SECOND DIVISION, INNER HOUSE, COURT OF SESSION

[2015] CSIH 77
XA128/14

Lord Justice Clerk
Lord Menzies
Lord Drummond Young

OPINION OF THE COURT

delivered by LORD DRUMMOND YOUNG

in an appeal to the Court of Session

by

THE ADVOCATE GENERAL FOR SCOTLAND

Appellant;

against

a decision of the Upper Tribunal dated 8 July 2014

in relation to assessments to tax made on

(1) MURRAY GROUP HOLDINGS LTD; (2) MURRAY GROUP MANAGEMENT LTD; (3) THE PREMIER PROPERTY GROUP LTD; (4) GM MINING LTD; and (5) RFC 2012 PLC (in liquidation) (formerly The Rangers Football Club PLC)

Respondents:

Act: Ghosh QC, D Thomson; Office of the Advocate General
Alt: R Dunlop QC, Richardson; Brodies LLP (Fifth Respondents)
Alt: First to Fourth Respondents – non-participating parties

4 November 2015

[1] The respondents are members of a group of companies whose ultimate parent company is Murray International Holdings Ltd. The first respondent is a subsidiary holding

company, and the other four respondents are members of what is referred to as the Murray Group of companies. In tax years from 2001/02 to 2008/09 the respondents entered into a series of transactions pursuant to a scheme designed to avoid the payment of income tax and National Insurance contributions ("NICs") in respect of their employees. Those transactions have resulted in assessments by Her Majesty's Revenue and Customs ("HMRC") to income tax under the Pay As You Earn ("PAYE") system and corresponding NICs. The respondents appealed against those assessments. Their appeal was heard before the First-tier Tribunal, who on 29 October 2012 upheld the appeal; that was the decision of a majority of the First-tier Tribunal (Mr Kenneth Mure, QC, and Scott Rae, WS); the third member of the Tribunal, Dr Heidi Poon, CA, dissented. The appellant appealed to the Upper Tribunal (Lord Doherty), which on 8 July 2014 refused the appeal and on 22 August 2014 granted permission to appeal on one ground to the Court of Session. Following that determination the appellant, who represents HMRC, has appealed to the Court of Session. The first to fourth respondents are now in liquidation and the fifth respondents, RFC 2012 PLC, are now the only party opposing the appeal. We should note that, although the appeal relates to NICs as well as income tax, it is a matter of agreement that our decision on the income tax issue will apply equally to NICs; consequently the discussion is confined to income tax and the PAYE system.

[2] The scheme as it typically operated may be summarized as follows. The second respondents (hereinafter referred to as "MGML") set up a trust known as the Employees' Remuneration Trust (hereinafter referred to as "the Principal Trust"). A company in the Murray Group which wished to benefit one of its employees made a cash payment to the Principal Trust in respect of that employee. The paying company recommended the trustee of the Principal Trust to resettle the sum in question on to a sub-trust, and would ask that

the income and capital of the sub-trust should be applied in accordance with the wishes of the employee. The beneficiaries of the sub-trust were chosen by the employee, and were generally the members of his family. In practice the trustees of the sub-trusts invariably gave effect to the wishes of the employee. The employee would be appointed protector of the sub-trust, and the trustee of the sub-trust would then lend the employee the money that had been advanced to the sub-trust from, ultimately, his employer. The First-tier Tribunal held that the trustee of the Principal Trust had a genuine discretion as to how to apply the funds advanced to it, and the settlement on to the sub-trust merely represented the exercise of that discretion. Thus the benefit enjoyed by the employee and his family resulted from the exercise of a discretionary power by the trustee of the sub-trust. Such a payment was not a payment of emoluments or earnings, and was therefore not subject to income tax.

[3] HMRC contend that that interpretation of the transaction is wrong. They assert that the cash payment made by the employing company to the trustee of the Principal Trust was in consideration of services by the employee, and thus had been earned by the employee. The employee was content to take the risk that he might not benefit if the trustee of the Principal Trust chose not to follow the recommendation of the employer. Nevertheless, the employer arranged for a letter of wishes from the relevant employee to be passed to the trustee of the Principal Trust, and also an application for a loan by the trustee of the sub-trust to the employee. HMRC's fundamental argument is that the cash payment to the Principal Trust was part of the remuneration package of the employee, comprising salary and bonuses; it had been earned for work done. The only reason that it was said not to be taxable was that it had been paid to someone other than the employee, namely the trustee of the Principal Trust, with a recommendation that the funds be passed to the trustee of the sub-trust. That, it is said, brings into operation the principle that if an employee or self-

employed person instructs that payment of money that he has earned through his work should be made not to him but to another person he is still obliged to pay income tax and NICs on that sum. Monies due to him have merely been redirected to another person. The first question for the court is whether that argument is correct. If it is not, HMRC advance a second argument, based on the proposition that the employee as protector can exercise his powers in such a way that the whole of the funds in his sub-trust are paid to him. That is said to bring the *Ramsay* principle (*Ramsay (WT) Ltd* v *IRC*, [1982] AC 300) into operation, with the result that the amount paid into the sub-trust is treated as at the absolute disposal of the employee and hence part of his emoluments or earnings. Finally, there is a possible third issue about the application of the PAYE legislation.

[4] We will first set out the facts of the case in greater detail. We will then consider three incidental questions. The first relates to the basis on which an appellant from the First-tier and Upper Tribunals may raise a new argument before the court; that is relevant to HMRC's first argument, which was not presented before the Tribunals. The second relates to the scope of the present appeal, which is an appeal on a point of law only: in particular the extent to which the court can interfere with the decisions of the First-tier Tribunal and the Upper Tribunal. The third relates to the manner in which the Court of Session should deal with questions of English law that arise in an appeal from the Tax and Chancery Chamber: can the Court, like the First-tier and Upper Tribunals, treat English law as a question of law, or must it treat it as a question of fact? If the latter is correct, the result will be that any findings on English law by the two Tribunals are binding on the Court. Thereafter we will consider HMRC's two principal arguments, and finally the PAYE issue.

Facts

General

[5] The facts as found by the majority of the First-tier Tribunal are as follows. These are taken from the majority opinion of the First-tier Tribunal (paragraphs 2, 103, 204-208 and 224-233). Representative documentation was also available, and we have had regard to that. At this stage we comment that the facts found by the First-tier Tribunal focused in large measure on the trust arrangements that were set up rather than the source of the funds involved and, most importantly, the reason that they were provided in the first place. It is, however, the findings relating to the latter that are important for our decision. We further note that in her dissenting opinion Dr Poon made a number of additional findings, largely based on the documents before the Tribunal. For present purposes, however, we must proceed on the facts as found by the majority; the appeal to the Court is on questions of law only.

[6] Murray International Holdings Ltd is the ultimate holding company of the Murray Group, and Murray Group Holdings Ltd, the first respondent, functions as a subsidiary holding company within the Group. MGML, the second respondent, provides management services to the companies in the Group. The group consists of approximately 100 subsidiary companies involved in trading and other commercial operations; one of the members of the group, the fifth respondent, was the owner of Rangers Football Club. By a deed dated 20 April 2001, referred to as "the Definitive Deed", MGML set up a trust known as the Employees' Remuneration Trust (referred to as "the Principal Trust"). This was subsequently amended by a Deed of Variation dated 28 January 2002, a Deed of Amendment dated 29 November 2002, and a Deed of Amendment and Rectification dated 12 October 2005.

[7] The Principal Trust was used as the basis of a scheme involving a large number of sub-trusts for the benefit of the families of employees of certain companies in the Group. After the Principal Trust was established, companies in the Group other than MGML were allowed to participate in the scheme. In summary, their participation took the following form. The company in question paid monies into the Principal Trust with a direction to the trustees of that trust that a sub-trust should be established and funded for the benefit of the family of one of the company's employees. In addition, the trustees of the sub-trust made a loan facility available to the employee, at commercial rates of interest but on a discounted basis. That would constitute a debt on the employee's estate, which was perceived as offering inheritance tax advantages on his death. The fundamental purpose of the sub-trust was to benefit the employee's family, but almost invariably the whole of the trust estate was used to make the loan available to the employee. The employee was appointed protector of the sub-trust, a concept which we consider in detail at paragraphs [78] *et seq* below. For present purposes it is sufficient to note two matters. First, the office of protector permitted the employee to alter the beneficiaries of the sub-trust; in traditional legal terms, it conferred a power of appointment on the protector. Secondly, the protector was empowered to appoint new trustees and remove existing trustees. 108 such sub-trusts were established subsequent to the date of the Definitive Deed. Each is in the name of an individual employee of a company within the Murray Group. The deeds creating the sub-trusts refer to and adopt the terms of the Definitive Deed.

[8] The procedure followed when a sub-trust was created was as follows. When the possibility arose of creating a sub-trust in the name of an employee, the operation of the trust mechanism and the benefits of making use of a trust would be explained to him. The benefits were said to be that the employee could obtain a loan from the relevant sub-trust;

this would provide him with a tax-free sum that was greater than a payment of salary net of tax deducted under the PAYE system. The loan would be repayable out of his estate, thus reducing its value for inheritance tax purposes. Further, the employee would be appointed protector of the trust, with extended powers in respect of the trust, but without title to the trust assets. It was further explained that being a protector would not enable the conferring of any absolute beneficial right on the employee himself.

[9] After it was decided that a sub-trust should be created in the name of a particular employee, that employee would be asked to complete a Letter of Wishes, naming the family members that he wished to benefit on his death, and almost invariably a Loan Application requesting that monies be advanced on loan to him by the trustees of the sub-trust. The Letter of Wishes and the Loan Application would be submitted to the trustee of the relevant sub-trust. A standard form of deed to create the sub-trust would then be provided by Messrs Baxendale Walker, who were specialist advisers to the Group on certain tax-related matters. Thereafter the company employing the employee in question would pay a contribution to the Principal Trust which, in the words of the First-tier Tribunal, "at its discretion would set up a sub-trust in name of the selected employee". Thus it appears that the trustees of the Principal Trust had a discretion as to whether or not to set up a sub-trust in the name of the employee, although the next finding indicates that they invariably did so. That finding is to the effect that the employing company would then advance monies to the trustees of the Principal Trust and "without exception" a sub-trust in the name of the employee was established. In almost all of these cases loans for the full amount advanced from the employer to the trustees of the Principal Trust were granted by the trustees of the sub-trust to the relevant employee, for a term of 10 years subject to extension and on a discounted basis. The employees' general expectation was that those loans would be

renewed after 10 years. The discount represented LIBOR interest rates fixed at the outset plus 1½-2%. With some limited exceptions none of those loans has been waived and "none of the nominated employees has obtained an absolute right to any part of the capital value of the loan", an expression which we take to mean that the loan remains repayable. Virtually all of the sub-trusts remain in existence.

[10] The trust arrangements related broadly speaking to two categories of group employees, executives and footballers. Findings are made regarding the contractual entitlements of each of those groups. Employees other than footballers had no contractual right to a bonus. A practice had developed within the Group, however, to pay annual bonuses on a discretionary basis depending upon the work performance of the employee in question and the profitability of his employing company (paragraph 103(xi)). It was those bonuses that were paid, in whole or in part, through the Principal Trust into a sub-trust. It is noted at paragraph 12 of the First-tier Tribunal's decision that that system had replaced an earlier system of discretionary annual bonuses paid to senior employees, and that the employing company would "recommend" to the trustee of the Principal Trust that a sum "effectively *in lieu* of bonus" be paid to a particular sub-trust.

[11] In the case of footballers their contractual terms of engagement were commonly recorded in two documents, one being a contract of employment and the other being described as a side-letter. The latter would provide ordinarily for the constitution of a sub-trust in the name of the footballer, benefiting his family and with the footballer as protector. The Scottish Football Association required players' contracts to be registered with it, but Rangers Football Club Ltd did not consider it appropriate to have side-letters registered (paragraph 103(xii)). Although, for reasons that are not obvious, this is not expressly recorded in the findings of fact by the First-tier Tribunal, it is clear that the sums paid into a

sub-trust, through the Principal Trust, were derived from the employee's employment arrangements. That is apparent from the fact that the side-letter was regarded as containing part of a player's contractual terms of employment, and it was the side-letter that provided for the setting up of the sub-trust, into which of course bonuses were paid. Consequently in both cases the payment of bonuses or the creation of trust arrangements resulted from the employment of the executive or footballer in question.

[12] The First-tier Tribunal concluded (paragraph 204) that, subject to limited exceptions, the structures employed were of legal effect; it had not been suggested that they were a sham. They then considered two particular categories of case, which covered the great majority of the payments involved.

Particular categories: executives' bonuses and footballers' engagement terms

[13] The respondent companies made payment of bonuses to senior employees (excluding footballers). The First-tier Tribunal accepted (paragraph 205) that those payments were entirely discretionary, without any contractual entitlement. While the views of the individual employee would be canvassed, he never had an enforceable claim to a bonus or other benefit. The arrangements were described as "very informal", and at most offered a hope or expectation. If the employee expressed interest, the employer would make a payment to the Principal Trust. In relation to these bonuses, the First-tier Tribunal considered that the benefit amounted to "a mere discharge of an employer's obligation to an employee". On that basis they concluded that no tax liability arose. We observe that, although the bonus arrangements may not have been enforceable, it seems self-evident that the only reason that the bonus was paid was the fact that the senior employee in question was working for one of the group of companies and providing services for it. If bonuses had

not been paid, the employment would have been significantly less attractive. Any contrary argument seems an affront to common sense.

[14] The footballers employed by the fifth respondents fell to be treated distinctly, and the First-tier Tribunal concluded that their cases fell into several categories (paragraphs 206-208). When the terms of engagement were negotiated, prospective players and their agents focused on payments net of tax, and were told that the net payments could be maximized by using a trust mechanism. Representatives of the fifth respondents gave evidence that such payments could only be afforded by the fifth respondents if the trust mechanism were used. It is stated that a deal would be offered by the fifth respondents on a "take it or leave it" basis. A contract of employment was then concluded; remuneration was paid subject to PAYE and NICs, and an additional side-letter provided for a discretionary trust payment. The Tribunal then stated that they considered that the obligation in the side-letter did not amount to an emolument; as with the executives' bonuses it fell within the description of "a discharge of an employer's obligation to an employee".

[15] On these matters we have two observations at this stage. First, the statement that the side-letter provided for a "discretionary trust payment" (at paragraph 208) appears inconsistent with an earlier statement (at paragraph 2) to the effect that employing companies would pay monies to the Principal Trust with a "direction" to the trustees of that trust that a sub-trust be established and funded for the family of a particular employee. Ultimately this distinction is not of great importance; in practice the Trustee of the Principal Trust invariably acted in accordance with the employing company's wishes. Secondly, if the obligation constituted by a side-letter amounts to "a discharge of an employer's obligation to an employee", it must have been an emolument or earnings; emoluments are normally paid in order to discharge the employer's obligation to pay salary or wages or bonus to the

employee, and the prior obligation must be in an obligation to pay remuneration of some kind. Consequently we cannot accept the First-tier Tribunal's reasoning on this matter. In our opinion the payments were, quite simply, bonus payments arising out of the footballer's employment, but paid to a third party, the Trustee of the Principal Trust. Two facts are critical: payments were made by the employer, albeit through a trust mechanism; and those payments were made because of the services rendered by a particular employee in such a way that they enured for the benefit of persons who were, realistically, chosen by that employee, through trust purposes to which he assented.

Terms of the trust deeds: Principal Trust

[16] It is not necessary to set out the terms of the various trust deeds at length. The critical terms are as follows. In relation to the Principal Trust, MGML was defined as "the Founder". The deed makes repeated reference to "the Trustees", and "the Original Trustees" were defined as Insinger Trust Company Ltd, of St Helier, Jersey. "The Beneficiaries" was defined (in clause 1.1.4) as

> "the present, past and future employees from time to time of the Founder and the wives husbands widows widowers children step-children and remoter issue of such employees and the spouses and former spouses (whether or not remarried) of such children and remoter issue… PROVIDED THAT no Excluded Person shall be a Beneficiary".

"Excluded Person" was defined in clause 1.1.4.1 and Scheduled 2 as comprising the Founder, any person connected with the Founder, any Participator in the Founder, the Founder's parent company or group of companies, and any person connected with any such Participator. The Declaration of Trust, setting out the trust purposes, is found in clause 2.1:

> "Subject as aforesaid and subject to Clause 10 hereof the Trustees shall during the Trust Period hold the Trust Fund UPON TRUST to apply the income and capital thereof to or for the benefit of all or any one or more exclusively of the others or other of the Beneficiaries in such shares and in such manner generally as the Trustees

> shall in their absolute discretion think fit PROVIDED THAT the Trustees may if in their absolute discretion [they] think fit accumulate the whole or any part of the income of the Trust Fund by investing the same and the resulting income thereof in any investments hereby authorized and adding the accumulations to the capital of the Trust Fund".

Further powers were conferred on the Trustees by clause 5.1 and Schedule 1. These included a power (clause 1.2.17 of Schedule 1) "to appoint any part or all of the Trust Fund on the trusts of any other existing settlement and to declare trusts of a new settlement whomsoever the Trustees thereof may be PROVIDED THAT the trusts thereof shall not permit the payment of any Prohibited Benefit nor any other sum or benefit the provision of which is prohibited by Clause 10 hereof".

[17] Clause 9.1 provided that the Founder should, with the consent in writing of the Trustees, have power to alter or add to the provisions of the Deed. Certain amendments were prohibited, however; the most significant prohibition (clause 9.2.5) was on altering the definition of Excluded Persons or any of the provisions of Schedule 2. Clause 10 of the Deed imposed what were described as "irrevocable limitations" on the Trustees' powers. Clause 10.1 provided that "Notwithstanding anything to the contrary express or implied in this Deed, no power or discretion hereby or by law conferred on the Trustees shall be exercisable nor exercised by the Trustees in such manner as to cause any part of the Trust Fund or the income thereof to be used to provide a Prohibited Benefit or to become payable to or applicable for the benefit of the Founder". "Prohibited Benefits" were defined by clause 1.1.5 as, in general terms, pension benefits falling within section 612(1) of the Income and Corporation Taxes Act 1988 and "any sum or benefit which, were it to be received by a Beneficiary, would constitute for the purposes of income tax an emolument of any person formerly employed by or holding office with the Founder". Finally, the Principal Trust was made subject to English law.

[18] In May 2001 the respondents other than MGML executed Deeds of Adherence to the Principal Trust. Under these, MGML as Founder agreed that the Adhering Company should be permitted to adhere to the Principal Trust, so that their present and future employees should become "beneficiaries" of that Trust. On 28 January 2002 MGML and the then Trustee entered into a Deed of Variation of the Principal Trust. Under clause 1.1.9 of that deed Sir David Murray was made the Protector of the Trust. Clause 9.1 provided that "the Protector shall with the consent in writing of the Trustees have the power at any time by deed to alter or add to all or any of the provisions of this Deed in any respect and such power shall be absolute and shall not be a fiduciary power". That power could not, however, be used to alter the provisions of Schedule 2 defining Excluded Persons. It should be noted that employers other than MGML were not parties to the Deed of Variation, and are thus not bound by it. On 29 November 2002 the provisions of the Principal Trust were varied by a deed of amendment in such a way as to exclude certain employees from the class of Beneficiaries. For HMRC it was contended that that deed was void and of no effect because it purported to have retrospective effect; this is a matter that might have been relevant to PAYE and liability. Nevertheless, for reasons discussed subsequently in relation to PAYE, we do not find it necessary to consider this argument.

Terms of the trust deeds: sub-trusts

[19] A substantial number of sub-trusts were set up, and we were referred to three specific examples. The first related to A, who occupied a senior executive position within the group, the second to B, who was a footballer employed by the fifth respondents, and the third to C, who was also a footballer employed by the fifth respondents.

[20] In relation to A, the sub-trust was established by a Declaration of Trust dated 17 September 2001. It was known as the Murray Group Management Ltd Eighth Sub-Trust. That deed was granted by Insinger de Beaufort Trust Company Ltd, of St Helier, Jersey, defined as "the Original Trustee". The interpretation clause defined "the Trust Period" as a period of 80 years from the date of the Deed establishing the Principal Trust, "the Principal Beneficiaries" as the named wife and children of A who should be living at his death, with the proviso that no Excluded Person should be a Principal Beneficiary, and "the Protector" was defined as A himself. The declaration of trust, in clause 2.1, was as follows:

> "… the Trustee shall during the Trust Period hold the Trust Fund and the income thereof UPON TRUST for all or any one or more exclusively of the others or other of the Principal Beneficiaries in such shares and in such manner and under such trusts and subject to such powers and provisions as the Trustee shall in its absolute discretion during the Trust Period by any deed or deeds revocable or irrevocable appoint, as the Trustee shall in its absolute discretion think fit, PROVIDED THAT the Trustee may if in its absolute discretion [it should] think fit accumulate the whole or any part of the income of the Trust Fund by investing the same and the resulting income thereof in any investments hereby authorized and adding the accumulations to the capital of the Trust Fund".

The trust itself was not revocable, but it was provided (in clause 2.2) that the Trustee might, with the consent of the Protector, declare that the class of Principal Beneficiaries had ceased to have any members, whereupon the Trust Fund would revert to the Principal Trust. Clause 9 contained a power of amendment; it provided that, subject to certain other provisions found in clauses 9 and 10, "the Protector shall have the fiduciary power at any time by deed to alter or add to all or any of the provisions hereof in any respect PROVIDED THAT the foregoing power shall not without the consent in writing of the Trustee be exercisable in any manner which would adversely affect the Trustee". Clause 9.2 prohibited use of that power to alter clause 2.

[21] Following execution of the foregoing Declaration of Trust, on 12 September 2001 A in his capacity as Protector wrote to the Trustee of the sub-trust to express his wishes as to the manner in which the Trustee might exercise its discretionary powers under the Trust. He wrote:

> "My wishes are that:
> 1. during my life the accumulated income and other capital of the Trust be held and applied according to my wishes;
> 2. upon my death that such remaining accumulated income and capital be held for the benefit of my wife, [D] and children, [E and F] in equal shares;
> 3. upon the death of my said children, accumulated income and capital be held in like manner for such of their children…, then or later alive, if more than one, in equal shares per stirpes".

On the same date A wrote to the Trustee of the sub-trust to ask whether it would give consideration to advancing a loan to himself for £15,000 upon commercial terms. The letter stated "Naturally I will abide by the Trustee's decision on this matter".

[22] In relation to B, the sub-trust was established by a Declaration of Trust dated November 2004. It was known as the Murray Group Management Ltd Sixty Ninth Sub-Trust. That deed was granted by Equity Trust (Jersey) Ltd, which had formerly been Insinger de Beaufort Trust Company Ltd. So far as material, the terms of the Declaration of Trust were the same as those for A. In this case the fifth respondent wrote to B on 17 June 2004 to confirm that its board would recommend to the Trustees of the Principal Trust to include him as the protector of a sub-trust and to fund that sub-trust with such amounts as give a beneficial interest, free of UK or other taxation, on specified dates in 2004 and 2005. In the event that the Trustees did not include B as protector of such a sub-trust on before 31 December 2004, the fifth respondent undertook to pay him on demand, free of UK or other taxes, £37,000. The same result was to follow if the Trustees would not fund a sub-

trust in the manner specified. That letter appears to us to indicate that the sums paid to the Principal Trust and to the sub-trusts represented remuneration for employment.

[23] In relation to C, the sub-trust was established by a Declaration of Trust dated 31 October 2001. It was known as the Murray Group Management Ltd Thirteenth Sub-Trust. That deed was granted by Insinger de Beaufort Trust Company Ltd, of St Helier, Jersey, defined as "the Original Trustee". So far as material, its terms were the same as those for A. In this case, discussions had taken place with an agent acting for the footballer. We were referred to the documents in which the footballer's remuneration had been agreed between the fifth respondent and the agent in July 2001. In the schedule containing details of the remuneration, it was stated:

> "2. Annual Salary
>
> £8,000 per week. Contribution to Remuneration Trust £8,000 per week namely £416,000 per annum which equates to the sum of £250,000 per annum net".

It is apparent from the totality of the documentation that the "Remuneration Trust" was the Principal Trust as above defined. That demonstrates that the payment to the Principal Trust was part of the total remuneration package.

[24] On 13 July 2001 the fifth respondent wrote to C to state that its board would recommend to the Trustees of the Principal Trust to include him as the protector of a sub-trust and to fund that sub-trust with £125,000 net in October 2001, February and October in each of 2002 to 2004 and in February 2005. On 15 October 2001 the fifth respondent sent C what was described as "the relevant paperwork needing to be completed prior to the payment you are due at the end of October". Thereafter the footballer sent a letter of wishes in similar terms to that set out in paragraph [21] above. Once again, there is an obvious

connection between the amounts paid to the Principal Trust and sub-trusts and the footballer's remuneration package.

Summary of financial arrangements

[25] Thus in summary the employers of the various executives and footballers paid sums to the trustees of the Principal Trust. Each such payment was related to a particular employee. The Trustee of the Principal Trust had a discretion as to what to do with the funds, but received a letter of wishes from the employee in question, and in practice effect was invariably given to that letter of wishes. The letters of wishes requested that a sub-trust be set up and nominated members of the employee's family as beneficiaries of the sub-trust. At the same time it requested that the employee himself be made the protector of the sub-trust. Thereafter funds were transferred to the trustees of the sub-trust, who held them for the purposes of the trust, namely on a discretionary trust to benefit members of the employee's family. In some trusts there was initially a direction to accumulate during the employee's lifetime, but those accumulations would accrue for the benefit of the family members who became entitled on his death. The employee then normally requested a loan from the trustees of the sub-trust, and in practice this was invariably granted. The First-tier Tribunal found that the discretions exercised by the trustees were genuine, and that the loan was a genuine loan, repayable by the employee-debtor.

[26] Nevertheless, the funds originated in the relationship between a particular employee and his employer. After the arrangements were given effect the result was that the trustees of the sub-trust held the funds for the benefit of beneficiaries who comprised members of the employee's family. That was an ordinary trust, and for tax purposes it would be subject to the ordinary tax regime that applies to trusts. After the loan had been granted, the

employee was the debtor in the loan and the trustees were the creditor. That loan became, obviously, the principal asset of the sub-trust. It remained trust property, however, and it was accordingly held for the specified trust purposes. The existence of the loan could have no bearing on the employee's income tax liabilities, although the debt would be deductible from his estate on his death for inheritance tax purposes; this matter was generally pointed out to the employees. To the extent that the trustees earned income they would be subject to income tax, but that was their tax liability, not the employee's. If the sub-trust were wound up for any reason, the beneficiaries, members of the employee's family, would be entitled to payment of the capital. That might give rise to liability to capital gains tax or inheritance tax, but it would not be relevant to income tax. Certain of the arguments presented to us were based on the premise that if the payments made to the Principal Trust or the trustees of the sub-trusts were liable to income tax as the earnings or emoluments of the employee in question, that could give rise to double tax liability. That suggestion does not appear to us to be well founded. Even if the payments made by employers to the Principal Trust are subject to income tax as emoluments or earnings, subsequent payments would be neither emoluments nor earnings, and therefore would not be subject to income tax.

First-tier Tribunal's conclusions

[27] On the basis of their findings in fact the majority of the First-tier Tribunal discussed the *Ramsay* principle (*Ramsay (WT) Ltd* v *IRC*, [1982] AC 300), and concluded that they had to regard the trust structure and loans as genuine legal events with real legal effects (paragraph 223). They held that the employees benefiting from the trust and loan arrangements "did not obtain an absolute legal entitlement to the monies". An employee's entitlement, or expectation, was to no more than a loan. Furthermore, this was not affected

by the position of the employee as protector of his sub-trust. It was accepted that there was a degree of orchestration in the arrangements made with employees, but the majority of the Tribunal held that these fell short of enabling an absolute transfer of funds to the employee. On that finding, we note that it was not argued before the Tribunal, and it has not been argued before the Court, that any such absolute transfer of funds took place. The existence of an absolute transfer of funds to the employee is not in our opinion essential for a payment to amount to an emolument; we return to this matter at paragraph [56] below.

[28] The majority of the First-tier Tribunal concluded:

> "231. The trust/loan scheme is essentially straightforward. It does not include a complicated sequence of stages. The extent of the employer's obligation is to make a payment into trust. The trust structure and loans bear to be of legal effect. Loans were discretionary although in fact they were (almost) invariably granted. But that was the extent of the employee's benefit. Whether the arrangement is viewed commercially or legalistically, the inexorable conclusion, in our view, is that the payments into trust became a loan and no more. They were not paid over absolutely and so do not become *earnings* or *emoluments*. We do not regard the liability to make repayment as a remote contingency which might in the context of a purposive construction fault to be disregarded as too remote for practical purposes….
>
> 232. Our Findings of Fact are as set out [in previous paragraphs] and… we have identified a factual matrix upon which we have proceeded. We are unable to make further Findings-in-Fact in support of there being an orchestrated scheme extending to the payment in effect of wages or salary absolutely and unreservedly to the employees involved, as [counsel for HMRC] urged us to do".

On the foregoing basis the Tribunal held that the sums advanced to employees by way of loan were made in pursuance of discretionary powers and remained recoverable and represented debts on their estates. The sums advanced by the appellant companies into the Principal Trust, whether to that trust or on payment to a sub-trust, or thereafter on being advanced by way of loan to an employee, "were not at any time held absolutely or unreservedly for or to the order of the individual employee".

[29] In relation to the foregoing approach, we make certain observations at this stage. First, the fact that the payments were ultimately made to employees by way of loan does not appear to us to be relevant to the tax treatment of the payments made by employers. The critical question is whether the payments made by the employing companies were part of the consideration for employees' services; if they were, they are emoluments or earnings, and are taxable. The fact that absolute payments were not made to employees is not in our opinion relevant to this issue. We return to these matters subsequently.

[30] Dr Heidi Poon, the third member of the First-tier Tribunal, dissented from the opinion of the majority. For present purposes it is sufficient to record that she examined the *Ramsay* principle at length, and concluded that, on a proper analysis of the transactions effected by the taxpayers, payments had been made to employees via the trust. Furthermore, those trust payments could be characterized as having placed funds unreservedly at the disposal of the employees. In so holding she had regard to the essential nature of the transaction, and applied the legislation in a practical and commercial manner. On that basis she considered that the trust payments must be considered as "emoluments" for the purposes of the tax legislation. For reasons discussed subsequently, we are in agreement with Dr Poon's conclusion. Nevertheless, as we have already noted, her detailed reasoning proceeds on a number of findings of fact that differ from or supplement the facts found by the majority. For present purposes we are constrained by the facts found by the First-tier Tribunal, and that obviously means the findings in fact of the majority. For that reason we are unable to adopt the whole of Dr Poon's reasoning.

Decision of the Upper Tribunal

[31] The appeal to the Upper Tribunal was dismissed. The First-tier Tribunal had not

accepted the conclusions advanced by HMRC. They had identified the applicable law and applied a purposive construction to the relevant statutory provisions. They had endeavoured to take a realistic view of the facts. The end result was therefore that the employees received loans, not earnings. There was accordingly neither payment of earnings nor the equivalent of payment in the form of monies being at the unreserved disposal of the employee; the employees could not without the intervention and co-operation of beneficiaries obtain absolute entitlement to the monies. The loans were recoverable, and recovery was not a remote contingency that could be ignored. Ultimately, despite the element of orchestration involved, the arrangements did not result in the employees having power to obtain anything greater than a loan. It was held that that was a conclusion which was open to the First-tier Tribunal. Thus the challenge based on a *Ramsay* line of argument must fail.

[32] Two further arguments presented by HMRC were also rejected: an argument that there was an underlying tacit agreement between employer and employee to pay earnings and an argument that there was a directed payment of earnings. These were rejected, the former on the basis that the First-tier Tribunal's findings in fact were inconsistent with any underlying tacit agreement to pay earnings, and the latter on the ground that at the time when employees choose to enter into the arrangements they did not have any present entitlement to payment. We note that the latter argument is not the same as the redirection of earnings argument presented to us on behalf of HMRC.

Relevant legislation

[33] During the tax years from 2001/02 to 2008/09 the incidence of income tax on employment income was governed by two separate regimes. First, during the years 2001/02

and 2002/03 the relevant legislation was contained in the Income and Corporation Taxes Act 1988 as amended. Under that legislation, the charge to income tax under a series of schedules was imposed by section 1. The payment of emoluments was subjected to income tax under Schedule E by section 19 of the Act. That section imposed a charge on emoluments derived from any office or employment where the person holding the employment was resident and ordinarily resident in the United Kingdom. "Emoluments" were defined in section 131(1) as including "all salaries, fees, wages, perquisites and profits whatsoever". Section 202A provided that income tax under Schedule E should be charged on the full amount of the emoluments received in any year of assessment in respect of the office or employment concerned. Section 202B defines when emoluments are to be treated as received for these purposes; subject to certain specialties in relation to companies which are not relevant for present purposes, the relevant date is the time when payment is made of or on account of the emoluments or the time when a person becomes entitled to payment of or on account of the emoluments.

[34] Secondly, during the tax years from 2003/04 to 2008/09 the legislation governing income tax on employment income was replaced by the Income Tax (Earnings and Pensions) Act 2003. Section 6 of that Act imposes a charge to tax on "employment income", which is defined by section 7 as including "earnings" as defined by section 62 (Chapter 1 of Part 3). The material parts of the latter definition are as follows:

> "(2) '[E]arnings', in relation to an employment, means –
>
> (a) any salary, wages or fee,
>
> (b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or
>
> (c) anything else that constitutes an emolument of the employment.
>
> (3) For the purposes of subsection (2) 'money's worth' means something that is –
>
> (a) of direct monetary value to the employee, or

> (b) capable of being converted into money or something of direct monetary value to the employee".

Thus the central concept of the tax regime governing employment income is the payment of emoluments or earnings.

[35] Under both regimes an employer making payment of income assessed to tax is obliged to deduct income tax in accordance with the PAYE regulations. Under the pre-2003 regime provision to that effect is made in section 203 of the Taxes Act 1988, which provides that on the making of any payment of or on account of any income assessable to income tax under Schedule E income tax shall be deducted in accordance with the applicable regulations. Under section 203A, payments of income are to be treated as made, subject to specialties relating to companies, on the earlier of the time when the payment is made or the time when a person becomes entitled to payment. Under the later regime equivalent provision is made in regulation 21(1) of the PAYE Regulations 2003, which provides that, on making a relevant payment to an employee during the tax year, an employer must deduct tax in accordance with the regulations. Under both regimes, therefore, an employer who makes a payment of earnings or emoluments to or on account of an employee is obliged to deduct tax in accordance with the PAYE Regulations. Other legislative provisions apply in the event that the payment is not made by the employer but through an intermediary; these are discussed subsequently in the context of the PAYE.

Parties' arguments on appeal

[36] HMRC have appealed against the decision of the Upper Tribunal on two grounds. First, it is contended that the payment of monies by the relevant employer to the Principal Trust, or alternatively the appointment of monies by the Principal Trust to a sub-trust set up for the benefit of an employee, constituted a payment of taxable earnings, taxable in the

hands of the employees whose services were so rewarded. On this basis, it is said that the scheme amounted to a mere redirection of earnings which did not remove the employee's liability to income tax. Of the two alternatives, it is submitted that the first should be preferred: the payment of monies by the relevant employer to the trustees of the Principal Trust triggered liability to tax. Secondly, HMRC contend that when monies were appointed by the trustee of the Principal Trust to the relevant sub-trust, that appointment was made in such a way that those monies were at the unreserved disposal of the employee, who was appointed protector of the sub-trust, and hence constituted a payment of taxable earnings, taxable in the hands of the employee. In advancing that contention, they relied on the *Ramsay* principle (*Ramsay (WT) Ltd* v *IRC*, *supra*) as explained in *Garforth* v *Newsmith Stainless Ltd*, [1979] 1 WLR 409, and *Aberdeen Asset Management PLC* v *HMRC*, 2014 SC 271. The argument as presented to the court was that each of the employees was appointed protector of the sub-trust set up for the benefit of his family. Powers were conferred on the protectors under the deeds constituting the sub-trusts, including a power to alter the trust purposes. That power could be used in such a way that the only beneficiary was the employee. In that way the funds were at the employee's unreserved disposal.

[37] For the respondents it was contended that no error had been demonstrated in the reasoning of the First-tier and Upper Tribunals. Those were specialist tribunals and the court should be slow to interfere with the decisions. In this case it should not do so. Furthermore, the first argument for HMRC, based on the proposition that the payments made into the trusts and as loans were mere redirected payments of emoluments or earnings, had not been put to the Tribunals, and should not be entertained at this stage. In relation to that argument, it was contended that the redirected payment principle had no application because there had been no payment of money or money's worth to any

employee. The only benefit that they had obtained was through loans made to them, but those were repayable and as such were not taxable. The First-tier Tribunal had specifically held that the trust arrangements and the loans were genuine; consequently they could not be disregarded. Particular reliance was placed on the recent decision, relating to National Insurance Contributions, in *Forde & McHugh Ltd* v *Revenue and Customs Commissioners*, [2012] STC 1872 (CA); [2014] 1 WLR 810 (UKSC). In relation to HMRC's second argument, it was submitted that the office of protector in all of the sub-trusts was fiduciary in nature. Consequently the protector could not use the powers for his own benefit. That meant that the funds in the sub-trusts were not at his absolute disposal, and HMRC's second argument must therefore fail.

Preliminary issues

[38] Before we consider the merits of the appeal, we must consider three preliminary matters which have an important bearing on the present appeal. The first of these is whether it is competent for the court to consider a ground of appeal that was not argued before either the First-tier Tribunal or the Upper Tribunal. This is directly relevant to the first ground of appeal for HMRC, which *ex concessu* was not argued before the First-tier or Upper Tribunals. The second issue relates to the powers of an appellate court on a statutory appeal under sections 13 and 14 of the Tribunals, Courts and Enforcement Act 2007: such an appeal is competent "on any point of law" (section 13(1)), and the critical question is what that expression encompasses. The third question is the extent to which, in an appeal under sections 13 and 14, the Court of Session should deal with questions of English law: whether it may take judicial notice of English law or whether, as in ordinary private law proceedings,

English law must be treated as a question of fact, with the result that the findings of the First-tier and Upper Tribunals would be binding. We consider these issues in turn.

New grounds of appeal

[39] We are of opinion that in a statutory appeal of this nature it is competent for the court to entertain a ground of appeal that has not been argued in the First-tier or Upper Tribunals, although it should be slow to do so in any case where additional findings of fact are required, and should not do so if unfairness results. The law on this matter is in our opinion correctly stated by Sedley LJ in *Miskovic* v *Secretary of State or Work in Pensions*, [2011] EWCA Civ 16; [2011] 2 CMLR 20, where, at paragraph 124, he referred to a number of earlier cases and continued:

> "None of these cases sets out a golden rule for the admission of new issues on appeal, but all proceed on the assumption that there is no jurisdictional bar to their being entertained in proper cases. It is an assumption which in my judgment can be made good on a simple constitutional basis. The Court of Appeal exists, like every court, to do justice according to law. If justice both requires a new point of law to be entertained and permits this to be done without unfairness, the court can and should entertain it unless forbidden to do so by statute".

We are in full agreement with that statement of the law, and for this reason we consider that we should entertain HMRC's first ground of appeal, even though it was not argued directly before the Tribunals. We are satisfied that it requires no new findings of fact; it proceeds on the First-tier Tribunal's findings of fact and the accompanying documents. Indeed aspects of the ground appear to have been canvassed to some extent before the First-tier and Upper Tribunals. We do not think that allowing this ground gives rise to any unfairness to the respondents; detailed notice of it was given in the grounds of appeal and the notes of argument, and counsel for the respondent was able to present a full argument in response. Nevertheless, we recognize that the introduction of a new ground of appeal may have

consequences in expenses, and for that reason we make no finding at this stage about the expenses of these proceedings.

[40] In relation to appeals from statutory tribunals, one further specialty applies. In such cases leave to appeal to the court is required, either from the Upper Tribunal or from the court itself. In cases where application is made to the Court of Session, the matter is governed by Rule of Court 41.57. That Rule applies to the new primary ground advanced by HMRC, which was not advanced before the Upper Tribunal. In accordance with that Rule, leave to appeal will only be given in a case that raises an important point of principle or practice or where there is some other compelling reason for the court to hear an appeal. In our opinion such leave should be granted on the basis that the argument raises an important point of principle and practice. We consider that the redirection of earnings principle is one of wide potential application, and the circumstances in which it may apply in particular cases require to be determined; none of the primary authorities relied on is directly in point in the present case. The underlying principle is in our view of importance in itself, and its impact on tax practice is clearly also important. We should add that we were informed by counsel for HMRC that the issue of redirection of earnings was of importance to the national revenue. Counsel for the respondents countered by pointing out that provisions of the Income Tax (Earnings and Pensions) Act 2003, notably section 201 and Part 7A, introduced in 2011, had been enacted to deal with cases such as the present; thus, for the future at least, any threat to the national revenue had been avoided. Notwithstanding the enactment of Part 7A, it appears to us that the matter is of obvious importance.

Powers of an appellate court on a statutory appeal

[41] This appeal proceeds under section 13 of the Tribunals, Courts and Enforcement Act 2007. Under that Act the first instance tribunal for all appeals against assessments to tax is the Tax and Chancery Chamber of the First-tier Tribunal. Section 11(1) of the Act confers a right of appeal from the First-tier Tribunal to the Upper Tribunal "on any point of law arising from a decision made by the First-tier Tribunal", with exceptions that do not apply in the present case. If the Upper Tribunal finds that the First-tier Tribunal has made an error on a point of law, it is empowered by section 12 to set aside the decision and to remit it to the First-tier Tribunal with directions for its reconsideration, or to re-make the decision. From the Upper Tribunal an appeal lies to the Court of Session under section 13 of the Act. This right of appeal is "on any point of law arising from a decision made by the Upper Tribunal", once again with exceptions that are not relevant to this case. The right of appeal is thus on a point of law, and does not extend to the facts, where the findings of the First-tier Tribunal are generally binding.

[42] Although the concept of appeal on a point of law might seem simple, it has given rise to considerable controversy; indeed in the well-known case of *Edwards* v *Bairstow*, [1956] AC 14, an appeal was taken to the House of Lords to adjudicate upon differences of approach that had developed between the Scottish and English courts. We are of opinion that an appeal on a point of law covers four different categories of case. The first of these categories is appeals on the general law: the content of its rules. In tax appeals these are largely statutory, but the interpretation of a particular statutory provision may be a matter of general law, and tax law also includes a number of general non-statutory rules, such as the redirection principle and the *Ramsay* principle, both of which are relevant to this case. The second category comprises appeals on the application of the law to the facts as found by the

First-tier Tribunal. This is in our opinion a clear example of an appeal on a point of law: it is the application of the general rules to particular factual situations that defines the frontiers of a legal rule and thus its practical scope. Furthermore, it is the application of the general rules to particular facts that brings about the development of those rules to meet new situations. For these reasons we consider that an appeal on the application of the general law to a particular factual situation must be regarded as being on a point of law. This is illustrated by the facts of *Edwards* v *Bairstow*. There the House of Lords, reversing the decisions of the General Commissioners and lower courts, held that a transaction involving the acquisition of spinning plant, dividing it into lots and selling those lots at a profit was an adventure in the nature of trade. In holding otherwise, the Commissioners and the lower courts had misdirected themselves as to the meaning and proper application of the expression "adventure … in the nature of trade" found in the relevant taxing statute, the Income Tax Act 1918: see Lord Radcliffe at [1956] AC 36-37.

[43] The third category of appeal on a point of law is where the Tribunal has made a finding "for which there is no evidence or which is inconsistent with the evidence and contradictory of it": *IRC* v *Fraser*, 1942 SC 493, at 497-498, per LP Normand. This runs into a fourth category, comprising cases where the First-tier Tribunal has made a fundamental error in its approach to the case: for example, by asking the wrong question, or by taking account of manifestly irrelevant considerations, or by arriving at a decision that no reasonable tax tribunal could properly reach. In such cases we conceive that the Court of Session and the Upper Tribunal have power to interfere with the decision of the First-tier Tribunal as disclosing an error on a point of law: *Edwards* v *Bairstow*, per Lord Radcliffe at [1956] AC 36.

[44] In practice the main difficulties that arise in determining whether an appeal raises a point of law occur when legal rules are applied to particular factual situations. The First-tier Tribunal makes findings of primary fact, and may draw inferences of fact from these, such as that goods acquired by the taxpayer are intended to be sold at a profit. Findings of that nature are not susceptible to review unless they fall within the third and fourth categories discussed above, where there is a lack of evidence for an inference of fact or a breakdown in proper intellectual processes. The next question, however, is whether a statutory charge to tax applies to the facts so found, and that is a point of law. Thus deciding whether an intended sale at a profit is an adventure in the nature of trade involves the application of legal rules and thus raises a point of law. No doubt cases exist where the inferences drawn are complex, involving both law and fact, and in that event the court must attempt to distinguish the two categories. Borderline cases will obviously exist, but the distinction is still important.

[45] Decisions of the First-tier Tax Tribunal frequently involve elements of evaluation and judgment. In general, a court, or the Upper Tribunal, should be slow to interfere with the decision of the First-tier Tribunal in cases of this nature. This is explained by the Court of Appeal in *Proctor & Gamble UK* v *HMRC*, [2009] STC 1990; [2009] EWCA Civ 407, a case on VAT. Food is generally zero rated for VAT purposes, but there is an exception for "potato crisps… and similar products made from the potato, or from potato flour, or from potato starch…". The question that arose was whether a savoury snack product known as "Regular Pringles", with a potato flour content of approximately 40%, was subject to that exception. The Value Added Tax and Duties Tribunal, the predecessor of the First-tier Tribunal, held that it was, and this was upheld on appeal. Toulson LJ, at paragraphs [47]-[49], stated that the question of whether Regular Pringles should be classified as falling

within the exception required a combination of fact finding and evaluative judgment; in particular the question of similarity to potato crisps and other potato products required an evaluative judgment. Parliament had created a specialist tribunal to determine these matters, and in reviewing the decision of such a tribunal he thought it right to bear in mind remarks by Baroness Hale in *AH (Sudan)* v *Secretary of State for the Home Department*, [2008] 1 AC 678. She referred to the fact that the Immigration Tribunal was "an expert tribunal charged with administering a complex area of law in challenging circumstances"; consequently the ordinary courts should approach appeals from them with appropriate caution, because it is probable that the tribunal will have reached the right decision. Similar remarks were made by Jacob LJ in *Proctor & Gamble* at paragraphs [9]-[15], in which he cited a range of statements in earlier cases regarding the need for appellate caution in reversing a judge's evaluation of the facts.

[46] We agree with the general proposition advanced by Toulson LJ. Nevertheless, it appears to us that evaluative decisions cover a wide spectrum. At one end is the sort of decision that is typically made by an immigration tribunal: it has a high factual content, frequently dependent on detailed information about the country from which the would-be immigrant has come. The same can be said of the question in *Proctor & Gamble*: it was in essence whether Regular Pringles were a potato product in the same category as potato crisps. That is an evaluative exercise in which the factual component is clearly dominant. Yet another example would be where a First-tier Tax Tribunal one of whose members was, as here, a chartered accountant reaches a conclusion on the application of accounting principles. It is common sense that in such a case an appellate court should be very slow to interfere, unless the case falls into the third or fourth of the categories discussed above

where the First-tier Tribunal has misunderstood the evidence or proceeded without evidence or has made a fundamental error in its method of reasoning.

[47] In some tax appeals, however, the evaluative exercise contains a much smaller factual component; an example would be a case such as the present where the transaction that must be evaluated involves legal institutions such as trusts or contracts or assignations. In a case of that nature it is much easier for an appellate court to interfere; the legal element is identifiable, and clearly raises a point of law. In an extreme case, for example if the First-tier Tribunal misconstrued the rights of the parties under a trust, that would be a straightforward error of law. In a slightly less extreme case, where the Tribunal had assessed the overall effect of a series of transactions, there is a greater element of evaluation, but we still consider that in such a case the courts might properly interfere if they considered that the transaction or the legal concepts involved in it had been misconstrued. It is a matter of degree: the higher the factual component in the evaluative exercise, the slower the court should be to interfere, but correspondingly if the factual component is relatively low and the legal component is high the court may properly interfere. As we have indicated, we consider that the present case falls into the latter category.

[48] Furthermore, the issues in the present case are, first, the scope of the redirection of earnings principle and its application to the particular facts of the case, and secondly, the application of the *Ramsay* principle by reference to the powers of a protector of a trust: in particular, the question is whether a protector can exercise those powers to secure a benefit for himself. In our opinion these issues raise clear questions of law. To the extent that legal principles have been misapplied, the court can and must interfere with the decision of the First-tier Tribunal.

Treatment of English law

[49] The third preliminary issue is the manner in which the Inner House should deal with questions of English law in hearing an appeal from the Upper Tribunal under the Tribunals, Courts and Enforcement Act 2007. Normally English law, like any legal system other than Scots law and other systems such as the law of the European Union that have been incorporated into Scots law, is treated as foreign law, which is a question of fact and must be established by evidence. In the absence of evidence or agreement between the parties, it will be presumed that foreign law is the same as Scots law. In the present case, however, proceedings were initiated in the First-tier Tribunal and the first appeal was heard in the Upper Tribunal. Both of those tribunals have United Kingdom-wide jurisdiction, and it is agreed between the parties that both of them have judicial knowledge of English law. In the event of an appeal from the Inner House to the United Kingdom Supreme Court, that court too has judicial knowledge of English law. The critical question is whether in that structure of tribunals and courts the Court of Session has judicial knowledge of English law.

[50] In our opinion it has such judicial knowledge. The result otherwise would be highly artificial. The lower tribunals would have judicial knowledge of English law; the court to which a final appeal may be taken would have judicial knowledge of English law; but this court would be constrained by the findings on English law of the First-tier and Upper Tribunals. We cannot believe that that was the intention when the structure of appeals in sections 11-14 of the 2007 Act was set up. We do not think that this will give rise to any practical difficulties. The basic legal concepts of Scots and English law, in this case the trust, the contract and the loan, are broadly similar. No doubt the theoretical nature of a trust is different, being based on the notion of legal estate and equitable interest in England, whereas in Scotland it is based on the notion of dual patrimonies of the trustee.

Nevertheless the practical results are similar, and the institution of the trust fulfils similar functions in both jurisdictions. Consequently Scottish judges should not have any great difficulty in understanding English law, and are expected to do so in the Upper Tribunal and UK Supreme Court. Moreover, it can be expected that the parties will present careful and informed submissions on English law, as occurred in the present case, and the Court of Session will obviously check submissions against the cases and textbooks that are referred to. Finally, we note that in *IRC* v *City of Glasgow Police Athletic Association*, 1953 SC (HL) 13, it was held that the Court of Session could take judicial notice of the English law of charity where that became relevant to liability for income tax, in accordance with the earlier decision in *Commissioners for Special Purposes of Income Tax* v *Pemsel*, [1891] AC 531. Although that decision is not directly in point, because the result of the decision in *Pemsel's* case was that for revenue purposes the English law of charity became part of Scots law, it points to the fact that there is no objection in principle to the Scottish courts' taking judicial notice of English law.

[51] We now turn to the two arguments presented in the appeal.

The first issue: whether there was a redirection of earnings

[52] The first submission made by HMRC was that the scheme involving payments to the various trusts and the application of the monies so paid amounted to a mere redirection of earnings which did not remove the liability of employees to income tax. In our opinion this submission is correct, and accordingly the appeal must be allowed on this ground.

The relevant legal principle

[53] Schedule E income tax was a tax on the emoluments of any office or employment, and since 2003 the charge to income tax under section 6 of the Income Tax (Earnings and

Pensions) Act 2003 is a tax on earnings from employment, as defined by section 62 of that Act. The definition of earnings in section 62 is wide; it comprises any salary, wages or fee, and also any gratuity or incidental benefit if it is money or money's worth, or anything else that constitutes an emolument. The critical feature of an emolument and of earnings as so defined is that it represents the product of the employee's work – his personal exertion in the course of his employment. This point was made by the Privy Council in *Hadlee* v *Commissioner of Inland Revenue*, [1993] AC 524. In that case the taxpayer, a partner in a firm of accountants, had executed a trust deed to benefit his wife and child, and by deed of assignment transferred a percentage of his share in the partnership to the trust. The result was that the trust became entitled to monies from the partnership. Those were assessed to income tax, and it was held that the assessment was properly made. Lord Jauncey, delivering the opinion of the Privy Council, stated (at 533D-E) that the income which accrued to the assignee flowed not from a capital asset which was capable of assignment but from the performance by the taxpayer of such obligations as he was required to perform under the partnership contract. On that basis, it was held (at 533F-G) that the applicable principle was one that had been stated by Richardson J in the New Zealand Court of Appeal:

> "There is no justification in principle for differentiating between salary and wage earners and professionals whose income is the product of their personal exertion. In either case the person whose personal exertion earns the income derives the income".

Thus income derived from the personal exertions of the taxpayer is his income for tax purposes, even if it is paid to a third party. That principle must in our opinion apply to the concepts of emoluments and earnings for the purposes of income tax on employment income in the United Kingdom.

[54] A similar approach is found in *Brumby* v *Milner*, [1976] 1 WLR 29, a case involving a profit-sharing scheme where a company lent money to trustees to purchase shares in the

company. The primary trust purpose was to use the shares so acquired to provide income for division among employees. On termination of the scheme any balance was to be distributed among employees and former employees in such proportions as the trustees might determine. When the scheme was wound up, the amounts paid to employees were assessed to income tax under Schedule E. It was held that the assessments were properly made. Lord Russell, delivering the opinion of the Court of Appeal, agreed with the contention for the Crown that

> "From its very birth the scheme was plainly intended as an incentive scheme both to encourage and to reward employees in respect of their services as such; payments made during the years before the scheme was terminated were therefore plainly profits from the employment as being rewards for and referable to services" (at 35H).

The terminal payments were equally subject to tax. They could not be regarded as a throw-away provision bearing no colour of a reward for services; the existence of a discretion in the trustees to allocate funds was against such an inference. Consequently "the scheme was one scheme based fundamentally on reward for services by employees, and the fact that after the final payment there was no more by way of bonus to look for does not relevantly distinguish that final payment" (at 36F). The House of Lords ([1976] 1 WLR 1096) agreed with Lord Russell. Lord Wilberforce stated (at 1098H)

> "The only question in this, and in the many similar cases which come before the courts relating to such payments as cricketers' or footballers' benefits or for Easter offerings, or housing subsidies, is whether the emolument can be said to arise 'from' the employment or office".

The answer in that case was plain. A similar approach was taken (at 1100E) by Lord Simon of Glaisdale, who suggested the question: "if the payment to the appellant was not made to him in respect of his personal situation as an employee, in what respect was it paid to him?" The manner in which the scheme was analyzed by both the Court of Appeal and the House of Lords is significant; it is clear that both courts adopted an approach based on a realistic

appraisal of the true nature of the transaction. That can be said to prefigure the development of the *Ramsay* principle in cases such as *Barclays Mercantile Business Finance Ltd* v *Mawson*, [2004] UKHL 51; [2005] 1 AC 684; [2005] STC 1; 76 TC 446. In our opinion a similar approach must be taken in the present case.

[55] We were also referred to the first instance decision in *Smyth* v *Stretton*, (1904) 5 TC 36, which involved a scheme established by the governors of Dulwich College for the benefit of assistant masters. Annual payments were made into the scheme on behalf of each master, but no benefit could be taken until the master either left the employment of the school or died. It was held that the payments made into the scheme were nevertheless assessable to Schedule E income tax. Channell J noted two general principles that are relevant to the present case. First (at page 42) he stated

> "a sum receivable by way of salary or wages is not the less salary or wages taxable because for some reason or another the person who receives it has not got the full right to apply it just as he likes".

Then (at page 43) he discussed a case where a man has a salary from his office and, by agreement with someone else, has bound himself to set apart a certain portion of that salary year by year and save it and invest it for the benefit of his wife and children. Such a case was quite clear; the payment was still income, notwithstanding that the employee had contracted with someone else to apply it in a particular way. That appears indistinguishable from the present case.

[56] The fundamental principle that emerges from these cases appears to us to be clear: if income is derived from an employee's services *qua* employee, it is an emolument or earnings, and is thus assessable to income tax, even if the employee requests or agrees that it be redirected to a third party. That accords with common sense. If the law were otherwise, an employee could readily avoid tax by redirecting income to members of his family to meet

outgoings that he would normally pay: for example to a trust for his wife, as in *Hadlee*, or to trustees to pay for his children's education or the outgoings on the family home. It follows that, if the principle applies, it is irrelevant that the redirection is through the medium of trust arrangements. It is equally irrelevant that the trustees who receive the payment, at whatever remove, exercise a genuine discretion as to what happens to the funds. The funds are ultimately derived as consideration for the employee's services, and on that basis they are properly to be considered emoluments or earnings. Indeed, in *Brumby* v *Milner*, the existence of a discretion in the trustees as to the benefits taken by employees was taken as a factor pointing towards the conclusion that the payments were derived from employment.

[57] This principle is ultimately simple and straightforward – indeed, so straightforward that in cases where elaborate trust or analogous relationships are set up it can easily be overlooked. That, it seems to us, is what happened before the First-tier and Upper Tribunals in this case

[58] In applying this principle to the facts of a particular case, one further general legal principle is of importance. In assessing the liability of a transaction to taxation, it is imperative in every case to determine the true nature of the transaction, viewed realistically: *Barclays Mercantile Business Finance Ltd* v *Mawson*, [2004] UKHL 51; [2005] 1 AC 684; [2005] STC 1; 76 TC 446, at paragraphs 32 and 35, quoting *Collector of Stamp Revenue* v *Arrowtown Assets Ltd*, [2003] HKCFA 46, at paragraph 35, and followed in *Aberdeen Asset Management PLC* v *HMRC*, [2013] CSIH 84; 2014 SC 271, at paragraph [25]; this is the principle that is prefigured to some extent in *Brumby* v *Milner*. In the present case, therefore, it is essential to have regard to the true nature of the individual transactions involving the Principal Trust, particular employees and the sub-trusts set up in respect of each employee. On such an approach, it must be determined whether the payments by the relevant employer into the

Principal Trust, and in due course the payments from the Principal Trust to the various sub-trusts, were derived from the employment of the employees in question. If they were, they amounted to the employees' emoluments or earnings.

Application of the principle to the facts

[59] The facts found by the majority of the First-tier Tribunal are set out above at paragraphs [6]-[15] and the relevant documentation is described at paragraphs [16]-[24]. Certain of the findings-in-fact were made for the purpose of dealing with the *Ramsay* argument that formed the main contention for HMRC before both First-tier and Upper Tribunals. Nevertheless, enough is said to allow full consideration of the new argument based on a redirection of earnings. First, in relation to employees other than footballers, the critical element is that bonuses were paid on the basis of the work performance of the employee in question, *qua* employee, and the profitability of his employing company. Thus the amount of the bonus was determined by reference to the employee's employment activities. While the bonuses were discretionary, and there was no contractual entitlement to them, it is very obvious that they were derived from and based on the work done by the particular employee. On any realistic view of the transactions under consideration, that conclusion is inevitable. The First-tier Tribunal considered that the benefit was "a mere discharge of an employer's obligation to an employee", but that ignores the manner in which any such obligation arose. Any obligation was created in our opinion by the decision of the employer to pay a bonus in recognition of the work performed by the relevant employee; we refer to our comments at paragraphs [13], [15], [25] and [26] above. Furthermore, it is not in our opinion necessary that there should be any prior obligation provided that the payment itself can be shown to be remuneration for the employee's

services. The mere making of a payment is sufficient to give rise to an emolument or earnings; this is discussed at paragraph [62] below. On the foregoing basis, we are of opinion that the sums received by the trustee of the Principal Trust and in due course by the trustees of the sub-trusts amounted to a mere redirection of income and thus constituted emoluments or earnings of the employees in question.

[60] In relation to footballers, when a contract of employment was concluded, an additional side-letter provided for a discretionary trust payment (paragraph [14] above). It seems to us to be self-evident that the obligations in the side-letter were part of the employee's employment package, and provided him with additional remuneration. They were negotiated as part of the total employment package; that is made clear not only by the findings of fact narrated by the First-tier Tribunal but also by the typical documentation relating to footballers that is referred to at paragraphs [22]-[24] above. The amount of any bonus was typically negotiated by the footballer's agent as part of his overall responsibility for securing proper remuneration for the footballer's services. That fact seems to us to be decisive by itself. The First-tier Tribunal expressed the view that the obligation in the side-letter was not an emolument, as it was a discharge of an employer's obligation to an employee. We have difficulty in understanding this statement. Furthermore, for the reasons stated at paragraph [16] above, we are of opinion that the statement that the obligation in the side-letter amounted to the "discharge" of an employer's obligation to an employee leads inevitably to the conclusion that the payment was an emolument or earnings; any prior obligation must have been an obligation to pay some kind of remuneration for the employee's services. Once it is accepted that the bonus payments represented consideration for a footballer's services *qua* employee, it inevitably follows that those payments represented emoluments or earnings of the footballer in question.

[61] Once payments were made to trustees, they obviously became subject to the trust purposes of the Principal Trust and in due course a sub-trust set up for the particular employee concerned. Nevertheless, as the First-tier Tribunal found, those sub-trusts were constituted in the name of a particular employee, and the employee in question completed a letter of wishes naming the family members who were to benefit under the sub-trust. In addition the same employee would complete a loan application. Thus the sub-trusts were requested by employees and were designed to provide benefits to their families. The result, as we have indicated at paragraph [26] above, was that funds held by trustees of a sub-trust were held as trust property for the benefit of the named beneficiaries, usually members of the employee's family, and they were thus subject to the tax regime applicable to trusts. After payment had been made by the employer, the employee could not be subject to further liability to income tax in respect of those monies. It follows that the existence of the trust arrangements and the loans made by trustees to the employee in question were irrelevant to the question of whether there was a redirection of earnings. The redirection of earnings occurred at the point where the employer paid a sum to the trustee of the Principal Trust, and what happened to the monies thereafter had no bearing on the liability that arose in consequence of the redirection. The position is exactly analogous to that found in *Hadlee* v *IRC*, *supra*. In that case the payment was made to the taxpayer's wife, but the principle would have been equally applicable if it had been made to trustees for his wife or other members of his family. That is the present case. The trust and loan arrangements are ultimately irrelevant.

[62] As will be apparent from the foregoing discussion, we are of opinion that it is immaterial that there was no contractual entitlement to the sums paid to the trustee of the Principal Trust. Gratuities are subject to income tax; that has long been recognized, and the

position is covered expressly by section 62(2)(b) of the Income Tax (Earnings and Pensions) Act 2003. That provision applies to gratuities if they are money or money's worth, but the sums paid to the trustee of the Principal Trust were in the form of money; this is not a case involving benefits in kind. Furthermore, so far as the footballers are concerned, at least, it seems to us that if bonuses had not been paid they might well have taken their services elsewhere. We realize that the fifth respondent was in, potentially, a difficult financial position, competing for good players in an international market where other countries may not have the same rigorous approach to taxation as the United Kingdom. Nevertheless, the law is clear: the payments made in respect of footballers were in our view derived from their employment, and thus the payments were emoluments or earnings. We also reject the argument that taxing the payments made to the trustees of the Principal Trust and the sub-trusts would give rise to potential double taxation, for the reasons set out above at paragraph [25] and in relation to *Forde & McHugh Ltd* v *Revenue and Customs Commissioners*, [2012] STC 1872 (CA); [2014] 1 WLR 810 (UKSC), discussed in the following paragraphs.

[63] For the purposes of the *Ramsay* principle it is frequently important to determine whether or not the sums paid have been placed at the unreserved disposal of the employee: *Aberdeen Asset Management Ltd* v *HMRC*, *supra*, is an example of such a case. In dealing with the redirection of income, however, it will not normally be relevant whether or not sums are at the employee's unreserved disposal. The employee chooses to redirect part of the consideration for his employment – emoluments or earnings – to trustees for specified trust purposes. In so doing he obviously hopes that those trustees will apply the funds in the manner that he has requested, in this case in accordance with the letters of wishes. He nevertheless runs the risk that they will not do so. Whatever happens, the sums paid to the

trustees were redirected from income, and that is enough to render them liable to income tax in the ordinary way.

[64] It is in our opinion immaterial that the payments from the Principal Trust to the sub-trusts and out of the various sub-trusts resulted from the exercise of a trustee's discretion, which the First-tier Tribunal have found to be a genuine discretion. If a payment amounts to a reward for services, it is apparent from the decision in *Brumby* v *Milner* that it is immaterial that it is made through the exercise of a trustee's discretion. In any event, we consider that even if the trustee exercised its discretion in a manner unfavourable to the employee's family, that would simply be a risk that he ran when he redirected his earnings to a trust. It does not alter the character of the earnings.

[65] Finally, we are of opinion that the relevant payment of emoluments or earnings is that made by the employer to the trustee of the Principal Trust. The critical feature of emoluments or earnings is that they represent consideration for services provided under a contract of employment, and such consideration is ultimately provided by the employer. Thus the critical point when it can be said that an emolument or earnings have been paid is when the employer makes a payment either directly to the employee or in a manner that has been requested or at least acquiesced in by the employee. In the present case the payment to the trustee of the Principal Trust occurred the point when funds left the employer, and they were made to an entity that had been selected by the employee (through the arrangements in the side letters), or at least acquiesced in by the employee, as the manner in which the funds would be channelled to his own sub-trust.

[66] We accordingly conclude that the primary argument presented for HMRC is correct: the payments made by the respondents to the Trustee of the Principal Trust in respect of employees were emoluments or earnings, and are accordingly subject to income tax.

Furthermore, those payments were made at the time of payment to the trustee of the Principal Trust, with the result that the obligation to deduct tax under the PAYE system fell on the employer who made such a payment.

Further cases

[67] A number of other cases were discussed at length in the course of submissions, and we propose to say something about these. Perhaps the most significant was *Forde & McHugh Ltd* v *Revenue and Customs Commissioners*, [2012] STC 1872 (CA); [2014] 1 WLR 810 (UKSC). It concerned an unapproved retirement benefits scheme set up by a company for employees through the medium of a trust. The company made a contribution in the form of cash and Treasury stock for the benefit of a director. The director had no immediate realizable interest in the fund held in his name; his enjoyment of it depended on his surviving to retirement age, although the trustee could apply the proceeds to benefit a defined discretionary class if he predeceased retirement. HMRC claimed that the contribution made by the employing company amounted to "earnings… paid to or for the benefit of an earner" for the purposes of liability to Class I NICs under section 6(1) of the Social Security Contributions and Benefits Act 1992. It was held by the UK Supreme Court, reversing a majority of the Court of Appeal, that the concept of "earnings" in the context of NICs looked to what the employee received from his employment, and not to what had been paid by his employer. Consequently, as the director had not received the sums paid by the company during the period prior to his retirement, they were not subject to NICs.

[68] The discussion of the issue begins (paragraph 14 of Lord Hodge's opinion in the UK Supreme Court) by noting that "earnings" in the legislation governing NICs is not to be equated with "emoluments" in the legislation governing income tax. The payment to the

trust was agreed by both parties to have been "for the benefit" of the director. HMRC, in a submission described as "remarkable", asserted that payment into the trust fund was earnings "because it was a sum paid as the quid pro quo for past or future services". If that were correct, earnings would be paid to an earner both when assets were transferred to a pension scheme to be held on trust and also when payments were made from the trust fund. That approach was rejected, for three reasons. First, it was essentially counter-intuitive that a person should earn remuneration both when money was paid into the trust and later when the trust fund was paid out; the same argument could apply to a bonus put into a trust and payable to the employee in the future when some future event, such as a specified performance level, occurred. Such a result should not be attributed to Parliament without a clear indication that it was intended. Secondly, the Revenue's view involved looking exclusively to what was paid by the company and ignoring what the earner received; that, however, would deprive the word "earnings" of any meaning, as the expression "earnings are paid" would amount to a statement that "payments are made" in respect of any one employment. The word "earnings" pointed towards what the employee received from his employment. Thirdly, if the payment into the trust were treated as earnings, that failed to take account of the existence of the contingency that the director survive until his retirement date. If he had predeceased, the trustees would have paid the proceeds of the fund to a member of the defined discretionary class, probably his wife. On that basis it could not be said that the director received anything through the transfer, other than the entitlement to a future pension once the condition that he reached retirement age had been purified. On that basis, the value to be attributed to the director's entitlement would not be the value of the assets paid into the fund but rather the value of his contingent right to the fund as it would be at his retirement date; that would not be a simple calculation.

[69] In our opinion this decision is readily distinguishable from the present case. In the first place, *Forde & McHugh* is concerned primarily with liability to NICs rather than income tax. For the tax years 2001/02 and 2002/03 it is "emoluments" that are subject to income tax, under sections 19 and 131(1) of the Income and Corporation Taxes Act 1988. Lord Hodge makes it clear at the outset of his opinion that "earnings" under the 1992 Act were not the same as "emoluments" under the 1988 Act. For the tax years from 2003/04 onwards, tax is due on "earnings", in terms of sections 6 and 7 of the Income Tax (Earnings and Pensions) Act 2003, but this is subject to the special statutory definition in section 62 of that Act. That definition is different from that applicable to NICs, and includes anything that constitutes an emolument of the employment. That is a point of distinction. In the second place, Lord Hodge's first reason for rejecting the wide concept of "earnings" propounded by the Revenue was the fact that that would lead to double taxation. That does not apply in the present case, however. In this case we have held that the payment made by the employing company to the Principal Trust is subject to income tax but payments out of the trust will not be so subject. The funds in question will be held by the relevant trustee as trust capital, and any payment of the fund originally received from the employing company will accordingly be treated for tax purposes as a capital payment out of a trust. The only liability to income tax is on income earned by the trustees, for example by investment of the trust funds. In these respects, however, the situation is no different from an employee who uses part of his post-tax income to fund a trust for the benefit of his family. In such a case the amounts that he received as income are transformed into capital in the hands of the trustees, and become subject to the ordinary tax regime governing funds held in trust. There is no double taxation.

[70] In the third place, the view that we have adopted does not deprive the words "emoluments" or "earnings" of any meaning in the relevant parts of the 1988 and 2003 Acts. The sums paid to the trustee of the Principal Trust are earned by the employee, and the net result is no different from an employee who uses post-tax income to fund a trust for the benefit of his family. In the fourth place the computation of tax is not especially complicated. When funds are paid to the trustee, they represent consideration for the employee's services, and are taxable accordingly. When sums are paid out of the trust, that is an entirely different matter, subject to a different tax regime. In the fifth place, in paragraph 20 of his opinion Lord Hodge notes that no argument had been advanced as to whether a payment into a pension or bonus fund might properly be analyzed as a payment out of the earner's salary, as in *Smyth* v *Stretton*, *supra*. Thus *Forde & McHugh* is not concerned with the arguments advanced in the present case.

[71] A further significant case is *Edwards* v *Roberts*, (1934) 19 TC 618, where an employee's service agreement provided that, in addition to annual salary, he should have an interest in a "conditional fund", which was to be created by his employer by the payment, following the end of each financial year, of part of its profits to the trustees of a fund to enable them to acquire shares in the employer. The employee was entitled to receive part of the capital of the fund after five years if he was then in the employer's service. The taxpayer left his employment, with his employer's consent, after six years, and the trustees transferred to him the shares that they had acquired on his behalf over the preceding five years. The taxpayer was assessed to Schedule E tax in the year of payment on the whole value of the shares so transferred. He contended that the assessment should have been restricted to the sums paid by his employer to the trustees in that year, because that was what amounted to an emolument of that year. The Court of Appeal held, with some hesitation, that the

assessment had been properly made. The sum made over was an emolument that accrued and was payable not in the years when payments were made into the conditional fund but in the year when the payment was made out of that fund. Counsel for the present respondents submitted that if HMRC's argument in this case were correct *Edwards* should have been decided in favour of the taxpayer, on the basis that the sums paid into the conditional fund were taxable in each of the years when they were made. In our opinion this does not follow. In considering *Edwards* it is important to bear in mind that a critical feature of the Court of Appeal's reasoning was that the taxpayer was not entitled to anything until the lapse of six years, and his right could have been entirely defeated if he had, for example, left his employment during that period: see Lord Hanworth MR at pages 35-36. In the present case, by contrast, the various trustees became entitled to funds immediately, to hold them as redirected income of the employee in question. The position is the same as that in *Smyth* v *Stretton* and *Hadlee* v *IRC*, and is distinguishable from *Edwards* v *Roberts*.

[72] In *Heaton* v *Bell*, [1970] AC 728, the taxpayer was employed by a company which introduced a voluntary car loan scheme for certain employees. Under the scheme the company bought the cars, paid their insurance and road tax, and lent them to employees who applied to join the scheme. A sum of money was then deducted from the weekly wages of the employee. A majority of the House of Lords held that the effect of these arrangements was that the employee's monetary wage remained unaltered, as part of his earnings. Consequently Schedule E tax was payable on the full amount. Lord Morris of Borth-y-Gest, part of the majority, referred (at 753-754) to the principle that, to be taxable, perquisites must be a cash or money payment or must be money's worth in the sense that it can be turned to pecuniary account. The free use of a car, however, did represent money's

worth and was accordingly taxable. In the present case the sums payable to the trustees of the Principal Trust and in due course the trustees of the various sub-trusts took the form of cash; consequently we are of opinion that the requirement for money or money's worth does not preclude the present payments from being treated as emoluments.

[73] Two further cases provide examples of the application of the redirection principle. First, in *HMRC Commissioners* v *Collins*, (2009) 79 TC 524, the taxpayer sold shares in a company. A substantial sum was paid by the purchaser of the shares to the company, subject to a condition that the purchaser should procure that the company made a pension contribution on behalf of the taxpayer into a scheme designed by him. It was held by Henderson J that the payment to the company which was ultimately transferred into the scheme was part of the consideration paid for the shares. It was immaterial that the sum in question was not payable to the taxpayer himself but to the company, and it was equally irrelevant that the agreement specified what the company was to do with the payment: see paragraph 29. That seems to us to be a clear application of the redirection principle. Secondly, in *Sloane Robinson Investment Services Ltd* v *HMRC Commissioners*, [2012] UK FTT 451, employees' bonuses derived from the employing company's profits were used to finance shares awarded to those employees, although the employee could have directed that they be paid as cash or as a donation to a third party. The First-tier Tribunal held that the result of the arrangements was to create a contractual entitlement, enjoyed as an employee, to a share of the final profits of the employer for a particular year. That allocation of profit was thus due to the employees "as the fruits of their employment" and was received in that capacity. That was so even though the employee was entitled to redirect the sums in question. That again appears to us to be a clear application of the principle.

[74] We were also referred to *Dextra Accessories Ltd* v *Macdonald*, (2005) 77 TC 146, a case involving an employee benefit trust funded by a group of employing companies. Under the trust income and capital were to be paid and applied as the trustee might think fit to for the benefit of members of a class comprising present and future officers and employees of the companies and a defined group of connected individuals. The directors provided the trustee with a schedule of employees to whom it was requested that the trustees consider providing benefit. Subsequently various benefits were provided to three shareholder directors, the wives of two directors and the mother of two directors. The critical question was ultimately held to be whether the employers' contributions were "potential emoluments" within section 43(11) of the Finance Act 1989, and hence deductible from the employing companies' tax liability. The Special Commissioners and the judge of first instance held that they were not potential emoluments, because they were not paid until after the end of the relevant accounting period. That decision was reversed by the Court of Appeal, whose decision was upheld by the House of Lords. The notion of "potential" emoluments was concerned with what might happen in the future, rather than any present intention on the part of the trustees of the benefit trust. On that basis, on the ordinary use of language, the whole of the funds paid to the trustees were potential emoluments: see Lord Hoffmann at paragraphs 15-20. Before the Special Commissioners the Revenue presented an alternative argument that allocation of monies to a sub-fund in respect of an employee was a benefit in kind taxable under the general provisions for taxing such benefits. For the taxpayers it was contended that the charging provision relied on, section 154 of the Taxes Act 1988, required actual rather than potential benefits. That argument was accepted, on the basis that the Revenue's interpretation could result in double taxation as the benefit could be charged when a sub-fund was created and when a subsequent benefit was paid. Counsel for

the respondents relied on this case as indicating the importance of avoiding double taxation. Nevertheless, we are of opinion that the decision is not relevant because, as explained above, the present case cannot involve double liability to income tax.

[75] Reference was also made to the decision of the Special Commissioners in *Sempra Metals Ltd* v *Revenue and Customs Commissioners*, [2008] STC (SCD) 1062. That case was concerned with an employee benefit trust into which bonuses were paid; the employee had a choice between taking a bonus in cash or having it paid into the trust. The critical question, arising under section 43 of the Finance Act 1989, was whether there could be a deduction from profits when payments were made into the trust. The Commissioners focused on the meaning of the word "payment", a matter which is discussed at paragraphs 139-142 of their opinion. It was held that the word "payment" has no settled meaning but takes its meaning from its statutory context. When money was placed unreservedly at the disposal of directors by a company, that was equivalent to payment. If a transaction were deliberately structured to include an element of uncertainty with no commercial purpose then the composite effect should be considered as it was intended to operate without regard to the possibility that it might not work as planned. We note that *IRC* v *Scottish Provident Institution*, 2005 1 SC (HL) 33, is an example of such a situation. On the facts of *Sempra Metals*, the Commissioners concluded that the payments made by an employer to trusts set up to hold employees' bonuses did not amount to the payment of money or a payment equivalent to cash, with the result that they were not taxable. For the Revenue it had been contended that payments to the trusts were placed unreservedly at the disposal of the employee in question. The Commissioners thought, however, that it was necessary to have regard to the existence of the trusts, the continuing discretion of the trustee and the existence of loans made to certain of the employees who benefited from the

trust (paragraph 142). The employees were not free to do whatever they liked with the allocated funds; they could apply for loans or request the making of investments, but the final decision remained within the discretion of the trustee. In our opinion that decision should not be followed. The fact that funds are paid to trustees at the request of an employee does not mean that no payment has been made; a payment of emoluments or earnings is made, but it is redirected by the employee to another person. This is not affected by the existence of trust purposes or by the discretion enjoyed by the trustee. The employee has chosen to have his emoluments or earnings paid to a trustee to be held for particular purposes and takes the risk that the trustee may not apply them as he wishes. For that reason we consider that we should not follow the decision in *Sempra Metals*.

[76] Finally, in *UBS AG* v *Revenue and Customs Commissioners*, [2013] STC 68 (UT); [2014] STC 2278 (CA), two banks provided bonuses for employees by funding an offshore company which was not controlled by the bank. Shares in the offshore company were transferred to employees of the bank, subject to temporary restrictions which were subsequently lifted. One of the questions argued was whether the employees were "entitled to payment" of earnings in terms of Rule 2 of section 18(1) of the Income Tax (Earnings and Pensions) Act 2003; that subsection defines when money earnings are to be received for the purposes of income tax, and Rule 2 specifies that that includes "the time when a person becomes entitled to payment of or on account of the earnings". It was held by the Upper Tribunal that it could not be said that in these circumstances the employees were "entitled to payment" of the amount of the bonuses. The rule was intended to deal with the position where a present right to present payment of the earnings had accrued but actual payment was delayed or withheld: paragraph [64]. In the case under consideration, it could not be said that any of the relevant employees, even those with guaranteed minimum bonuses,

became entitled to immediate payment of the bonuses awarded to them: paragraph [71]. A similar approach was taken by the Court of Appeal: paragraphs [67] *et seq*.

[77] Implicit in this approach, however, is the proposition that if an employee is entitled to payment of a bonus that can, realistically, be considered as money, he is treated as receiving it as soon as he becomes entitled to payment of the bonus. That is accepted by the Court of Appeal, at paragraphs [71] and [75], where it is emphasized that the employees in question were only entitled to shares, not money; therefore an entitlement to a bonus was transmuted into an entitlement to shares before the bonus became due. In the present case, by contrast, the bonus was a money bonus that was actually paid, albeit to trustees. That brings it within Rule 1 of section 18(1), not Rule 2; Rule 1 provides that money earnings are to be treated as received at the time when payment is made. The bonus was paid not to the employee but to trustees for members of the employee's family, but that is, as indicated above, a mere redirection of income and does not avoid liability to income tax. For the respondents it was submitted that it was necessary for liability to income tax on a bonus that there should be a present entitlement to payment of money or money's worth. We disagree with that proposition. The fact that a payment is made is sufficient to produce a liability to income tax.

The second issue: whether an employee *qua* protector had power to obtain trust funds absolutely

[78] Our decision on HMRC's primary submission is sufficient to determine the appeal in their favour. Nevertheless we were presented with arguments on their secondary submission, and we will consider that, albeit somewhat more briefly. The submission was that the appointment of monies by the trustee of the Principal Trust on to each sub-trust was made on terms that placed those monies at the unreserved disposal of the employee and

hence constituted a payment of taxable earnings, taxable in the hands of the employee. Central to the argument was the fact that the employee was appointed as protector of the sub-trust. By exercising his powers as protector, it was said, the employee had power to exclude all of the existing beneficiaries of the sub-trust, appoint himself sole beneficiary and wind up the sub-trust. In that way he could take the monies settled on the sub-trust absolutely. The appointment of monies to the sub-trust accordingly placed those monies at the unreserved disposal of the employee and constituted a payment of taxable earnings, taxable in the hands of the employee.

The trust deeds

[79] The relevant provisions of the trust deeds creating the Principal Trust and representative sub-trusts are set out above, at paragraphs [15] *et seq*. In each case an individual was appointed protector. In the case of the Principal Trust there was originally no protector, although MGML had certain responsibilities as the Founder, but the Deed of Variation of 28 January 2002 by clause 1.1.9 appointed Sir David Murray as protector. The only parties to that deed were MGML and the then Trustee; the other companies that had adhered to the trust by the deeds of adherence executed in May 2001 were not parties, and thus were not bound by the appointment of Sir David Murray as protector. Nevertheless, we do not think that this point is of practical significance for present purposes. In relation to the various sub-trusts, in most cases the employee connected with the sub-trust was appointed protector; the provisions of a typical sub-trust are quoted above at paragraph [19]. The protector was given a fiduciary power to alter the provisions of the deed constituting the sub-trust, although this was subject to certain important limitations; these prevented the protector from exercising the power in a manner that would adversely

affect the trustee, unless the trustee's consent were obtained, and from exercising the power to alter the clause that contained the basic declaration of trust. In some cases the powers of the protector were expressly declared to be fiduciary; in others they were not so declared. In the case of the Principal Trust, following its amendment, Sir David Murray's power to alter the provisions of the deed was declared to be absolute and not a fiduciary power.

The relevant principles

[80] The argument for HMRC is that, where an employee was appointed protector of a trust set up for his family, he was able to use his powers as protector to amend the trust purposes in such a way that he alone would be the beneficiary; other beneficiaries would be removed and he would be appointed the sole beneficiary. On that basis it was said that the funds paid into a sub-trust were placed unreservedly at the disposal of the protector, in such a way that he had practical control over those funds. The relevant legal principle, which is explained in *Garforth* v *Newsmith Stainless Ltd*, *supra*, and *Aberdeen Asset Management PLC* v *HMRC*, *supra*, is that if money is placed unreservedly at the disposal of an employee – if it is under the employee's practical control – it will be treated as a payment for the purposes of the PAYE legislation. That is clear from the following passage in *Garforth* (at pages 413-414):

> "I therefore come back to the question whether, on the facts of the present case, there was 'payment' to the directors. The argument really was, on the one hand, that all that happened was that the balances in the directors' loan accounts with the taxpayer company were increased without them getting anything out of it unless and until they withdrew their money from the taxpayer company, and, on the other hand, that the money was placed unreservedly at their disposal, they could have had it at any moment they chose, and that amounts to payment. As between those two contrasting views, I have no hesitation at all in saying that, in my judgment, when money is paid unreservedly at the disposal of directors by a company, that is equivalent to payment".

That passage was cited with approval in *Aberdeen Asset Management* (at 2014 SC 286, paragraph [33]). It was there indicated that money is a medium of exchange, and therefore

the crucial question in practical terms was whether the funds had been placed in a position where as a practical matter they might be spent by the employee as he wished; it was at that point that the employee could be said to obtain the benefit of the funds. Thus it was the fact that the employee had practical control over the disposal of the funds that was sufficient to constitute a payment for the purposes of the PAYE legislation.

Application to the facts

[81] The critical question for the purposes of HMRC's argument is accordingly whether each employee had practical control over the disposal of the funds placed either in the Principal Trust (in the case of Sir David Murray) or in the relevant sub-trusts. It is the position of the employee as protector that is critical for that purpose. HMRC contended that the First-tier Tribunal and the Upper Tribunal had misapplied the foregoing test. They had treated the relevant test as being one of "absolute right" or "absolute entitlement" (First-tier Tribunal at paragraph 231; Upper Tribunal at paragraphs 65-67) rather than the question of whether as a practical matter the sums paid are placed unreservedly at the disposal of the employee. We agree that the test is not one of absolute right, and is properly categorized as involving practical control over the funds in such a way that they are placed unreservedly at the disposal of the employee, so that they may be spent by the employee as he wishes. It therefore appears that the First-tier Tribunal addressed the wrong test, and in this were affirmed by the Upper Tribunal.

[82] It is, however, critical to HMRC's argument that an employee *qua* protector should have control over the disposal of the funds held in trust, so that he can determine how they should be applied and if necessary alter the trust purposes so that he is the sole beneficiary. That depends on the powers of the protector. The protector is an institution that until

recently was unknown in Scots or English law. It appears to have originated in offshore trusts during the 1980s. The institution is discussed in the Scottish Law Commission's Discussion Paper on Supplementary and Miscellaneous Issues relating to Trust Law (DP No 148, 2011), at Chapter 11, and their Report on Trust Law (Scot Law Com No 239, published on 22 July 2014), at chapter 15. Although these were prepared with a view to the reform of the law of trusts in Scotland and the present trusts are subject, generally, to the law of England and Wales, they are based on detailed consideration of the law in a range of jurisdictions, including the offshore jurisdictions where the institution of the protector has been pioneered. In the Discussion Paper and Report reference is made to an article by Donovan Waters, an eminent Canadian lawyer, "The Protector: New wine in old bottles?" in which the function of a protector was described as being: "to ensure that the trustee of [an offshore] trust, so many miles away from the settlor and invested with the settlor's property, was actually and efficiently discharging the various trustee duties". In this way the settlor, or truster, might exercise a degree of control, or at least influence, over the trustees. The Scottish Law Commission notes at paragraph 15.3 of its Report that it is generally seen as essential to prevent a protector from being regarded as a trustee, as that may have very serious tax or estate planning consequences. The First-tier Tribunal, at paragraph 103(v), suggest that a protector enjoys extended powers in respects resembling trusteeship, but without title to the trust assets. We would endorse that statement; generally speaking it is essential that a protector should not be equiparated with a trustee. Nevertheless, as the Scottish Law Commission indicates, protectors' powers can still be fiduciary in nature, and different jurisdictions have taken different approaches to the question of whether the duties of a protector are or are not fiduciary. Thus the duties of a protector may or may not be fiduciary.

[83] The notion of a fiduciary duty is of great importance in a number of areas of the law. We were referred to the decision of the Court of Appeal in *Bristol and West Building Society* v *Mothew*, [1998] Ch 1, where Millett LJ (at 18) describes a fiduciary relationship as follows:

> "A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary".

We are in broad agreement with that description, although it might be said that it fails to recognize the breadth of fiduciary relationships and the different features of each of them. In this respect, the trustee of a traditional trust may be contrasted with the trustee of a trust set up for commercial purposes, or an agent in a commercial transaction. Nevertheless, the fundamental point is that in any matter falling within the scope of the fiduciary relationship the fiduciary is always obliged to put the principal's interests before his own.

[84] In the case of a protector, his primary function is to ensure that the intentions of the truster or settlor are protected and enforced. Enforcing those intentions obviously includes ensuring that the trust purposes laid down by the truster or settlor are fulfilled. It follows, in our opinion, that normally a protector will owe fiduciary duties; in this connection we note that the Scottish Law Commission recommended (at paragraph 15.18 of its Report) that a protector should be subject to fiduciary duties in the exercise of his or her office. Some jurisdictions, such as the Cook Islands and Guernsey, expressly make the office non-fiduciary, but that seems to us to be an exception to the norm for which express provision is made. So far as English law is concerned, that being the legal system that governs the

majority of the present trust documents, we are of opinion that a protector will normally owe fiduciary duties, but that this may be excluded by the express terms of the trust deed or other deed appointing him protector. In the absence of express, or possibly clearly implied, exclusion, however, the office of protector will carry fiduciary responsibilities. We reach that conclusion from first principles, but it accords with the views of the authors of Underhill and Hayton, *Law of Trusts and Trustees* (18th ed, 2010), at paragraph 1.79, and of the authors of Lewin on *Trusts* (18th ed, paragraph 29-41; 19th ed, 2015, at paragraph 29-45 approved in Jersey by Commissioner Clyde-Smith in *Re Representation of Centre Trustees (CI) Ltd*, [2009] JRC 109; 12 ITELR 720, at paragraph [23]).

[85] The fiduciary duties will obviously be owed to the settlor, but those duties include ensuring that the trust purposes are properly enforced. For that reason the fiduciary duties must also operate in favour of the beneficiaries, who are the persons that the settlor intends to benefit. That would mean that, in any question between the protector *qua* fiduciary and the beneficiaries of the trust, the protector is generally obliged to put the interests of the beneficiaries before his own. In particular, if a protector is subject to fiduciary duties, he cannot exercise his powers in such a way as to deprive the beneficiaries chosen by the settlor of their existing rights and put himself in their place. That would amount to the clearest of breaches of fiduciary duty; a fiduciary must always put the interests of those in whose interests he acts above his own.

[86] In the present case we are of opinion that the duties of a protector will be fiduciary in every case where there is no express declaration to the contrary. With some of the sub-trusts the appointment of a protector is expressly declared to be fiduciary; in others nothing is said. In all those cases we are of opinion that the appointment is fiduciary in nature; that follows from the essential nature of a protector's responsibilities, which are intended to

secure the enforcement of the trust purposes, including the rights of the beneficiaries. In the case of the Principal Trust, when Sir David Murray was appointed a fiduciary in the Deed of Variation of 28 January 2002, it was expressly declared that the appointment was not fiduciary. In that case, however, the Protector is prohibited, by clause 9.2.5, from altering the definition of "Excluded Persons". Those persons are prohibited from being beneficiaries (clause 1.1.4), and they include any person connected with the Founder (MGML). That category would include Sir David Murray. Thus Sir David Murray could not exercise his powers as protector in such a way as to make himself a beneficiary, notwithstanding the expressly non-fiduciary nature of his office.

[87] Furthermore, in other cases the protector is invariably prohibited from altering any of the provisions of the clause containing the declaration of trust (normally clause 2). That clause requires that the trust fund and income should be held on trust for one or more of the Principal Beneficiaries. The Principal Beneficiaries are defined in the interpretation clause (normally clause 1.1.4) as meaning the chosen relatives of the person appointed protector. For HMRC it was argued that the prohibition on altering the declaration of trust did not affect the definition of the Principal Beneficiaries. We are of opinion, however, that that would not be a proper interpretation of the sub-trust deeds. The purpose of the declaration of trust is to define who the beneficiaries of the trust are, and the Principal Beneficiaries as defined in the interpretation clause are the chosen beneficiaries. If, therefore, the definition of the Principal Beneficiaries could be altered by the protector in such a way as to appoint himself as the sole beneficiary, that would subvert the fundamental purpose of the declaration of trust in clause 2. That in our opinion is something that was not contemplated by the deeds constituting the sub-trusts. Thus the argument for HMRC would also fail on

the ground that the protector, under the terms of the declarations of trust affecting the sub-trusts, had no power to change the definition of the Principal Beneficiaries.

[88] For the foregoing reasons we are of opinion that HMRC's secondary submission must fail. To the extent that the position of the protector is fiduciary, removing the existing beneficiaries and appointing himself in their place would amount to a clear breach of fiduciary duty. In any event, such an appointment would be subject to limitations on the power of the protector to amend the trust deed, which prevent the alteration of the fundamental declaration of trust, including the definition of the beneficiaries of that declaration. In the case of the Principal Trust, Sir David Murray *qua* protector is unable to exercise his powers in such a way as to benefit himself because of the express terms of the deed.

[89] One further argument might have been relevant. Two general defences are available to a *prima facie* breach of fiduciary duty: the conduct may have been specifically authorized in the deed or other arrangement that creates the fiduciary duty (the trust deed in a traditional trust) or the persons for whose benefit the duty exists may have consented to the conduct that would otherwise constitute a breach of fiduciary duty: so far as Scotland is concerned the law is stated in the Stair Memorial Encyclopaedia, volume 24, at paragraph 173, and similar principles apply in other jurisdictions, including England and Wales. In the present case there can be no question of consent by the beneficiaries of the fiduciary relationships (the beneficiaries nominated in the various declarations of trust). In some cases it might be argued that the appointment of a protector, in context, is in such terms that the protector may override all fiduciary duties and appoint himself as a beneficiary. While that remains a theoretical possibility, we are of opinion that there is nothing in the present case that would produce such a result. The beneficiaries of the

various sub-trusts are carefully defined, and the plain intention of the declarations of trust is that it is those beneficiaries that should benefit from the trust. The protector is in a wholly different position from the named beneficiaries. It is true that he will normally have received a loan from the trustees, but that is a quite different matter from taking a benefit under the trust, if only because the loan is subject to an obligation of repayment. Thus the general defences that are available in respect of a breach of fiduciary duty do not apply, and the result remains that HMRC's secondary argument must fail.

PAYE and the Principal Trust

[90] The last matter for consideration is the application of the PAYE legislation in the light of our opinion. We heard submissions on it on behalf of HMRC, but not on behalf of the respondent. We have concluded, at paragraph [65] above, that a payment of emoluments or earnings was made at the point where the relevant employer made a payment to the trustee of the Principal Trust. The result of that is that the incidence of PAYE is quite straightforward: the obligation to deduct tax under the PAYE legislation falls on the employer who pays the sum to the Principal Trust. That follows from the ordinary application of section 203 of the Taxes Act 1988.

[91] If that had not been so, HMRC's alternative contention was that a payment of emoluments or earnings was made when the trustee of the Principal Trust made payment to the trustee of the relevant sub-trust. In that event, it was submitted, an employer other than MGML would be among the beneficiaries of the Principal Trust, with the result that the trustee of that trust could be regarded as an intermediary of the employer in terms of section 687(4)(b) of the Income Tax (Earnings and Pensions) Act 2003, or alternatively section 203B(4) of the Taxes Act 1988. The result under sections 687 and 203B, would be that the

employer was treated for the purposes of the PAYE regulations as making a payment of earnings in respect of which it was liable to PAYE. In the case of MGML, it was submitted that the Deed of Variation of November 2002 was of no effect, and that accordingly MGML was in the same position as other employers in respect of its own employees. In view of our conclusion that the payment to the Principal Trust constituted emoluments or earnings, we do not find it necessary to reach a decision on the foregoing arguments.

Conclusion

[92] For the foregoing reasons we will accordingly allow HMRC's appeal on the first ground advanced by them. On that basis we will answer the fourth question in the appeal in the affirmative, and hold that the First-tier Tribunal erred in allowing the original appeal and that the Upper Tribunal erred in refusing the appeal before it. The other questions in the appeal do not therefore arise. The assessments to PAYE have been correctly made, for the reasons already discussed. On that basis we will recall the orders of the First-tier and Upper Tribunals and affirm the determinations appealed against, including that relating to PAYE, with the exception of the determinations and decisions concerning Sir David Murray in relation to the Bel Azur property transaction, which is conceded by HMRC. We will reserve the question of expenses in view of the history of the appeals.