares were still valuable, and while at this point the value was confusingly in the wrong EBT (i.e. the one for employees of FM and not SA), the deduction would then have been due in respect of a transfer of valuable assets by the employer company, and paragraph 1 Schedule 24 would have applied.

158. Both parties made representations in relation to the conflict of law question as to whether the grant of the option was void, notwithstanding the absence of consideration, when the agreement was said to be governed by English law, the ostensible grant was made by SAIL, a company incorporated in Scotland, and the agreement was executed in London by SAIL, and then executed by the EBTs in Guernsey. We were told the plainly irrelevant, but mystifying, fact that the first draft of the option agreement was expressed to be governed by Scottish law. We were also asked to assume that Guernsey law (as to which there was no evidence) was the same as the law of England, and we assumed that the two Turcan Connell trustee companies were incorporated in Guernsey.

159. We have considered the terms of the Rome Convention that was in force at the relevant time, and the authorities such as *In re Bonacina* [1912] Ch 394. We have found the terms of the Convention unclear and the case of *Bonacina* to be of no assistance. In that case the absence of consideration appears to have been considered irrelevant but since the relevant agreement was between two Italians, and governed by Italian law, the case appears not to be of much assistance in considering whether it is the choice of proper law or the *lex situs* that governs the present issue.

160. A perhaps unhelpful tentative conclusion that we reach is that when the parties advanced different views on the present issue, and we have found the terms of the Convention and the authorities and indeed the references to Dicey & Morris to be less than definitive themselves, one obvious consequence is that any buyer of the trivial shares of SAIL, following the ostensible grant of the option, would have been distinctly wary of giving any significant consideration for those trivial shares because of the risk that the option might be valid. That practical and non-legalistic line of thought happens to correspond to a further argument advanced by Mr. Thornhill. His contention was based on the accounting proposition that the clearly evidenced intention to contribute to EBTs gave SA a constructive obligation to ensure that profits were made available to SA's employees in the period to 30 April 2004, all recognised in SA's accounts, and that this obligation would have made it unthinkable or unlawful not to ensure that that this obligation was honoured.

161. While we reach no absolute conclusion in relation to this point, we consider that this claimed error did not wholly undermine the paragraph 1 Schedule 24 scheme. That would only have been the result, had the analysis been that the trivial shares were worth approximately £7,636,000 when transferred to FM EBT, and beyond the fact that the value would then have been in the wrong EBT, we consider that that valuation result is inconceivable. The English law choice, and the bewildering feature that the other two option agreements were governed by Scottish law and that the first draft of the SAIL option agreement was also governed by Scottish law may at

worst have eroded the proposition that the trivial shares were worth slightly more than the very low amount intended, but we consider that to be the extent of this highly confused point.

The set-off point

162. At this point we are not concerned with the timing point relevant to the PAYE claims, geared to whether the subscription into SAIL actually occurred on 5th as distinct from 6th or 7th April 2004. We are simply concerned to consider HMRC's contentions in relation to the absence of set-off wording and whether this could mean that no set-off was effected at all.

163. We have no hesitation in saying that we do not accept that the two sets of board minutes that Mr. Dryburgh produced (one from SA and one from SAIL) were genuine. We conclude that Mr. Dryburgh must have typed them out during the hearing; must have transferred them to a memory-stick; then printed out the claimed original, signed it and printed off the copies. We note that Ms. Moola mentioned in giving oral evidence by video link that Mr. Somper had mentioned that attention needed to be given to the set-off point, and that she assumed that this would have been done. Her recollection in relation to this sounded vague, however, and she was certainly unable to say what was done about the set-off mechanics even if her recollection was correct and it had been appreciated by Mr. Somper that this needed attention.

164. While there was thus no documented confirmation that the set-off occurred, we consider it unrealistic to doubt that it did. SA's board resolution to subscribe the trivial shares of SAIL at an aggregate subscription amount of £7,636,000 could only have been achieved if the set-off was effected, or if (as we have already said) it was implicit that a substantial part of the value contributed on subscribing the trivial shares was to take the form of a simple release by SA of those previous debts owing to SA by SAIL. We may have seen no actual subscription agreement, or indeed evidence that the trivial shares were issued on 5 April to SA. We do, however, know that the cash element of the subscription was paid to SAIL on 5 April; the letter to Barclays making the required arrangements for the assignment of the four further charged deposits was dated 5 April, and on 7 April SA was transferring the trivial shares to FM EBT, which presumably indicates that it owned those shares.

165. We also accept the point made by Mr. Dryburgh, not so much because we accept his evidence, but rather because it is fairly obvious, namely that the set-off feature, or rather just the unilateral release of SAIL's obligation to repay the pre-existing debts to SA was inevitably implicit in any subscription at £7,636,000. The accounts of both companies were drawn up accordingly, and any claim that on an on-going basis, the net worth of SAIL was in fact vastly less than the figure just mentioned because the SAIL indebtedness had not been released is just unrealistic.

166. We note in passing that no attention was paid to the feature that since the charged deposits were "fettered assets", it was probably wrong to have treated the subscription amount and the resultant premium to have reflected the full face value of the deposits. There appears to have been no tax significance to this point, save for the related point, already dealt with, concerning "duality of purpose". That point

would have arisen however the deposits had been valued in any contract or memorandum related to the non-cash subscription for shares, and the feature that the significance of the charges was altogether ignored at the point of the subscription (and indeed fairly generally) is of no further significance.

The feature that the option granted to FM EBT to subscribe shares in FMIL (and the option granted to FM (2004/5) EBT to subscribe shares in NCSIL) were granted by Mr. Dryburgh and Mr. Somper as the directors of FMIL (and NCSIL), and not strictly by those companies

167. We are at a loss to understand why the two options to subscribe shares in respectively FMIL and NCSIL were granted by the two directors and not by the relevant companies. HMRC based no particular tax claim on this point; Mr. Thornhill contended that since the companies could only act through their directors, the point was of no significance. On the reasoning that on the worst analysis the directors had in any event committed to procure discharge of the option rights by the companies (and could have done so), we ignore this oddity. It appears to have been deliberate and may have resulted from advice by Mr. Thornhill, but we fail to understand why this strange route was chosen.

Whether the December 2003 option was in force on and after 16 December 2003, or only when the agreement was signed by the two EBTs, i.e. after the critical point for the purposes of the scheme, since the trivial shares would only have been worth the diminished amount if the option had in fact been granted

168. This is the point that we explained in paragraphs 53 to 56.

169. Our understanding of Scottish law is that we need to decide whether the option was a transaction that was granted unilaterally by the directors, so being a valid right on the part of FM EBT prior to FM's subsequent disposal of the trivial shares, or whether it was merely an offer of an option that would only result in FM EBT having a valid right once it had been executed by FM EBT and indeed also perhaps by SA EBT. The support for the "offer and acceptance" analysis consists in the fact that we were told that in Scottish law:

- in commercial transactions there was an element of a presumption that the "offer and acceptance" analysis was to be preferred to the "unilateral grant" analysis;
- in the case of doubt, the fallback analysis was that of "offer and acceptance";
- it was possible (again a matter of considering actual or implied terms) that an offer could be accompanied by a contractual obligation not to withdraw it; and
- the feature that the relevant document contemplated signature by FM EBT suggested (according to HMRC) that that implied the requirement of acceptance because there was no obligation assumed by FM EBT in the transaction and thus no other reason for FM EBT to have to sign.

170. Our decision is that the trivial shares had been down-valued by the option transaction by the time the trivial shares were sold. Whilst we note the first two bullet points in the previous paragraph, we also observe that the more realistic

construction of the document is that of an outright grant. Nothing is remotely phrased in terms of an offer. Although there is provision for FM EBT to execute the document, that signature box is certainly not worded in terms of FM EBT "signifying their acceptance of the offer by signing", which would generally be the appropriate wording to insert when accepting an offer. Furthermore, whilst there was no purpose in FM EBT executing the document, other than arguably to signify acceptance, it is perfectly possible that the other explanation for the superfluous addition of FM EBT's execution was simply yet a further slip in the documentation. We also note that it was absolutely clear to Mr. Dryburgh and Mr. Somper that a valid option had to subsist in favour of FM EBT, prior to the disposal by FM of the trivial shares in FMIL, and so unless it is claimed that they simply failed to remember this point, they must obviously have intended the grant to be effective when the document was executed simply by themselves. We accept that pending the only other relevant signature, namely that by SA EBT (required to add the non-dilution covenants) there was some very mild doubt in relation to the value of the option, though since it was capable of being exercised immediately we consider this point to be of little significance.

171. Were the conclusion in the previous paragraph disputed, we still consider that at the point when the directors had signed the option document (on 16 December 2003, when the document was immediately posted to Guernsey for signature), no third party would have given any material consideration for the trivial shares. Such a third party would have had to observe that once the option was executed by the EBTs, the value of the trivial shares would have been diminished, and the suggestion that a buyer of the trivial shares might have contemplated that it would be possible to remove the directors and initiate urgent action to dilute the value of the option before it was exercised (for instance by issuing other shares or procuring some form of distribution by FMIL) is ridiculously far-fetched. The reality is that even if the "offer and acceptance" analysis was the preferred analysis, nobody would have paid anything significant for the trivial shares.

Summary of conclusions in relation to the disallowance of the EBT contributions for corporation tax purposes

172. Numerous arguments were advanced as to why corporation tax deductions should be disallowed in this case, and we have given different conclusions in relation to each. It may assist, by way of summary, to confirm that:

- our decision in relation to the "duality of purpose" point dealt with in paragraphs 146 to 149 is that the entire deductions claimed by both SA and FM should be disallowed;
- our decision in relation to the points dealt with in paragraphs 137 to 139 is that £2,765,000 of the contribution made by SA should be disallowed;
- our decision in relation to the points dealt with in paragraphs 140 to 145 is that an amount equal to the rate of corporation tax in respect of SA's total contributions should be disallowed, or (in the event that the ultimate outcome is that the point in the first bullet point above is over-turned on appeal, but the point in the second bullet point is sustained), then the disallowance under this head is for the rate of corporation tax in respect of

the balance of SA's contribution, disregarding the amount already disallowed under the second bullet point;

- the element of contributions destined for Mr. Charles should be disallowed: and that
- we consider it unnecessary and unduly complicated to provide a figure for the modest disallowance of corporation tax in respect of the minor contentions dealt with in paragraphs 161 and 171 above.

The PAYE questions

173. We must deal first with two inter-related timing points concerning the contributions made into SAIL. These relate simply to whether HMRC was out of time to make assessments in relation to any PAYE liability in respect of the April 2004 transactions between SA and SAIL.

174. HMRC's contention in relation to PAYE liability was that the point at which the liability arose was the point at which value was contributed by SA into SAIL, namely when SA subscribed the trivial shares in SAIL at the very substantial premium. At that point it was contended that because Mr. Dryburgh and Mr. Somper were the directors of SAIL, the value in SAIL was "unreservedly at the disposal of the directors" and that accordingly PAYE tax should have been accounted for.

175. Great attention was given, therefore, to the issue of whether SA had actually subscribed the shares in SAIL on 5 April 2004, or whether the subscription occurred a day or two later. Had the subscription occurred on 5 April, HMRC appeared to concede that they would have been out of time to raise assessments.

176. Our decision, not that in the event it has any bearing on the ultimate outcome, is that notwithstanding that we did not see any actual subscription agreement or any documentation dealing with the set-off points, the very great likelihood is that the trivial shares of SAIL were indeed subscribed on 5 April. It was certainly the intention of SA that that should be so because the manifestly genuine board minute of SA resolved to subscribe the shares for £7,636,000 and it was clearly intended that that subscription would be effected immediately. That intention, and indeed to an extent the fulfilment of that expectation, were confirmed by the fact that we were shown the bank statements that confirmed that the cash element of the subscription amount was indeed paid to SAIL on 5 April and, as we have said, the letter to Barclays dealing with the required arrangements for the transfer of the further four charged deposits was also dated 5 April. Insofar as we were shown no documentation in relation actually to SA releasing SAIL from its pre-existing loan liabilities to SA, or documentation achieving set-off between an obligation to contribute further cash to SAIL which was then set-off against the pre-existing debts, we have already concluded that that was implicit. Once we have concluded that the other actual elements of the contribution (i.e. the cash and the four further charged deposits) had actually been made on 5 April, such that steps to subscribe the actual shares of SAIL had been effected on 5 April, it follows that other implicit steps in relation to that subscription should also be treated as having occurred on that day.

177. Whilst it might seem curious to attach little importance to a conclusion that would appear to render HMRC out of time for the purpose of making by far the largest element of the total PAYE assessments, we do find this conclusion relatively immaterial. This is for the reason, first, that we conclude that at no time was there a liability for PAYE tax in any event, and that secondly were we wrong in relation to that, then we would actually consider the critical trigger point for the PAYE liability to arise at a different point than that suggested by HMRC and implicit in their contentions. We will deal with that more minor point first, though if the fundamental point is right, to the effect that there has as yet been no PAYE liability at any point, it is a very secondary point.

178. We rather adopt what we understood to be Mr. Thornhill's points in relation to the timing issue, albeit that one might have thought that on behalf of the Appellant Mr. Thornhill would have been keen to throw the minimum of doubt upon the proposition that the timing point for by far the majority of the contributions occurred on 5 April 2004, so that HMRC were out of time to assess.

179. In the case of SA, we have already recorded that during March and on 2 April 2004, SA lent very substantial amounts to SAIL (at which point we assume that SA held some shares in SAIL, perhaps just the subscriber's shares, though that was never expressly confirmed), and SAIL made significant loans to both Mr. Dryburgh and Mr. Somper. At this time, Mr. Dryburgh and Mr. Somper were the directors of SAIL.

180. No suggestion was made that anyone should have accounted for or paid PAYE in respect of the making of those loans. At that stage, however, the two directors in question had as much or more potential control over the affairs of SAIL, certainly than they did once the EBTs had acquired the SAIL shares, and the option to acquire the entire value of SAIL. For at that early stage, SAIL, a company of which they were directors, was a subsidiary of a company entirely owned in the 50/50 ratio by Mr. Dryburgh and Mr. Somper, so that in reality they had director and shareholder control over it.

181. It was appreciated that interest-free or low-interest loans would have attracted tax charges, and quite possibly there may have been potential liability to the 25% tax charge in respect of loans to participators in close companies. There was no claim by HMRC, however, that there was any liability to PAYE tax until SA had contributed the amounts previously lent to SAIL to SAIL as equity capital.

182. It is extraordinarily difficult to see any reason why any liability to PAYE tax in respect of loans made to Mr. Dryburgh and Mr. Somper already made by a subsidiary of SA (namely SAIL) should be affected or triggered by the simple fact that SA effectively subscribed further shares in SAIL by releasing SAIL's pre-existing liability to SA for the amount previously lent to SAIL. SAIL remained a subsidiary of SA, Mr. Dryburgh and Mr. Somper remained the directors of SAIL, and had SA wished to procure repayment of the loans, it could have done that (subject of course to the terms of the loans) quite as easily after the share subscription as before it.

183. If there is any timing point around 5 April 2004 that would appear to have had some logical bearing on when a PAYE liability might have arisen, ignoring the law at

this stage, it would rather have been on and after the occurrence of the later two transactions, the grant by SAIL of the option and the sale of the trivial shares to FM EBT. For the significance of those two transactions was that the value in SAIL was put out of the reach of SA, and was transferred to trusts that in one way or another held the entire value of SAIL The resultant feature, then, that the funds in SAIL were under the "director" control of Mr. Dryburgh and Mr. Somper, and that the shares were held by EBTs that were set up to benefit the directors and employees of SA in the period to 30 April 2004 (Mr. Dryburgh and Mr. Somper in particular) does make a possible PAYE liability more appropriate. On the reasoning that the earlier share subscription step was, however, completely and logically irrelevant, we are at a loss to understand why such attention was given to the issue of when precisely the subscription into SAIL for shares was actually made.

184. The decisive point in relation to PAYE liability appears to us, however, to be the feature that Mr. Justice Warren has decided in *Aberdeen Asset Management plc v. HMRC* [2012] STC 650 that when an EBT transferred cash-rich debt-free companies to each of the employees intended to benefit from the particular EBT, the feature that the employees each owned the shares in the various companies and could have fired the directors and appointed themselves as directors still did not mean that the monies in the companies were "unreservedly at the disposal of the various employees". That phrase had been satisfied in *Garforth (I of T) v. Newsmith Stainless Ltd* [1979] STC 129 but that is because monies had actually been voted to the directors and the directors were able to call for immediate payment of the amounts in question. Where shares in a cash-rich debt-free company were transferred to an employee, however, the employee did not receive payment. If he received loans from the company, he had received loans but that was not the equivalent of receiving money itself absolutely.

185. The critical passages of Mr. Justice Warren's decision are in paragraphs 81 to 83, as follows:

> *81. ………As the Tribunal held the facts, viewed realistically, show unequivocally that control was vested in the employee who had access to the pot of money contained within the corporate money box and the directors would, in reality, be inevitably compelled to comply with the individual employee's wishes. And as I put it in that paragraph, the employee became the owner of a company from which he could in practice extract the cash within it whenever he wished, subject of course to whatever tax charge of one sort or another, depending on the method of extraction, might result.*
>
> *82. But even so, the employee had no present right to receipt of cash from the company when its shares were transferred to him. The case is different from Garforth v. Newsmith Stainless Ltd where the directors had an immediate right to payment (even though it might have been necessary to sue for the debt, just as it might be necessary to sue on a cheque representing payment of salary if the employer defaulted). Mr. Ghosh says that what the employee received was as good as money. I do not agree with that. There is a difference, in my view, between an immediate right to obtain money (e.g. by drawing on a bank account to which salary has been credited by direct debit or cheque) and obtaining money only after the implementation of a procedure*

> *required by company law. This is not a case where it is possible to lift the corporate veil so as to treat the company's money as that of the employee. Nor, on the findings of fact, is this a case where the composite transaction ends up with money (in the conventional sense) in the hands of the employee (e.g. in his bank account). Indeed, it needs always to be remembered that the emolument in question is the shares and not the money in the company.*
>
> *83. In my judgment, the transfer of shares to an employee was not a "payment" to that employee for the purposes of s. 203. The powers which he had over "his" company did not result in his rights being "as good as cash" as Mr. Ghosh would have it or, as I would say, being able to turn what was prima facie a benefit in a form not consisting of money (i.e. shares) into a benefit consisting of money. The money is not unreservedly at the disposal of the employee, a condition which is, I consider, a necessary, even if not a sufficient, condition for there to be a payment within s. 203".*

186. A distinguishing factor between the various companies transferred to employees in the *Aberdeen* case and the present case is that in the *Aberdeen* case the various employees ended up owing the companies though initially at least they were not the directors. In the present case the facts are reversed. It is clear that shareholder control is of far more significance since, as Mr. Justice Warren mentioned, the shareholders could fire the directors and appoint themselves and thereby secure control in every sense.

187. It is important to note in the present case that once the EBTs held the shares in the various Newcos the directors did consult the trustees when aiming to make some new loan. We were not shown evidence of this in relation to every advance made, but we were shown many instances of such referrals. Whether others had been lost or whether no referral was made we do not know. Of rather more relevance is the fact that the trustees declined to lend money back to SA (see item 18 of paragraph 62 above) when requested to do so by Mr. Dryburgh. We accept that by this point SAIL had been liquidated and that the moneys were in the direct hands of the trustees. But this still suggests that the trustees were acting independently and there is no reason to suppose that they would have acted very differently had the funds still been in a company wholly owned by them. It is also worth noting that it is the trustees that have called for the repayment of loans made to Mr. Dryburgh that has been one of the reasons why Mr. Dryburgh has been declared bankrupt. Whilst the requested repayment is of the replacement loans made by the trustees and not those originally made by the companies, the present state of affairs does make it abundantly clear that Mr. Dryburgh does not have control over the moneys in the trusts, and does not have those funds "unreservedly at his disposal". The final point to note is that when HMRC are apparently raising assessments under section 419 Taxes Act in respect of loans to participators in close companies, these assessments are also inconsistent with the proposition that the moneys in the Newcos were properly subject to PAYE liability either when contributed into the Newcos or indeed at any point.

188. Mr. Coleman sought to distinguish this case from the *Aberdeen* case. He claimed that while that case had been quoted by the Appellant for the proposition that *"payment to a company controlled by an employee is not payment to the employee himself"* the position was *"otherwise where the employee uses the company to*

advance his own interests, not the company's". This was to our minds a rather strange proposition in the context that the Newcos were formed in order to be held by trustees whose objects were to provide benefits in one form or another to directors and employees. Presumably precisely the same was so in the *Aberdeen* case. When under the trusts that owned the various Newcos it would have been perfectly proper for the various companies to have paid their whole net worth in whatever manner was feasible as a matter of company law to the various directors, it seems very strange to be claiming that these Newcos were somehow acting improperly, and in a different manner from the obvious strategy of the companies in the *Aberdeen* case when they were doing precisely what they were intended to do. We reject that argument on the part of HMRC.

The Regulation 72 (5) issue

189. HMRC issued a notice under Regulation 72 (5) indicating that they had grounds for believing that Mr. Dryburgh was aware that he had received moneys or benefits from which PAYE tax should have been deducted, but had not been deducted, such that he personally became liable for the tax. The result of such a notice was that initially at least the tax could not be sought from the company, SA, or its liquidator.

190. In case our conclusion as to liability to PAYE tax is itself wrong, and is overturned on appeal, we need to consider the issue of whether Mr. Dryburgh knew that tax should have been deducted from the payments or benefits provided to him. It was accepted by HMRC that an appeal against the 72(5) direction was not confined to our considering whether HMRC had formed a reasonable judgment when asserting that they believed that Mr. Dryburgh had had the relevant knowledge. The question for us is whether we consider that Mr. Dryburgh did in fact have that relevant knowledge. We consider that he did not. This is not just on the basis of Mr. Warren's decision of which naturally he could not have known at the time. It is simply on the broadly similar point that he appears to have contemplated that at no time would he have done anything other than borrow money at interest, and we can well sympathise with the resultant belief that we consider that Mr. Dryburgh had to the effect that no PAYE tax would have been due.

191. There was a dispute between HMRC and the Appellants as to whether, if the Regulaion 72(5) notice was revoked or discharged, HMRC could revive its claim against the company, SA, and the company's liquidator, and seek to sustain HMRC's PAYE contention against those parties. As we understand matters, it was agreed that this disputed point was academic since on any basis it was accepted that HMRC would be out of time to assess the company. Accordingly there is no basis on which any claim in respect of PAYE tax might flow through to HMRC as one of the claimants in the insolvency proceeds that may follow this case.

192. Our decision is that the PAYE appeals are allowed.

Costs

193. The Appeal hearing commenced with a very involved dispute and negotiation about costs, principally involving the requirements of Mr. Dryburgh's trustee in

bankruptcy. We will not record any of the points discussed because our understanding of the outcome was that as this case was categorised (perhaps rather oddly) as a Standard case, such that only a wasted costs order could be made, and HMRC undertook not to apply for such an order, no issue of costs now arises.

Right of Appeal

194. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JUDGE HOWARD M. NOWLAN

Released: 13/5/13