Neutral Citation Number: **[2012] EWCA civ 1429**

Case No: A3/2012/0216

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)
JUDGE COLIN BISHOPP
FTC/89/2010

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 06/11/2012

Before :

LORD JUSTICE MUMMERY
LORD JUSTICE ETHERTON
and
SIR STEPHEN SEDLEY

- -

Between :

CHESHIRE EMPLOYER AND SKILLS DEVELOPMENT LIMITED (FORMERLY TOTAL PEOPLE LIMITED)	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondent**

- -
- -

Giles Goodfellow QC and Charles Bradley (instructed by **Grant Thornton UK LLP**) for the **Appellants**
Richard Vallat and Richard Adkinson (instructed by **HMRC Solicitors Office**) for the **Respondents**

Hearing dates : 4th October 2012

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Approved Judgment

Lord Justice Etherton :

1. This appeal concerns the question whether lump sum payments made by the appellant, Cheshire Employer and Skills Development Limited ("CESDL"), to its employees to cover motoring expenses gave rise to a liability to pay national insurance contributions ("NICs").

2. It is an appeal by CESDL from the decision of Judge Colin Bishopp, sitting in the Upper Tribunal ("the UT"), released in amended form on 25 November 2011 holding that the payments were emoluments of employment liable for NICs and that, accordingly, CEDSL failed in its claim for reimbursement of Class 1 NICs which CESDL claimed it had overpaid for the tax years 2002/3 to 2005/6. In so holding, the UT allowed HMRC's appeal from the decision of the First Tier Tribunal (Judge Richard Barlow and Mrs Marilyn Crompton) ("the FTT") released on 12 August 2010 which had found the payments in question were not paid as earnings and had allowed CESDL's appeal from HMRC's refusal to make any refund.

The factual background

3. There is no material dispute as to the facts. An agreed statement of facts was presented to the FTT. That, and documentary evidence, was supplemented in the FTT by the oral evidence of Mr Nigel Hartley, CESDL's managing director, who was cross examined. The FTT found him to be a truthful and reliable witness. The following facts were found by the FTT or, where indicated below, appear from the agreed statement of facts.

4. CESDL, which changed its name from Total People Limited in the course of these proceedings, was formerly known as the South East Cheshire Training and Enterprise Council. Its business has always consisted of the provision or placement of apprentices and other trainees with employers and the supervision of their training. At the times relevant to this appeal its staff numbered about 200 of whom about 160 were Training Advisors. The Training Advisors had to visit the employers and the trainees at their places of work. They specialised in certain trades and, as the training places were scattered about an area covering Cheshire and parts of the adjoining counties, there was a need for the Training Advisors to do a good deal of travelling in the course of their duties. In practice, that could mostly only be done by car. Motor travelling expenses were paid to CESDL's staff as necessary but most of them were paid to the Training Advisors.

5. CESDL's "Travel Policy", which was part of a Staff Handbook, said that there were two options for payment of travel expenses. One option was a "cash entitlement", which was 12p. and later 13p. per mile plus a lump sum. The other option was "mileage expenses", which were 40p. per mile or thereabouts. Which of those options applied to a member of staff was stated to be subject to agreement with the service director or chief executive on appointment or promotion. In practice staff appointed to posts that were likely to involve extensive travel on CESDL's business were not given the option of electing for the 40p. per mile option. Staff who travelled only occasionally were entitled to the mileage expenses option as and when they actually travelled on business. The cash entitlement was stated to be subject to the employee travelling at least 2,500 miles per annum on business, and the level of the lump sum

was set according to salary. In practice, the lump sum was paid by monthly instalments.

6. The FTT accepted Mr Hartley's evidence that the rationale, genuinely believed by him, for structuring the payments in that way was that a 40p. per mile arrangement risked encouraging staff to maximise their travel so as to maximise their profit, which they might have perceived they could make from the 40p. payments, and that it was administratively more convenient.

7. CESDL also had a Driver Handbook which included a section on eligibility for the car allowance in much the same terms as the Staff Handbook.

8. Both documents stated that eligibility for the cash entitlement was on the basis of a need to travel to trainees' sites and CESDL's other offices, but they also stated that for some senior posts the entitlement was "additional". The FTT took that to mean that it was paid despite the fact that the holders of such posts did not have to travel to the same extent as the Training Advisors.

9. The documents also stated that the entitlement of senior staff to receive the lump sum payments would form "part of the recruitment package".

10. The contracts of employment did not, however, show the lump sum as part of salary. In a separate paragraph from the one dealing with salary some of the contracts of employment did state whether or not the post came with a car allowance and in some cases the amount of that allowance was stated.

11. Although not mentioned by the FTT in its decision, the agreed statement of facts records CESDL's recollection that the lump sum was originally calculated on the basis of the costs of running a Ford Mondeo 1.8LX petrol driven car for 15,000 miles per year and used 50 per cent for business. Mr Hartley's evidence was that CESDL had a policy of requiring staff to have reasonably good cars and not "old bangers" and that the lump sums in part recognised that a member of staff might well have to take out a hire purchase or other loan to buy the car and needed to know what he or she could commit to by way of monthly instalments.

12. Most of the employees who received the lump sums received £3,600 per annum in the years 2002/03 and 2003/04, £3,667 in 2004/05 and £3,700 in 2005/06. The amounts were reviewed with effect from 1 August each year. There was in fact only one increase in the four years in question. It occurred on 1 August 2004 giving rise to a pro rata increase of £67 for the then current tax year. A small number of more senior staff received £4,100 per annum which was increased to £4,200 from 1 August 2004, and two directors received £7,000 which was increased to £7,100. The 160 or so Training Advisors received the £3,600 and £3,700 amounts.

13. CESDL increased its staff salaries by an inflation related percentage in each of the four years in question, which was in the region of 3-4 per cent but, as is apparent from the sole increases of the lump sum payments in that period, increased in the travel allowance were not in any way linked to those increases and were at a much lower level and occurred less frequently.

14. Not all the senior staff, who were paid the higher lump sums, travelled the 2,500 miles used as the basis of the award to the more junior staff. Indeed, some of the more junior staff who had fallen below the 2,500 mileage did not thereby lose their entitlement. The FTT found, however, that those departures from the generality of the arrangements were statistically insignificant, and they attached little, if any, significance to them.

15. The lump sums were paid pro rata where a member of staff joined or left during a year or was a part time worker. Although not stated by the FTT in its decision, the agreed statement of facts records that the lump sum was also pro-rated where the employee had a dual role: for example, if an employee spent three days per week visiting businesses and two days per week tutoring at CESDL's "home" office, the employee would receive three-fifths of the allowance. Where a member of staff took extensive sick leave the lump sum payments stopped when the employee ceased to be paid their full salary after 12 weeks.

The legal framework

16. Section 6 of the Social Security (Contributions and Benefits) Act 1992 ("the 1992 Act") provides that NIC is payable where in any tax week "earnings are paid to or for the benefit of an earner over the age of 16". Section 3(1) of the 1992 Act provides that the expression "earnings" includes "any remuneration of profit derived from an employment".

17. The payment of earnings to or for the benefit of employed earners triggers a liability to primary and secondary Class 1 NICs. These liabilities are paid by the "secondary contributor" (generally the employer). The difference is that the primary liability is paid by the secondary contributor on behalf of the earner (with the secondary contributor having the right to recover this cost from the earner by deduction from the earnings) whereas the secondary liability is solely that of the secondary contributor (with no deduction from earnings allowed).

18. Regulation 25 and Part VIII of Schedule 3 of the Social Security (Contributions) Regulations 2001 ("the 2001 Regulations") provide (among other things) that certain travelling expenses are to be disregarded in the calculation of an employed earner's earnings for NIC purposes. They include the following:

> *"Qualifying amounts of relevant motoring expenditure*
>
> 7A To the extent that it would otherwise be earnings, the qualifying amount calculated in accordance with regulation 22A(4)."
>
> *"Specific and distinct payments of, or towards, expenses actually incurred*
>
> 9(1) For the avoidance of doubt, these [sic] shall be disregarded any specific and distinct payment of, or contribution towards, expenses which an employed earner actually incurs in carrying out his employment. This is subject to the following qualification.

(2) Sub-paragraph (1) does not authorise the disregard of any amount by way of relevant motoring expenditure, within the meaning of paragraph (3) of regulation 22A, in excess of that permitted by the formula in paragraph (4) of that regulation."

19. Regulation 22A of the 2001 Regulations ("Reg. 22A") provides as follows, so far as relevant:

> *"Amounts to be treated as earnings in connection with the use of qualifying vehicles other than cycles*
>
> 22A(1) To the extent that it would not otherwise be earnings, the amount specified in paragraph (2) shall be so treated.
>
> (2) The amount is that produced by the formula—
>
> RME−QA
>
> Here—
>
> RME is the aggregate of relevant motoring expenditure within the meaning of paragraph (3) in the earnings period; and
>
> QA is the qualifying amount calculated in accordance with paragraph (4).
>
> (3) A payment is relevant motoring expenditure if—
>
> (a) it is a mileage allowance payment within the meaning of section 229(2) of ITEPA 2003;
>
> (b) it would be such a payment but for the fact that it is paid to another for the benefit of the employee; or
>
> (c) it is any other form of payment, except a payment in kind, made by or on behalf of the employer, and made to, or for the benefit of, the employee in respect of the use by the employee of a qualifying vehicle.
>
> Here "qualifying vehicle" means a vehicle to which section 235 of ITEPA 2003 applies, …
>
> (4) The qualifying amount is the product of the formula—
>
> M × R
>
> Here—
>
> M is the sum of—
>
> (a) the number of miles of business travel undertaken, at or before the time when the payment is made—

(i) in respect of which the payment is made, and

(ii) in respect of which no other payment has been made; and

(b) the number of miles of business travel undertaken—

(i) since the last payment of relevant motoring expenditure was made, or, if there has been no such payment, since the employment began, and

(ii) for which no payment has been, or is to be, made; and

R is the rate applicable to the vehicle in question, at the time when the payment is made, in accordance with section 230(2) of ITEPA 2003 and, if more than one rate is applicable to the class of vehicle in question, is the higher or highest of those rates."

20. The Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"), to which reference is made in Reg. 22A, contains provisions concerning the treatment of mileage allowance payments and mileage allowance relief for income tax purposes. The relevant provisions are in ITEPA ss. 229-232, which are set out in the Appendix to this judgment.

21. There was considerable commentary in the written skeleton arguments on this appeal, elaborated upon in the oral submissions of Mr Giles Goodfellow QC, for CESDL, concerning the history of the legislative treatment of travelling allowances and expenses for the purposes of income tax and NIC. In the event, it is not necessary for the purpose of disposing of this appeal to trace in any detail that history, or to describe precisely the relationship between the treatment of travelling allowances and expenditure for income tax purposes, on the one hand, and NIC, on the other hand. The following brief and general summary is sufficient.

22. It is implicit in the concept of earnings, remuneration and profit that there is some overall net financial benefit to the recipient. In the context of income tax it has long been recognised as a general principle that the reimbursement by an employer to an employee, whether in whole or in part, of an expense that the employee has had to incur in order to perform his or her duties is not, without more, an "emolument" of the employee's employment. For income tax purposes, however, ITEPA ss. 70 and 72 deem sums paid to most employees in respect of expenses to be "earnings" from the employment, but this is subject to the right of the employee to show that the expense incurred by them is deductible. There is nothing equivalent to ITEPA ss. 70 and 72 for NIC purposes.

23. Prior to the enactment of Reg. 22A there was no specific statutory regime dealing with the NIC treatment of payments by employers in respect of business travel expenses incurred by employees using their own cars. The treatment of reimbursement payments depended mainly on the general meaning of "earnings", including acceptance that the genuine reimbursement of expenditure necessarily incurred by employees on business travel does not constitute "earnings". There was no legislative provision dealing with the mechanics for calculating the amount which

could be paid by way of reimbursement without giving rise to a payment of "earnings" for NIC purposes. The treatment of such payments was dependent largely upon HMRC's practice.

24. Change in that respect came with the amendments to the 2001 Regulations made by the Social Security (Contributions) (Amendment No.2) Regulations, SI 2002/307. Those amendments included the insertion of Reg. 22A, and the insertion of paragraph 7A and the amendment of paragraph 9 in Part VIII of Schedule 3. Those amendments came into force on 6 April 2002. There came into force at the same time amendments to income tax legislation which included the provisions now in ITEPA ss. 229 – 232.

25. Essentially, although the drafting mechanisms and some details are slightly different, the broad effect of the amendments to the 2001 Regulations and to the income tax legislation was to introduce comparable treatment of mileage allowance payments. Exemption for mileage allowance payments was limited by reference to the number of miles of business travel by the relevant employee multiplied by a standard rate or rates per mile – 40p. in the case of a car (for the first 10,000 miles and 25p. after that).

The FTT's decision

26. The FTT stated in its decision (at [5]) that the relevant statutory provision it had to consider was Reg. 22A, and (at [9]) that it was therefore necessary to consider first whether the sums paid to CESDL's employees as motoring expenses were earnings. It further stated (at [9]) that, if they were earnings, that was the end of the question and they were subject to NICs; but, if they would not otherwise be earnings, they were deemed to be earnings under Reg. 22A if they were RME (as defined in Reg. 22A(3)) except to the extent that they were QA (as defined in Reg. 22A(4). CESDL's case before the FTT was that the payments were not "otherwise … earnings" within Reg. 22A but they were, for the purposes of Reg. 22A, RME and so exempt from NIC to the extent of QA. Paragraph [13] of the FTT's decision recorded that HMRC accepted that, if the lump sums were not earnings, then they would be RME. Accordingly, the sole issue before the FTT, as recorded in paragraph [14] of its decision, was whether or not the lump sum payments were paid as earnings on ordinary principles.

27. The FTT set out the facts and considered the various arguments advanced by Mr Richard Adkinson, HMRC's counsel, including that what someone calls a payment does not necessarily characterise it for tax purposes, that treating the lump sum payments as part of the recruitment package was tantamount to admitting that the lump sum payment was effectively an addition to earnings, that not all the senior staff who were paid the higher lump sums actually covered the 2,500 miles, that some of the junior staff who had fallen below the 2,500 mileage did not lose their entitlement, that the suspension of lump sum payments due to sick leave was an indication that the allowance was regarded as part of salary, and that a result of the lump sum payments was that the effective rate of travel allowance varied considerably from one member of staff to another in the same grade and with a similar job description because of the difference in the mileage travelled by each employee. The FTT's conclusion was that, on balance, the lump sum payments were not earnings. It said, quite briefly, as follows:

> "25. Clearly there are indications, if taken separately, that could lead to a conclusion either that the lump sum payments were additions to salary or that they were paid as motoring expenditure but we have decided that, taking all the evidence into account, they were the latter. The most important single piece of evidence is the absence of a link between the increase in salary and the increase in the motoring allowances. The appellant's rationale for structuring the payments as it did is also significant.
>
> 26. Accordingly we find that the payments in question were not paid as earnings and so the appeal is allowed."

The UT's decision

28. On appeal to the UT HMRC advanced a number of further arguments and contended that the FTT had made an error of law in reaching its decision.

29. Judge Bishopp began his analysis of the law by saying (at [10]) that the relevant law was to be found in Reg. 22A. He said (at [11]) that it was common ground that the sums paid by CESDL by reference to miles actually driven fell within Reg. 22A(3)(a) and that Reg. 22A(3)(b) was not in point and that the issue before him was whether the lump sum payments fell within Reg. 22A(3)(c). It was common ground that the employees' cars were all qualifying vehicles within ITEPA s. 235.

30. Judge Bishopp noted (in [12]) that CESDL had always accepted that only so much of the lump sums as did not exceed the amounts determined in accordance with Reg. 22A(4) (when added to the mileage payments made to the employees) were capable of being exempt from NICs, and that CESDL had limited its claim accordingly; and HMRC had accepted that, if a refund was due at all, the claim had been correctly calculated.

31. Judge Bishopp summarised the arguments of Mr Adkinson, for HMRC, in paragraph [13] of the UT's decision. He said that the essence of Mr Adkinson's argument was that:

> "although the FTT had identified as the first issue whether the lump sum payments were earnings in any event, and had decided they were not, it had not gone on to consider whether they represented relevant motoring expenditure within the meaning of Reg. 22A(3). It had instead decided the appeal on the footing that if the payments were not earnings they must be motoring expenditure. The question the FTT had asked did not properly address the legislative test."

32. In the section of the UT's decision headed "*Discussion and conclusions*" Judge Bishopp said (at [17]) that HMRC's argument that the FTT "asked itself the wrong question" was "irresistible". It seems that the basis for that conclusion is to be found in paragraph [18] of the UT's decision as follows:

> "It is plain from para 25 of its decision that the First-tier Tribunal was drawing a distinction between earnings, in the shape of additions to salary, and motoring expenditure. Despite Mr Adkinson's criticisms, I see no great difficulty in characterising the lump sums as payments in respect of motoring expenses. But it is not enough that the payments represent, or are intended as, reimbursement of motoring expenditure; they must be of "relevant motoring expenditure" within the meaning of Reg 22A(3), which in turn requires that the payment satisfies one of the three prescribed conditions."

33. So far as those conditions are concerned, Judge Bishopp said that:

> "condition [22A(3)](a) sets the scene; the purpose of (b) and (c) is to bring within the definition payments which might not fit within (a), but which are of the same character."

34. Judge Bishopp then said the following at paragraph [22]:

> "At para 9 of its decision the First-tier Tribunal first made the point that it was necessary to decide whether the payments in question were earnings because, if they were, there was nothing more to determine: NICs would be due on them, however the employer and employee chose to describe them. It decided that point in favour of CESDL and HMRC do not, in terms, attack that finding. In the same paragraph the tribunal identified the need next to determine whether the payments were of relevant motoring expenditure, but in my judgment it then failed to make that determination. It may well have been side-tracked by its understanding, recorded at para 13, that "[i]f the lump sums were not earnings the respondents accept that they would then be part of the RME", a concession which, Mr Adkinson told me, he had not made and which, it seems to me, HMRC are most unlikely to have made since it is inconsistent with the thrust of their argument, as it is set out in their statement of case. Critically, in my view, there is nothing in the decision which suggests that the link between the payments and the use of the vehicles was considered by the tribunal."

35. Judge Bishopp found, having regard to the evidence, that the necessary link was absent. He said:

> "23 … The managing director's explanation of the schemes which I have mentioned above indicated that the payments were made, not to defray the cost of use, but to defray the cost of acquisition or ownership. The sums paid bore no relation, save by chance, to the scale of the use made by the employee of his car for CESDL's purposes; as Mr Adkinson argued, and I agree, it is difficult to see how a payment which is made irrespective of the number of miles covered can properly be said to be related to use, even leaving aside what I have said

> about the drafting of s 229(2). The fact that senior employees using their cars very little received more than junior employees using their cars extensively, too, is inconsistent with a link between payment and use. Moreover, Mr Summers' argument that the lump sum represented a payment in respect of standing charges while the 12p or 13p per mile covered the marginal costs seems to me to support HMRC's rather than his own case: standing charges are a consequence of ownership, or of possession, rather than of use. It is true that (as I understand the findings of fact) only those employees who made some use of their cars for CESDL's business received any payment, but for the reasons I have given it is in my view clear that the necessary link is with the degree, rather than the mere fact, of use. I am unable to read s 229(2) in any other way.
>
> 24. It is no answer that reg 22A(4) limits the amount allowable. The calculation required by that paragraph must be related back to para (2): their combined effect is not simply to restrict the amount which is eligible for exemption from NICs, but to restrict the amount of relevant motoring expenditure which is so eligible. In other words, if the payment is not of relevant motoring expenditure, no relief is available. …"

36. Judge Bishopp said (at [25]) that the FTT having "asked itself the wrong question or, at least, an inadequate question" and given an answer based on an error of law, it was open to him to disturb it if he was satisfied that it was wrong, which he was. He said (at [26]) that there was no need to remit the case to the FTT for the facts to be found again or for further facts to be found since the facts found were adequate to enable him to re-make the decision. He said that he adopted that course, and he concluded his judgment very simply as follows:

> "The payments were not of relevant motoring expenditure and they were accordingly emoluments of employment liable for NICs. CESDL's claim for reimbursement must fail."

<u>The appeal to the Court of Appeal</u>

37. On this appeal CESDL is now represented by Mr Giles Goodfellow QC, leading Mr Charles Bradley. Its argument in the briefest outline is as follows. The UT proceeded on an erroneous basis in holding that (1) if the lump sum payments were not RME within Reg. 22A(3), then they are to be treated as "earnings" and so chargeable to NIC, (2) the lump sum payments were not RME within Reg. 22A(3), and (3) the FTT made an error of law. CESDL submits that the FTT was entitled to conclude that the lump sums were not earnings, on ordinary principles, and that, since HMRC's case is that they were not RME, Reg. 22A is irrelevant and the FTT rightly treated its decision on the earnings point as conclusive in favour of CESDL's appeal. CESDL advances the alternative argument, for the first time on this appeal, that if, contrary to the conclusion of the FTT, the lump sum payments were earnings on ordinary principles, then, pursuant to paragraph 7A of Part VIII of Schedule 3 to the 2001 Regulations an amount equal to the QA under Reg. 22A(4) is to be disregarded for NIC purposes.

38. Mr Richard Vallat leading Mr Adkinson, for HMRC, supported the decision of the UT, while acknowledging that its decision was not in all respects entirely transparent. He submitted that the UT had correctly concluded that the FTT had made an error of law in deciding that the lump sum payments were, on ordinary principles, not earnings. He said that FTT's error of law was in concluding that the lump sum payments were not earnings merely because they were not "additions to salary" but were "paid as motoring expenditure". He submitted that the legal flaw of the FTT was in failing to consider whether, and to find that, the lump sums were earnings because, even if not paid as salary, they nevertheless were over generous and so involved a profit element for the employees. In that connection he particularly relied upon the reasoning in, but distinguished the facts and findings in, *Donnelly v Williamson* [1982] STC 88.

39. HMRC's case is that the analysis of the UT leading to its conclusion that the lump sum payments were not RME within Reg. 22A(3) because there was an insufficient link between the payments and the actual use by employees of their cars on CESDL's business was also decisive of the question whether the payments were earnings on ordinary principles; it was an exercise which should have been carried out by the FTT, but was not; and had the exercise been carried out by the FTT, the only conclusion to which it could have come was that the lump sums were over generous allowances and, accordingly, earnings for NIC purposes.

40. While supporting generally the analysis of the UT on the linkage point, Mr Vallat emphasised particularly that the allowances were fixed by reference to a Ford Mondeo being driven a certain number of miles every year, whereas, in reality, there was a vast discrepancy in the miles driven by the different employees for business purposes and also a vast discrepancy in the types of car driven. He reasoned that, accordingly, the actual cost of motoring differed widely between different employees. HMRC also argue that the necessary linkage between the actual use and the lump sums payments, if the payments were to qualify as earnings, was fatally undermined by the avowed purpose of the lump sums being to facilitate the purchase of the cars. HMRC say, in short, that the lump sum payments were not based on a genuine estimate of expenses necessarily incurred by CESDL's employees and the payments did not apply with approximately equal justice to all employees receiving them.

41. HMRC further contend on this appeal that if, as the UT held, the lump sum payments were earnings on ordinary principles, then paragraph 7A of Part VIII of Schedule 3 to the 2001 Regulations does not apply to reduce the payments by an amount equal to the QA under Reg. 22A(4). It submits that paragraph 7A is implicitly limited to RME and, for the reasons given by the UT, but not explored by the FTT, the lump sum payments were not RME. Mr Vallat, endorsing the comment of Judge Bishopp in paragraph [22] of his decision, said that the FTT had been mistaken in its comment in paragraph [13] of its decision that HMRC accepted that, if the lump sums were not earnings, they would be RME.

42. HMRC have not served a Respondent's Notice, but Mr Vallat submits that all the above reasoning is to be treated as implicit in Judge Bishopp's brief conclusions at the end of paragraph [26] of the UT's decision that the payments were not RME "and they were accordingly emoluments of employment liable for NICs" and "CESDL's claim for reimbursement must fail".

43. Mr Vallat submitted that, in the circumstances, the UT was entitled to decline to remit the matter to the FTT and was entitled to re-make the decision itself -on the facts found by the FTT - as to whether the lump sum payments were earnings. He submitted that, the UT having re-made the decision, that decision can only be disturbed on appeal to this court if the UT made an error of law, but it did not. Its conclusion, he said, was not merely one to which a reasonable tribunal could come; it was the only conclusion to which a tribunal could properly come.

Discussion

44. In the light of the arguments advanced on this appeal, it is clear that the FTT and the UT were not well served by the parties' advocates. No cases were cited to the FTT, and, in particular, no reference was made to *Donnelly*. Nor was any reference made to paragraph 7A of Part VIII of Schedule 3 to the 2001 Regulations, let alone any submission made that paragraph 7A is implicitly limited to RME within Regulation 22A(3). It appears that HMRC left both the FTT and the CESDL under the impression that in the course of oral submissions HMRC accepted that, if the lump sum payments were not earnings, then they would be RME.

45. On appeal to the UT, once again no mention was made of *Donnelly*. The UT's decision, presumably reflecting the arguments before it, focused almost entirely on Reg. 22A. Even though Reg. 22A in terms only applies where the relevant payments are not otherwise earnings, the UT did not take as the first issue to be determined the question whether the lump sum payments in the present case were earnings on ordinary principles. Indeed, Judge Bishopp was left with the impression, recorded in paragraph [22] of his decision, that HMRC were not attacking the FTT's decision in favour of CESDL on the question whether the payments in question were earnings. The decision is, therefore, perplexing in some respects.

46. HMRC's skeleton argument for the appeal to the UT only made a passing reference to paragraph 7A of Part VIII of Schedule 3 to the 2001 Regulations in the context of Reg. 22A. It did not articulate the argument which it has advanced on this appeal as to the implied restriction of paragraph 7A to RME. It is hardly surprising, therefore, that the decision says nothing about the application of paragraph 7A on the UT's finding that the lump sum payments were earnings.

47. The proper structured approach to the issues in this case seems quite clear. The first question is whether the lump sum payments were earnings for NIC purposes on ordinary principles. If they were not, then that is the end of the matter and CESDL succeeds in its claim for reimbursement of NIC. It succeeds because either, as HMRC contend, the payments were not RME and so the deemed earnings provisions of Reg. 22A do not apply; or, if, as CESDL contends, they were RME, the claim still succeeds because CESDL has limited its claim to reimbursement to the QA. If, on the other hand, the lump sum payments were earnings for NIC purposes on ordinary principles, then other questions arise. The first is whether paragraph 7A of Part VIII of Schedule 3 to the 2001 Regulations is, as HMRC contend, implicitly limited to RME. If it is not, then again that is the end of the matter and CESDL succeeds in its claim for reimbursement. If it is implicitly limited to RME, then, thirdly, it must be determined whether, as CESDL contends, the payments were RME or, as HMRC contend, they were not.

48. Two things are immediately apparent from that structured approach. First, CESDL's scheme for travelling allowances is not an obviously abusive one where the intention or effect is to avoid all payment of NIC on the lump sum allowances or artificially to escape payment of income tax. HMRC have not claimed that there was no element at all of genuine compensation for business travel expenditure in the lump sum payments. There is no doubt that CESDL's employees did incur expenditure for business travel in their cars. HMRC's case is merely that the linkage is not sufficiently close between the amount of the payment and actual use for business purposes and so there is an element of profit, or potential profit, for the employees. CESDL is not, however, seeking reimbursement of more than the 40p. per actual business mile specified as the QA in Reg. 22A(4) and as the approved amount in ITEPA s. 230(2). Further, the effect of ITEPA ss. 70 and 72 is that CESDL's employees will pay income tax on the entire amount of the allowances save to the extent that they can invoke an exemption under ITEPA ss.229 to 232 up to 40p. per business mile. The effect of HMRC's analysis and submissions is to eliminate entirely any right to reimbursement of NIC in respect of any genuine element of compensation for travelling expenses in the lump sum payment.

49. Secondly, the FTT was correct in its approach of deciding, first, whether the lump sum payments were earnings for NIC on ordinary principles and, having found that they were not, in treating that as decisive in upholding CESDL's claim to reimbursement. The first question on this appeal, as it was for the UT, is whether the FTT made an error of law in reaching its conclusion on the earnings point. If it made no error of law, then the UT had no jurisdiction to overturn the decision of the FTT and to re-make it, as it purported to do.

50. The ordinary principles for establishing whether an allowance for expenses is part of an employee's earnings are well established. They are not in dispute. It is common ground that, so far as relevant to the issues in the present case, they are the same for income tax and NIC: comp. *Kuehne + Nagel Drinks Logistics Ltd v HMRC* [2012] STC 840 in which (as recorded at [2]) the parties were similarly agreed on that point (and, per contra, the convertibility and defeasibility principles of income tax considered in *HMRC v Forde and McHugh Limited* [2012] EWCA Civ 692). In *Hochstrasser v Mayes* [1959] Ch. 22 at 33 Upjohn J said:

> "In my judgment the authorities show this, that it is a question to be answered in the light of the particular facts of every case whether or not a particular payment is or is not a profit arising from the employment. Disregarding entirely contracts for full consideration in money or money's worth and personal presents, in my judgment not every payment made to an employee is necessarily made to him as a profit arising from his employment. Indeed, in my judgment, the authorities show that to be a profit arising from the employment the payment must be made in reference to the services the employee renders by virtue of his office, and it must be something in the nature of a reward for services past, present or future."

51. That passage was approved by Viscount Simonds at [1960] AC 376, 388, on appeal to the House of Lords. Lord Radcliffe, who concurred with Viscount Simonds, said at pages 391-2:

> "… while it is not sufficient to render a payment assessable that an employee would not have received it unless he had been an employee, it is assessable if it has been paid to him in return for acting as or being an employee…. The money was not paid to him as wages."

52. Those passages were cited and applied by Lord Guest in *Pook v Owen* [1970] AC 244 in which the House of Lords held that sums paid to a medical practitioner for travelling expenses between his residence and a hospital where he held part-time appointments as an obstetrician and an anaesthetist were not part of his emoluments for income tax. Lord Guest said at pages 255-256:

> "The facts in that case [viz. *Hochstrasser v Mayes*] were widely different from the present, but if the proper test is whether the sum is a reward for services, then, in my view, the travelling allowances paid to Dr. Owen are not emoluments. To say that Dr. Owen is to that extent "better off" is not to the point. The allowances were used to fill a hole in his emoluments by his expenditure on travel. The allowances were made for the convenience of the employee to allow him to do his work at the hospital from a suitably adjacent area. In my view, the travelling allowances were not emoluments."

53. Lord Pearce said at page 259:

> ""Emoluments" are charged. These are defined as including "all salaries, fees, wages, perquisites and profits whatsoever".
>
> The reimbursements of actual expenses are clearly not intended by "salaries", "fees", "wages" or "profits". It is contended that they are "perquisites". The normal meaning of the word denotes something that benefits a man by going to his own pocket. It would be a wholly misleading description of an office to say that it had very large perquisites merely because the holder had to disburse very large sums out of his own pocket and subsequently received a reimbursement or partial reimbursement of these sums. If a school-teacher takes children out for a school treat, paying for them out of his (or her) own pocket, and is later wholly or partially reimbursed by the school, nobody would describe him (or her) as enjoying a perquisite. In my view, "perquisite" has a known normal meaning, namely, a personal advantage, which would not apply to a mere reimbursement of necessary disbursements. There is nothing in the section to give it a different meaning. Indeed, the other words of the section confirm the view that some element of personal profit is intended."

54. The authorities were reviewed by Walton J in *Donnelly v Williamson* [1982] STC 88. In that case the taxpayer, a teacher employed by Birmingham Education Authority, received a mileage allowance for travelling by car to attend certain out of school functions which did not form part of the duties which she was obliged to perform by

the terms of her contract of employment. The payments were made under a scheme introduced by the council to reimburse teachers for expenses incurred in travelling to out of school functions. She appealed against assessments to income tax on the allowance. Walton J dismissed the Crown's appeal from the decision of the General Commissioners allowing the taxpayer's appeal from the assessments. Having referred to the relevant authorities, Walton J said as follows at pages 97-98:

> "Therefore, the question under this head of the case simply is, as I see it, whether the allowance here in question was intended as a genuine estimate of the cost to the taxpayer of undertaking the journeys she did in fact undertake, or whether, on the other hand, it included an element of bounty. I observe that it was in fact contended on behalf of the Crown before the commissioners that there was a profit element in the allowance. This the commissioners expressly negatived. Was there evidence on which they could properly do so?
>
> In my judgment, there was. They had evidence before them of Mr Rimell, who was involved in the negotiations on rates of mileage allowance for car users, and, having regard to the submissions of the inspector, it is quite obvious that he must have been closely questioned as to the composition of these rates. And he must therefore have satisfied the commissioners that there was no element of bounty built into such rates.
>
> This, is, I think, a matter where it is necessary to paint with a broad brush, otherwise the possible distinctions would become totally unrealistic. Thus, for example, the rates are clearly all built on an assumed cost of a gallon of petrol, or of a replacement tyre. If the recipient of the allowance should be successful in finding a petrol station selling petrol at a cut price, or a new tyre at a cut price, so that he or she in fact makes a few pence profit out of the journey, is one to say that the consequence is that there is an element of bounty in the allowance? The answer is, in my judgment, in the negative; when constructing such allowances, the aim is to produce a formula which will apply with approximately equal justice to all within its scope. (Compare, in another field, a 'genuine pre-estimate of damage'.) It takes no account of the fact that one person must perforce buy some petrol at the maximum price while another may be lucky enough to get some a bit cheaper, and so forth. The test therefore is, I think, not whether the allowance produced mathematical equivalence with the expenditure, but whether it was constructed in a genuine endeavour to do just that.
>
> Of course, this is only the second limb of the taxpayers' defence, but if it were to fail, then I think that it is obvious that, even so, the only matter which could be properly called an 'emolument' would be the benefit element in the allowance, the non-benefit element being properly protected by the undeniable

> principle of *Pook* (*Inspector of Taxes*) *v Owen*. No attempt was apparently made before the commissioners, and no real attempt was made before me, to isolate what this element might be thought to be. And I think for the best of all possible reasons—namely that it is quite impossible to identify that which truly has no existence."

55. Both sides accept the analysis of Walton J in that case. What emerges from his judgment are the sensible propositions that, in a case where an employer establishes a general scheme for reimbursement of employees' travelling expenditure, then in determining whether the allowances are to be treated as the taxable earnings of the employees because they involve a profit element or they are to be ignored because they are reimbursement of expenditure: (1) a broad brush approach is necessary in view of the practical constraints of devising a scheme that can apply to a number of different employees and is administratively workable; (2) the test is not whether the allowance produces a mathematical equivalence with the expenditure; (3) rather, the question is whether the scheme was constructed in a genuine endeavour to produce an equivalence between the allowance and the expenditure and to apply with approximately equal justice to all within its scope.

56. As I have said, HMRC's case is that the FTT failed to address the *Donnelly* test and, had it done so, the FTT could only properly have come to the conclusion that the payments failed the test. I do not agree. As I have said earlier, neither side cited *Donnelly* to the FTT. Nor did HMRC advance before the FTT an argument that, even if the lump sum payments were not part of the employees' salaries, they nevertheless were earnings for NIC purposes because they involved an element of bounty or profit for the employee. It is hardly surprising, therefore, that the FTT's decision does not mention *Donnelly* and is not worded so as expressly to address the argument now being run by HMRC based on that case.

57. I consider it is quite impossible, however, fairly reading the FTT's decision, to say that the FTT failed to address the relevant issues mentioned in *Donnelly* or to say that there was no material on which the FTT could properly have come to the decision which it did. It weighed up all the arguments addressed to it by Mr Adkinson, on behalf of HMRC, challenging the degree of linkage between the amount of the lump sums and actual business use. Critically, it found as facts that the scheme was a bona fide scheme, that the lump sum element was designed precisely in order prevent staff making a personal profit by maximising their travel on a 40p. per mile basis, and that the scheme was designed with a view to administrative convenience. The FTT expressly recognised that it was carrying out an evaluation exercise, in which there was evidence and there were arguments capable of pointing to different conclusions. It was fully entitled, in the light of the evidence as a whole, to come down finally in favour of the conclusion that, on general principles, the lump sum payments were not earnings. It follows that it did not make an error of law on that issue, and that it was right to allow CESDL's appeal.

58. It also follows that, since there could only be an appeal to the UT for an error of law, the UT had no jurisdiction to set aside and to re-make the decision on the earnings point. I would, therefore, allow the appeal.

59. The issues as to the meaning and effect of paragraph 7A of Part VIII of Schedule 3 to the 2001 Regulations and of Reg. 22A(3) (RME) do not, therefore, arise. Mr Goodfellow was eager that we should, nevertheless, address those issues because the reasoning and conclusions on them of the UT (expressly in respect of Reg. 22A and, according to HMRC, impliedly in respect of paragraph 7A) would remain. They remain, however, only as obiter dicta. Our own views on them would themselves be obiter dicta. It is, at the least, highly doubtful whether permission would be given for an appeal from our obiter dicta on the UT's obiter dicta. For those reasons, having formed a clear view on the earnings point, we declined to hear oral argument on Reg. 22A(3) and paragraph 7A. I express no view whatever on them or on anything that the UT said about them (expressly or impliedly).

Conclusion

60. For those reasons I would allow this appeal.

APPENDIX

ITEPA ss. 229-232

"229 *Mileage allowance payments*

(1)No liability to income tax arises in respect of approved mileage allowance payments for a vehicle to which this Chapter applies (see section 235).

(2)Mileage allowance payments are amounts, other than passenger payments (see section 233), paid to an employee for expenses related to the employee's use of such a vehicle for business travel (see section 236(1)).

(3)Mileage allowance payments are approved if, or to the extent that, for a tax year, the total amount of all such payments made to the employee for the kind of vehicle in question does not exceed the approved amount for such payments applicable to that kind of vehicle (see section 230).

(4)Subsection (1) does not apply if—

(a)the employee is a passenger in the vehicle, or

(b)the vehicle is a company vehicle (see section 236(2))."

"230 *The approved amount for mileage allowance payments*

(1)The approved amount for mileage allowance payments that is applicable to a kind of vehicle is—

M x R

where—

M is the number of miles of business travel by the employee (other than as a passenger) using that kind of vehicle in the tax year in question;

R is the rate applicable to that kind of vehicle.

(2)The rates applicable are as follows—

Table	
Kind of vehicle	Rate per mile
Car or van	40p for the first 10,000 miles
	25p after that
Motor cycle	24p
Cycle	20p

(3)The reference in subsection (2) to "the first 10,000 miles" is to the total number of miles of business travel in relation to the employment, or any associated employment, by car or van in the tax year in question.

(4)One employment is associated with another if—

(a)the employer is the same;

(b)the employers are partnerships or bodies and an individual or another partnership or body has control over both of them; or

(c)the employers are associated companies within the meaning of section 416 of ICTA."

(5)In subsection (4)(b)—

(a)"control", in relation to a body corporate or partnership, has the meaning given by section 840 of ICTA (in accordance with section 719 of this Act), and

(b)the definition of "control" in that section of that Act applies (with the necessary modifications) in relation to an unincorporated association as it applies in relation to a body corporate.

(6)The Treasury may by regulations amend subsection (2) so as to alter the rates or rate bands."

“231 *Mileage allowance relief*

(1)An employee is entitled to mileage allowance relief for a tax year—

(a)if the employee uses a vehicle to which this Chapter applies for business travel, and

(b)the total amount of all mileage allowance payments, if any, made to the employee for the kind of vehicle in question for the tax year is less than the approved amount for such payments applicable to that kind of vehicle.

(2)The amount of mileage allowance relief to which an employee is entitled for a tax year is the difference between—

(a)the total amount of all mileage allowance payments, if any, made to the employee for the kind of vehicle in question, and

(b)the approved amount for such payments applicable to that kind of vehicle.

(3)Subsection (1) does not apply if—

(a)the employee is a passenger in the vehicle, or

(b)the vehicle is a company vehicle.”

“232 *Giving effect to mileage allowance relief*

(1)A deduction is allowed for mileage allowance relief to which an employee is entitled for a tax year.

(2)If any of the employee’s earnings—

(a)are taxable earnings in the tax year in which the employee receives them, and

(b)are not also taxable earnings in that year that fall within subsection (3),

the relief is allowed as a deduction from those earnings in calculating net taxable earnings in the year.

(3)If any of the employee’s earnings are taxable earnings in the tax year in which the employee remits them to the United Kingdom, there may be deducted from those earnings the amount of any mileage allowance relief—

(a)for that tax year, and

(b)for any earlier tax year in which the employee was resident in the United Kingdom,

which, on the assumptions mentioned in subsection (4), would have been deductible under subsection (2).

(4)The assumptions are—

(a)that subsection (2)(b) does not apply, and

(b)where applicable, that the earnings constitute taxable earnings in the tax year in which the employee receives them.

(5)Subsection (3) applies only to the extent that the mileage allowance relief cannot be deducted under subsection (2).

(6)A deduction shall not be made twice, whether under subsection (2) or (3), in respect of the same mileage allowance relief.

(7)In this section "taxable earnings" or "net taxable earnings" means taxable earnings or net taxable earnings from the employment for the purposes of Part 2."

Sir Stephen Sedley

61. I agree.

Lord Justice Mummery

62. I also agree.