THE RANGERS DECISION

Robert Venables Q.C. [1]

1. Overview

1.1 Introduction

The decision of the Supreme Court in *RFC 2012 Plc v Advocate General* for Scotland (on appeal from the Court of Session (Inner House)[2] in *Advocate General for Scotland v Murray Group Holdings Ltd*) ("Rangers") is triply flawed in that it is inconsistent with over 100 years of judicial decisions, including a decision of the Supreme Court itself in 2014 and ignores the legislative history and is internally inconsistent.

It appears to have been heavily influenced by the view that the taxpayer had engaged in tax avoidance. Indeed the whole of Lord Hodge's speech is shot through with references to "tax avoidance". That the taxpayer had engaged in tax avoidance appears, surprisingly, not to have been contested. Yet on the authorities (apparently not cited to the Supreme Court) on the meaning of "tax avoidance", there was no "tax avoidance" or even a "tax avoidance" motive in this case.

Further, the lead judgment, of Lord Hodge, appears to have begged the whole question, namely whether payments made by the employer to an employee benefit trust were indeed "remuneration" and whether they were paid "to" any employee.

He began his judgment:

> "1. This appeal concerns a tax avoidance scheme by which employers paid remuneration to their employees through an employees' remuneration trust in the hope that the scheme would avoid liability

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2 The Scotts equivalent of the English Court of Appeal.

> to income tax and Class 1 national insurance contributions ("NICs"). The appeal raises a fundamental question about the nature of the income tax charge on employment income. That question is whether an employee's remuneration is taxable as his or her emoluments or earnings when it is paid to a third party in circumstances in which the employee had no prior entitlement to receive it himself or herself."[3]

(Curiously, there opening words may be helpful in restricting the scope of the decision in that

(a) one must first identity something which can be accurately described as "remuneration" of a given employee and

(b) there must be a "payment" of that remuneration to a third party.)

The current state of the law is now in considerable confusion. First, there are two recent inconsistent decisions of the Supreme Court.

Second, the Supreme Court in Rangers could not have dismissed the appeal in its entirety if it had properly applied its own test. Even if it is sound in law, its precise scope is far from clear.

1.2 The Position before the Decisions

The position before the decision in the Court of Session, as it had been understood for well over 100 years, was as follows.

1. An employee is in general taxable on "general earnings"[4] which relate to his employment if and only if he receives them or is currently indefeasibly to them.

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3 In paragraph 2 reference is made to an "aggressive tax avoidance scheme", in a quote, apparently with approval, of the First Tier Tribunal decision.

4 See Income Tax (Earnings and Pensions) ACT 2003 section 7(3) and (5). In this context, the category of general earnings which is in point is "earnings within Chapter 1 of Part 3". That Chapter contains only one section, section 62 (Earnings), which provides:

"(1) This section explains what is meant by "earnings" in the employment income Parts.

(2) In those Parts "earnings", 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.

(4) Subsection (1) does not affect the operation of statutory provisions that provide for amounts to be treated as earnings (and see section 721(7)"

2. There is a "redirection principle" which is simply a corollary of the above. If the employee has become currently and indefeasibly entitled to general earnings and directs that they be paid to a third party that does not affect his liability to income tax.

3. A further corollary is that there is no "derivation principle". Under a derivation principle, anything which is paid to anyone only as a result of the employee's employment services would constitute "general earnings" of the employee and thus form part of his taxable remuneration.

   This would apply even where the payment was made to a fiduciary, such as a trustee for beneficiaries and even if none of the beneficiaries has any fixed interest in what is paid, which is paid only because of the employment, and thus in that sense "derived" from it, is regarded as emoluments or general earnings of the employee and thus taxable on him when the payment is made.

   The principle could apply even where the payment was entirely voluntary on the part of the payer and the employee had no contractual right that it be paid.

4. There can be express statutory exceptions from the above. W here, for example, a payment is made to (or a benefit is conferred on) a third party by reason of an employee's employment, an employee may be taxable by virtue of the application of the benefit in kind provisions, contained in Income Tax (Employment and Pensions) Act 2003 Part 3 Chapters 2 - 10. However, they clearly did not apply on the facts of this case. Moreover, their very existence should have made the Supreme Court query whether the much more general principle they propounded was sound.

1.3 The Supreme Court Decision

The decision was that certain payments made by an employer to an employee benefit trust constituted taxable earnings of certain of its employees even though they had no right to receive them, had not redirected them (in the classic sense) and had not at that point obtained any benefit and might never obtain any benefit from the payments.

All that appears to have been necessary is that each payment was connected with the employment of the particular employee.

In effect, the Supreme Court was introducing a derivation principle into United Kingdom tax law.[5]

2. The Facts as Perceived by the Supreme Court

The following statement of the facts is taken from the judgment of Lord Hodge interspersed with my comments.

"18. The employing companies were at all relevant times members of a group of companies whose ultimate parent company is Murray International Holdings Ltd. … Other than RFC[6], the employing companies were Murray Group Holdings Ltd, which is a subsidiary holding company, Murray Group Management Ltd ("MGML"), which provided management services to the group, the Premier Property Group Ltd, and GM Mining Ltd. MGML by deed dated 20 April 2001 set up a trust known as the Remuneration Trust, which I will refer to as "the Principal Trust".

19. A company within the Murray group of companies which wished to benefit one of its employees made a cash payment to the Principal Trust in respect of that employee. When it did so, the employing company recommended the trustee of the Principal Trust to resettle the sum which it paid on to a sub-trust and asked that the income and capital of the sub-trust should be applied in accordance with the wishes of the employee. The trustee of the Principal Trust had a discretion whether to comply with those requests, but, when an employing company provided the funds, the trustee without exception created a sub-trust for the favoured employee. 108 sub-trusts were established in the n am e of individual employees, of which 81 were for RFC employees (footballers and executives) and 27 for other Murray group employees. The group companies also used the combination of the Principal Trust and a sub-trust to pay discretionary annual bonuses to employees, other than the footballers whom RFC employed. Since 2005 only RFC used the Principal Trust to remunerate its employees."

As regards the footballers, the facts as found were very strong in favour of the Revenue. Each cash contribution to the trust was made by the employer in respect of and to benefit one specific employee.

As regards the non-footballers, the statement that discretionary annual bonuses were paid "to" them is highly tendentious.

5 Pace Lord Hodge's statement in paragraph 3 of his judgment: "The Advocate General for Scotland on behalf of HM RC appealed to the Inner House of the Court of Session and advanced a legal argument which had not been presented to, or at least had not been developed before, the tribunals, namely that the payment of the sums to the remuneration trust involved a redirection of the employee's earnings and accordingly did not exclude those earnings from the charge to income tax."

6 Rangers Football Club Plc

"20. In this appeal we are concerned only with the sums which RFC paid to the Principal Trust and which were re-settled on to a sub-trust in accordance with the wishes of each of its employees who took part in the scheme. I discuss employees other than footballers in para 31 below, but first address the operation of the scheme by reference to the footballers. It is instructive to understand (a) how the trust mechanism was established when a footballer was recruited and how the mechanism was explained to the player, (b) the powers over the sub-trust which were conferred on the footballer, and (c) how the trustee of the various sub-trusts exercised its discretion in operating the arrangement which RFC (and the other Murray group companies) had initiated."

Note the words "in accordance with the wishes of each of its employees". Again the facts are very strong pro-Revenue. But the fact that the employees may have wished a payment to be made does not mean that they were in a position to insist that it be made. This falls far short of a redirection case.

"21. The establishment of the trust mechanism: When RFC negotiated the engagement of a footballer with the prospective player or his agent, the discussions focused on the figure net of tax which the footballer would receive. A senior RFC executive would explain the mechanism of creating a sub-trust in the name of the employee and the benefits which the trust mechanism would give. In particular, the prospective employee would be told that he could obtain a loan of the sum paid to the sub-trust from its trustee which would be greater than a payment net of tax deducted under PA Y E if he were to be paid through RFC's payroll. The lo an w as to be repayable on an extended term of ten years on a discounted basis, that is to say that the player would not p ay an nu al interest on the loan but that the interest would be accrued and applied so that a grossed up sum would be repayable. Both RFC and the footballer expected that the loans would not be repaid at term but would be renewed, as RFC's executive explained to the footballer or his agent that the arrangement had the additional tax advantage that the loans would be repayable out of the footballer's estate on death, thereby reducing its value for Inheritance Tax purposes. It was also explained that the player would be appointed as protector of the sub-trust, with powers to change both the trustee and also the beneficiaries of the sub-trust, as I discuss below.

"22. On recruitment of a footballer, the terms of his engagement were recorded in two separate contractual documents. The first was a contract of employment which set out the terms of employment and the footballer's remuneration which would be paid subject to deduction of PAYE and NICs. The second was a side-letter in which a senior executive of RFC undertook that RFC would (a) recommend to the trustee of the Principal Trust (i) to include the footballer as protector of a sub-trust and (ii) to fund the sub-trust with the sum or sums which had been agreed in the recruitment negotiation, and (b) fund the Principal Trust to enable the trustee to carry out those recommendations."

Again the facts were very strong in favour of the Revenue. Yet there is no finding that any employee had at any material time the right to take cash himself rather than have it contributed to the trust.

"23. It is clear from documents, which were before the First Tier Tribunal and were made available to this court as examples of the arrangements, that the sums paid to the Principal Trust and to the sub-trusts represented remuneration for employment."

That is a crucial finding. Yet it begs the entire question! While the term "remuneration" is not used in Income Tax (Earnings and Pensions) Act 2003, its ordinary meaning would be the same as that of "earnings" in section 62.

> "[23 continued] In one case, RFC undertook in the side-letter to an employee dated 17 June 2004 to pay him free of UK or other taxes the sum which it had undertaken to pay into the Principal Trust for funding the sub-trust, if the trustee of the Principal Trust did not make him the protector of the sub-trust or fund the sub-trust. In another case, we were referred documents in which a footballer's remuneration had been agreed between RFC and his agent in July 2001. The footballer's agent recorded his client's remuneration in these terms:
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> > "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. The player will accordingly receive £125,000 in October and February during each year of the Contract. Rangers will grant the appropriate indemnity that they will be responsible for payment of any tax should the revenue seek to recover any tax from the player on these amounts."

I do not see how the understanding or English usage of a third party not used to the technical expressions of tax law could be in any way material.

> "Thereafter RFC and the footballer entered into a contract of employment which provided for the payment of an annual salary of £416,00 0 and RFC's finance director sent the footballer a side-letter dated 13 July 2001 in which he confirmed that RFC would recommend to the trustee of the Principal Trust to include him as the protector of a sub-trust and to fund the sub-trust with £125,000 on each occasion in October and February during the period which matched the term of the contract of employment. The majority of the FTT recorded (para 207) that RFC offered the prospective employees this form of deal, combining a payroll payment and the transfer of funds through the trust mechanism on a "take it or leave it" basis."

That the employee had no option to take cash showed very plainly that this was not a case of redirection.

"24. …

25. RFC initiated the creation of a sub-trust by having the employee complete a letter of wishes, in which the employee, as protector of the sub-trust, wrote to the trustee to express his wishes as to the exercise of the trustee's discretionary powers. The court was shown examples of such letters, which were in a standardised form, in which the employee asked that the income and capital be held and applied according to his wishes, and that on his death, the trust fund be held for the benefit of a specified member or members of his family. In all but one case, RFC had the employee complete a loan application on his own behalf. The letter of wishes and the loan application were then submitted to the trustee. Messrs Baxendale Walker, the solicitors who devised and operated the scheme for the Murray group, then submitted a standard form of trust deed for the trustee company, in its capacity as trustee of the Principal Trust, to sign in order to create the sub-trust. RFC paid its agreed contribution to the Principal Trust; and, on receipt of the funds, the trustee company invariably exercised its discretion to create a sub-trust in the name of the employee. The trustee company, in its other capacity as trustee of the sub-trusts, almost invariably exercised its discretion to grant a loan of the full amount in the sub-trust in response to an employee's request."

Loans are not earnings. If and in so far as they conferred a benefit on the employee, they would have been taxable under the benefit in kind provisions, in particular Income Tax (Earnings and Pensions) Act 2003 Part 3 Chapter 7.

"26. The employee's powers over the sub-trust: The employee enjoyed extensive powers under the sub-trust as its "protector". In an example of a sub-trust which was shown to the court, clause 7 gave the protector a power, which was stated to be a fiduciary power, to appoint and remove any trustee. Clause 9 gave the protector the power, which again was stated to be a fiduciary power, to alter the provisions of the sub-trust. Significantly, that power included the power to change the beneficiaries of the sub-trust. The power of alteration was subject to exclusions and required the written consent of the trustee if it was exercised in a manner which would adversely affect the trustee. The employee as protector was also empowered to appoint a protector in his place (clause 1.1.7). The FTT summarised the position (in para 103(v) of the majority decision) in these terms: "the employee could also be appointed protector with extended powers in respects resembling trusteeship, but without title to the trust assets, and not enabling the conferring of any absolute beneficial right on the employee himself".

27. This statement by the majority of the FTT is accurate in so far as it thus state what the employee could do while he was a protector. The majority of the FTT recorded (paras 23 and 227) that foreign p layers who left RFC and moved to reside overseas were able to "unscramble" the legal framework and receive an absolute right to the moneys which had been put in the sub-trust. The majority of the FTT stated that this could be done "only with the consents of those interested in the capital of the sub-trust

concerned". I am not persuaded that that is correct. In some cases, such as the one to which the majority expressly referred, the player's wife cooperated with RFC, the trustee and the player to assign the receivables of the sub-trust to the player and thus extinguish the loan. But the power of a replacement protector to alter the beneficiaries may have enabled the player to be nominated as the beneficiary and for him in cooperation with the trustee to extinguish the loan and bring the sub-trust to an end. Dr Poon's more detailed findings on the termination of sub-trusts in paras 145-151 of her dissenting decision suggest that this device also was used."

It is curious that Lord Hodge deals with the role of the employee qua protector without then replying on it in reaching his decision. If he had found that the employee could, by appointing someone else as protector after securing a binding agreement from them that they would appoint the trust funds in question to the employee, then I could perfectly have understood HMRC's victory. The sums paid to the employee benefit trust would have become earnings as soon as they were transferred to the sub-trust because at that point the employee would have had complete dominion over them. Yet that does not appear to be basis of the decision.

"28. The exercise of discretion by the trustee: The initial trustee of the Principal Trust was Insinger Trust Company Ltd, which was resident in Jersey and which later changed its name to Equity Trust (Jersey) Ltd ("Equity"). Equity was also the trustee of the sub-trusts. Both the Principal Trust and the sub-trusts are governed by English law. In 2006 MGML replaced Equity with Trident Trust Company Ltd ("Trident"), another company resident in Jersey, as trustee of the Principal Trust, and transferred the trusteeship of certain sub-trusts to it. As I have said, in every case in which an employing company paid money to the Principal Trust, the trustee, whether Equity or Trident, exercised its discretion to create a sub-trust.

29. When the employee applied for a loan of the sum paid into the sub-trust, the trustee gave the employee a loan of that sum. In no case did the trustee take a security from the employee-borrower to protect the repayment of the fund of the sub-trust. The majority of the FTT recorded (paras 91, 103(x) and 225) that Equity was replaced as trustee by Trident after Equity had responded to some loan applications by requesting the provision of security and delayed the payment of the loans. It is clear from Dr Poon's more detailed findings of fact (paras 50, 60, 166(xiii) and 201) that Equity's request for security was prompted by an investigation by its regulator, the Jersey Financial Services Commission, as to whether the loans were on commercial terms. Trident's managers proved to be more compliant with MGML's wishes and the majority of the FTT (para 225) described the trustee's attitude as "lax".

30. The majority recorded (para 225) that the trustee had the benefit of a broad indemnity from MGML; but the majority in its judgment treated the structure of the trust mechanism as important rather than the lax attitude of a particular trustee.

It is curious that Lord Hodge deals with the role of the trustees without then replying on it in reaching his decision. If he had decided that the trust was a sham and the so-called trustees mere ciphers who were there to do the bidding of the employee, I would have entirely understood the result. Yet that course was not open to him. It was contrary to the findings of the First Tier Tribunal and HMRC did not seek to argue the contrary. See para 32 of his judgment.

31. RFC used the same trust mechanisms in making termination payments to players and in the payment of guaranteed bonuses. The majority of the FTT discussed these and also certain exceptional cases in paras 206 to 211 of its decision. The other companies in the Murray group, which were respondents before the Court of Session, used the same trust mechanisms and loans when paying discretionary annual bonuses to senior executives. The majority recorded (paras 103(xi) and 205) that these bonuses differed from the footballers' bonuses, which were agreed on their engagement, as the senior executives had no contractual right to the bonuses before they were awarded. But the bonuses were paid as a reward for the work which the employees had carried out in their capacity as employees. RFC also used the same mechanisms in paying discretionary bonuses to its senior executives. One director, whose evidence the majority of the FTT accepted, described his understanding that the loan of the funds from the sub-trust could be extended after ten years and would ultimately reduce the value of his estate for Inheritance Tax. He had received an indemnity from RFC against any personal tax liability from the arrangement (para 71)."

It is crucial that in the case of the discretionary bonuses in respect of non-footballers there was no prior discussion (as there was in the case of the footballers). To state that "the bonuses were paid as a reward for the work which the employees h ad carried out in their capacity as employees" begs an important question.

I return later to the distinction between the footballers and the non-footballers.

3. The Legislation and the Legislative History

3.1 The Legislative History

3.1.1 What the Supreme Court Considered

The Supreme Court considered nothing earlier than Income and Corporation Taxes Act 1988. As will be seen, they concluded that nothing in that Act nor in Income Tax (Employment and Pensions) Act 2003 required remuneration to be received by an employee before a charge to income tax on earnings could be imposed on him.

3.1.2 The History

The charge to tax on "employment income" was, until the enactment of Income Tax (Earnings and Pensions) Act 2003, a consolidation act, formerly under Schedule E.[7]

Schedule E was to be found in Income Tax Act 1842, which reintroduced the income tax, which has remained ever since. It was there introduced by section 146.

Originally, Schedule E applied only to "public offices and employments" (other employments being taxable under Schedule D). Finance Act 1922, however, transferred all offices and employments to Schedule E unless the emoluments were "foreign emoluments". Finally, Finance Act 1956 brought all offices and employments within Schedule E.[8]

Passing over Income Tax Act 1918, the next consolidating act was Income Tax Act 1952, to which I refer below. Further consolidations were Income and

Corporation Tax Act 1970 and Income and Corporation Tax Act 1988 and then, finally, Income Tax (Earnings and Pensions) Act 2003.

While Finance Act 1956 and Finance Act 1974 amended the precise scope of Schedule E, neither of those acts, nor any other act following Income Tax Act 1952, altered the basic principles of the Schedule E charge.

It is Income Tax Act 1952 which is most instructive in the present context. Section 156 contained Schedule E. It provided:

"156. The Schedule referred to in this Act as Schedule E is as follows

Schedule E

1. Tax under this Schedule shall be charged in respect of every public office or employment of profit, and in respect of every annuity, pension or stipend payable by the Crown or out of the public revenue of the United Kingdom or of Northern Ireland, other than annuities charged under Schedule C, for every twenty shillings of the amount thereof for the year.

2. Tax under this Schedule shall also be charged in respect of any office, employment or pension the profits or gains arising or accruing from which would be chargeable to tax under Schedule D but for the proviso to paragraph 1 of that Schedule.

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7 Income Tax (Earnings and Pensions) Act 2003 was primarily a consolidation act and did not purport to enact any new law in any way material to this case.

8 It also divided the Schedule into three cases. The cases were amended by Finance Act 1974. They are not relevant for present purposes as they related to matters such as residence and whether the source was United Kingdom or not.

3. Where

   (a) any emoluments, pension or annuity are or is payable in the United Kingdom by or through any public department, officer or agent of the Government of any part of Her Majesty's dominions, but otherwise than out of the public revenue of the United Kingdom or the public revenue of Northern Ireland, to a person who is or has been employed in the service of the Crown outside the United Kingdom in respect of that service; or

   (b) any pension or annuity is so payable to the widow, child, relative or dependant of any such person as aforesaid,

   and the person in receipt of the emoluments, pension or annuity is chargeable to income tax as a person resident in the United Kingdom, the emoluments, pension or annuity shall be chargeable to income tax under this Schedule.

This paragraph shall apply in relation to any emoluments, pension or annuity payable by or through any public department, officer or agent of the Government of any territory under Her Majesty's protection, of the Republic of Ireland, or of India or any part of India as it applies in relation to any emoluments, pension or annuity payable by or through any public department, officer or agent of the Government of any part of Her Majesty's dominions.

4. The preceding provisions of this Schedule are without prejudice to any other provision of this Act directing tax to be charged under this Schedule, and tax so directed to be charged shall be charged accordingly.

5. The provisions set out in the Ninth Schedule to this Act shall apply in relation Schedule E."

3 above is instructive. Why should it cover only emoluments paid to an employee, past or present, if they would still be taxable if paid to a third party? It was the clear intention of Parliament that sums paid to a third party would not be emoluments. Otherwise, there would have been a gaping hole in the provisions.

The Ninth Schedule (Rules Applicable to Schedule E) is even more instructive. Paragraphs 1 to 4 provided machinery for estimated assessments and for corrections if the estimates proved to be wrong. They provided:

"1. Tax under Schedule E shall be annually charged on every person having or exercising an office or employment of profit mentioned in Schedule E, or to whom any annuity, pension or stipend chargeable under that Schedule is payable, in respect of all salaries, fees, wages, perquisites or profits whatsoever therefrom for the year of assessment, after deducting the amount of duties or other sums payable or chargeable on the same by virtue of any Act of Parliament, where the same have been really and bona fide paid and borne by the party to be charged.

2. Every assessment shall be made for one year, and the tax in respect thereof shall be levied for that year without any new assessment, notwithstanding any change in the holder of any office or employment; but if, during the year of assessment, any person chargeable quits the office or employment, or dies, he, or his executors or administrators, respectively, shall be liable for tax in respect of the period during which he held or exercised the office or employment, and any successor shall in like manner be liable in respect of the period during which he has held or exercised the same.

3. If an annuity, pension or stipend ceases within the year of assessment, the assessment thereon shall be discharged as from the date of cessation.

4. (1) If, at any time, either during the year of assessment or in respect of that year, a person becomes entitled to any additional salary, fees or emoluments beyond the amount for which an assessment has been made upon him, or for which at the commencement of that year he was liable to be charged, an additional assessment shall, as often as the case may require, be made upon him in respect of any such additional salary, fees or emoluments, so that he may be charged in respect of the full amount of his salary, fees or emoluments for that year.

(2) If any person proves to the satisfaction of the Commissioners concerned that the amount for which an assessment has been made in respect of his salary, fees or emoluments for any year of assessment exceeds the amount of the salary, fees or emoluments for that year, the assessment shall be adjusted and any amount overpaid by way of tax shall be repaid."

It is clear from 4(1) that Parliament again presupposed that they only relevant "salary, fees or emoluments" were those to which the employee became entitled and that those alone were "his" "salary, fees or emoluments". That is completely inconsistent with the decision of the Supreme Court in Rangers.

3.1.3 The Legislation Considered by the Supreme Court[9]

Lord Hodge stated correctly:

"6. [Income and Corporation Taxes Act 1988] was replaced by the Income Tax (Earnings and Pensions) Act 2003 which governs RFC's liability to income tax on employment income during the relevant tax years from 2003/04 to 2008/09. Section 6 of that Act imposes a tax on employment income, which so far as relevant is on "general earnings". Section 7 defines "general earnings" by reference to section 62 which, so far as relevant, provides:

"(2) … '[E]arnings', in relation to an employment, means –

9 I discuss this only in terms of Lord Hodge's comments on Income Tax (Earnings and Pensions) A ct 2003. There is no material difference, mutatis mutandis, between those and his comments Income and Corporation Taxes Act 1988.

(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."

4. Statutory Construction

After mentioning at paragraphs 10 -14 in a section headed "The interpretation of tax legislation", some unexceptionable principles of statutory construction. Lord Hodge then continued:

"15. In summary, three aspects of statutory interpretation are important in determining this appeal. First, the tax code is not a seamless garment. As a result provisions imposing specific tax charges do not necessarily militate against the existence of a more general charge to tax which may have priority over and supersede or qualify the specific charge. I return to this point towards the end of this judgment (paras 68-72 below). Secondly, it is necessary to pay close attention to the statutory wording and not be distracted by judicial glosses[10] which have enabled the courts properly to apply the statutory words in other factual contexts. Thirdly, the courts must now adopt a purposive approach to the interpretation of the taxing provisions and identify and analyse the relevant facts accordingly."

Lord Hodge's first point is fine provided one emphasises "not necessarily". An interpretation of a more general charge which renders redundant a more specific and later charge is unlikely to be the correct one.

While Lord Hodge's second point is sound, the irony is that what the Supreme Court has done in this case is to place its own judicial gloss on the meaning of the legislation and one which runs counter to what had always been the common understanding of its plain meaning until this case reached the Court of Session Inner House). That, if nothing else, should have caused them to pause to consider whether they may in fact have been plumb wrong.

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10 A "gloss" is an explanation of the meaning of a text, traditionally inserted in the margin of a manuscript of the text. Students of ancient languages will know how, when texts were copied by hand, it sometimes happened that the gloss in one manuscript was by accident copied as part of the text in another.

Third, a purposive approach is indeed required where that would conflict with a purely literal approach. Yet that does not give judges carte blanche to decide a priore what the purpose of a statute was and then to give it an interpretation which conforms with that presupposition. As Peter Gibson J stated in the Court of Appeal in *Marshall v Kerr* [1993] STC 354 at page 366, in a passage approved by the House of Lords in the same case:

> "Of course if the policy of the Act or the purposes of the statutory fiction can be ascertained from the wording of the Act, it is permissible in construing the Act to adopt a purposive approach to try to give a meaning that accords with that policy or those purposes. But as [the judge at first instance] recognised …, it is only too often that the purposes of a fiscal provision are not apparent, and there is a real danger that if a court in every case feels bound to commence its construction of a statutory provision by finding that purpose, it will make a self-fulfilling assumption of what the purpose is."

5. The Issues in the Supreme Court

In a section headed "The basis of this appeal" Lord Hodge set out his understanding of the decision of Court of Session and the contentions of the parties on appeal to the Supreme Court.

I set out relevant parts of it:

"33. HMRC succeeded in its appeal before the Inner House on the basis that income, which is derived from an employee's work qua employee, is an emolument or earnings, and that it is assessable to income tax, even if the employee requests or agrees that it be redirected to a third party. The Inner House held that the scheme, which involved payments into the Principal Trust and the application of the funds through the sub-trusts, amounted to a redirection of the employee's earnings and did not remove the employer's liability to pay income tax under the PAYE system. It held that the redirection occurred when the employing company paid the sums to the Principal Trust; the fact that the employee took the risk that the trustee would not apply the funds as he requested was irrelevant. The payments by the employing company into the Principal Trust were derived from the employee's work as an employee and so were emoluments or earnings."

So Lord Hodge starts off with a basic confusion between two quite separate concepts: (1) a supposed derivation principle and (2) the redirection principle.

It is hardly surprising that with such an inauspicious beginning, the judgment goes very badly wrong.

"34. RFC challenges this conclusion. Andrew Thornhill QC submits on its behalf that the Inner House erred in applying what it called "the redirection principle" in the circumstances of this case. In essence, he asserts that it is not sufficient that the payment of money arises from the performance of the duties of an employment. The payment of money so arising to a third party does not amount to the payment of earnings or emoluments unless the employee already has a legal right to receive the payment and it is paid at his direction to a third party. He submits that the employing companies did not incur liability to pay income tax or NICs because the employees of the Murray group companies never had a right to receive the sums which were paid into the trust mechanism. An employee received only a loan from the trustee of the relevant sub-trust and that loan did not fall within the PAYE system."

As will be seen, in my view, that submission was impeccable in law.

6. The Decision

Lord Hodge continued:

"36. The central issue in this appeal is whether it is necessary that the employee himself or herself should receive, or at least be entitled to receive, the remuneration for his or her work in order for that reward to amount to taxable emoluments."

Agreed. So a certain amount of what Lord Hodge had said when setting out the facts was strictly irrelevant.

"37. A careful examination of the provisions of the primary legislation reveals no such requirement. First, section 13 of Income Tax (Earnings and Pensions) Act 2003 defines "the taxable person" who is liable for any tax on employment income. Subsection (2) of that section provides: "If the tax is on general earnings, the 'taxable person' is the person to whose employment the earnings relate." The employee, whose work gives rise to the remuneration, is taxed, not the recipient of the earnings. This is consistent with the prior history of the tax charge under Schedule E which, as RFC acknowledged in its written case, made the employee the taxable person even if the emoluments were received by a third party."

First, if RFC really did make that admission, it was one which should never have been made. I find it virtually inconceivable that Counsel for RFC could have done so. I suspect that Lord Hodge must have misunderstood what was conceded in the written case. If that is the case, then the whole decision is based on a perceived concession and of zero authority in cases where taxpayers have the good sense not to make a like concession.

Second, no one doubts that if there are general earnings, the tax charge in respect of them is on the employee. The whole question is whether a sum paid to a third party, otherwise at the direction of the employee, is earnings at all. This question is not addressed.

Third, as shown above, the history of the primary legislation was not fully considered. In particular Income Tax Act 1951 was apparently not cited, vital though it was. Again, it appears that the Supreme Court decided the case on a false basis, which completely removes any authority the decision might otherwise have.

> "38. Secondly, the provisions of ICTA and Income Tax (Earnings and Pensions) Act 2003, to which I have referred in paras 5 and 6 above, with one exception, do not restrict the concept of emoluments by requiring their payment to a specific recipient. Section 131 of ICTA and section 62(2) of Income Tax (Earnings and Pensions) Act 2003 define taxable emoluments, but, other than section 62(2)(b) which I discuss in para 45 below, do not specify the recipient. Section 202A of ICTA, which established the receipts basis of the tax charge, spoke of "the emoluments received in the year" without specifying the recipient and section 202B spoke of "the time when a person becomes entitled to payment of or on account of the emoluments" (emphasis added). Section 18 of Income Tax (Earnings and Pensions) Act 2003, which sets out rules as to when money earnings are received is similarly unspecific as to the identity of the recipient. It provides:
>
> > "(1) General earnings consisting of money are to be treated for the purposes of this Chapter as received at the earliest of the following times -
> >
> > Rule 1
> >
> > The time when payment is made of or on account of the earnings.
> >
> > Rule 2
> >
> > The time when a person becomes entitled to payment of or on account of the earnings."
> >
> > …

Section 686 of Income Tax (Earnings and Pensions) Act 2003 contains the same rules for the purposes of the PAYE Regulations. Section 203A of ICTA used a similar formulation in the context of the PAYE regime. Section 203 of ICTA, like the other provisions which I have mentioned, was silent as to the identity of the recipient."

The legislation did not need to specify that the employee was chargeable only on sums payable to him or at his direction. For most of the period from 1842 to 2003, the United Kingdom was a civilisation which rested on Judaic-Christian principles. It would have been immoral and manifestly unjust to tax a person on a benefit he had not received and had never been entitled to receive. That the recipient had to be the employee or a person to whom he had directed payment did not need to be spelled out. As we have seen, a consideration of Income Tax Act 1952 shows that was Parliament's understanding too. It is therefore hardly surprising that over a century of judicial decisions, until the decision of the Court of Session Inner House in this case, proceeded on the basis that this requirement was implied as it was so obvious.

"39. I see nothing in the wider purpose of the legislation, which taxes remuneration from employment, which excludes from the tax charge or the PAYE regime remuneration which the employee is entitled to have paid to a third party. Thus, if an employee enters into a contract or contracts with an employer which provide that he will receive a salary of £X and that as part of his remuneration the employer will also pay £Y to the employee's spouse or aunt Agatha, I can ascertain no statutory purpose for taxing the former but not the latter. The breadth of the wording of the tax charge and the absence of any restrictive wording in the primary legislation, do not give any support for inferring an intention to exclude from the tax charge such a payment to a third party which the employer and employee have agreed as part of the employee's entitlement. Both sums involve the payment of remuneration for the employee's work as an employee."

I have some measure of sympathy with Lord Hodge at this point, even though I cannot accept all of his reasoning.[11] I can at least understand how, where an employer offers to pay an employee a salary of £X + Y p.a. and it is the employee who stipulates instead that he is to receive only £X but £Y is to be paid to a third party for their own use and benefit, it might be considered, authority apart, that the £Y would form part of the earnings of the employee.[12]

Yet it is one thing to stipulate for a payment to a third party for their own use and benefit and quite another to stipulate for a payment to an employee benefit trust under which beneficial ownership is held in suspense.

Further, it is clear from the statement of the facts (see above) that even footballers did not have the option of contracting to take the entire cash sum.

Further still, this can have no application to the so-called "discretionary bonuses".

After considering delegated legislation (which throws no light on the question), Lord Hodge continued:

"41. As a general rule, therefore, the charge to tax on employment income extends to money that the employee is entitled to have paid as his or her remuneration whether it is paid to the employee or a third party."

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11 E.g. that the payment made to the third party is indeed "remuneration", which to my mind involves begging the question.

12 It would entail the consequence that the Optional Remuneration Provisions contained in Finance Act 2017 are entirely redundant but interpreting taxing legislation in such a way as to make whole swathes of it redundant does not appear to upset Lord Hodge, as it would have upset every previous generation of judges.

The conclusion is not warranted by the (very slim) argument. And it again begs the whole question what is "remuneration". Moreover, it does not cover those case where the employee is not entitled to have the money paid to the third party. That, of course, was the case at least with the "discretionary bonuses" in respect of non-footballers and was apparently the case with at least some of the footballers.

> "[Para 41. continued] The legislation does not require that the employee receive the money; a third party, including a trustee, may receive it. W hile that is a general rule, not every payment by an employer to a third party falls within the tax charge. It is necessary to consider other circumstances revealed in case law and in statutory provisions which fall outside the general rule. Those circumstances include: (i) the taxation of perquisites, at least since the enactment of Income Tax (Earnings and Pensions) Act 2003, (ii) where the employer uses the money to give a benefit in kind which is not earnings or emoluments, and (iii) an arrangement by which the employer's payment does not give the intended recipient an immediate vested beneficial interest but only a contingent interest. As I shall seek to show, in the first circumstance, current legislation requires receipt by the employee; in the second circumstance, there are special rules for the taxation of such benefits; and, in the third circumstance, where on a proper analysis of the facts there is only a contingent right, the taxable earnings or emoluments are not paid by the employer as remuneration until the occurrence of the contingency".

42. The first such circumstance is the taxation of "perquisites and profits" or, in the updated wording of Income Tax (Earnings and Pensions) Act 2003, "any gratuity or other profit or incidental benefit". Section 131 of ICTA spoke of "perquisites and profits". While in colloquial usage a "perk" may take many forms, judicial interpretation of tax legislation has long required that the perquisite be capable of being converted into money in order to fall within the tax net under this provision. … [He then discussed *Tennant v Smith* [1892] AC 150, *Abbott v Philbin* [1961] AC 352 and *Heaton v Bell* [1970] AC 728.]

…

45. These judicial decisions gained statutory expression in section 62 of Income Tax (Earnings and Pensions) Act 2003 which in subsection (2)(b) provides that earnings include "any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth" and defines "money's worth" in subsection (3) which looks to the monetary value of the thing "to the employee" (para 6 above). Thus, in contrast with the more open definitions of earnings in section 62(2)(a) and (c) ("salary, wages or fee" and "anything else that constitutes an emolument of the employment"), Parliament has required that the benefit be obtained by the employee and that it is or is capable of being converted into money or something of direct monetary value to the employee. The Notes on Technical Points, which were annexed to the Bill which became Income Tax (Earnings and Pensions) Act 2003, described subsection 2(b) as a

"significant departure" in contrast with the continuity between the statutory concepts of "emoluments" and "earnings" (Annex 2, note 13). Section 62(2)(b) and (3) were intended to be the modern equivalent of the prior statutory reference to "perquisites and profits whatsoever". It is not clear in principle why such benefits should be restricted to those which are received by and of value to the employee when the other forms of employment earnings are not."

In this last sentence, Lord Hodge has given the game away. There is absolutely no rhyme or reason why amounts paid to third parties (other than at the direction of the employee) can be "salary wages or fee" whereas (other) perquisites should be taxable only if received by the employee. Judges should not be imputing to Parliament an intention to make a distinction which is entirely bereft of logic. It is only by holding, as had all decisions prior to this case, that all forms of general earnings (or, in old speak "emoluments") need to be paid to the employee that consistency and rationality are achieved.

This so-called exception to the rule of Lord Hodge is highly relevant to the so called "discretionary bonuses" and those payments made to the employee benefit trust where the employee in question had no right to require them to be made. They were clearly not "salary, wages or fee" within Income Tax (Earnings and Pensions) Act 2003 section 62(2)(a) but were at the most "any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth" within section 62(2)(b). Hence, in holding that there was a liability to income tax of those employees too, Lord Hodge was failing properly to apply his own test. That further greatly undermines the authority of the decision.

"46. A second circumstance, which falls outside the general rule, is where the employer spends money to confer a benefit in kind which the recipient cannot convert into money. Such expenditure is not a perquisite or profit, gratuity or incidental benefit for the reasons discussed above and only falls within the income tax regime because of special statutory provision, such as, currently, the "benefits code" in Part 3 chapters 2-11 of Income Tax (Earnings and Pensions) Act 2003, which cover among others the provision of living accommodation, cars or loans and the payment of expenses. Part 7 of Income Tax (Earnings and Pensions) Act 2003 also has special rules for shares etc acquired in connection with an employment, and Part 6 of that Act is concerned with income which is not earnings or share-related.

Again, in the case of so called "discretionary bonuses" and those payments made to the employee benefit trust where the employee in question had no right to require them to be made, could be taxable under the benefits code as it was impossible to show what expense had been incurred by the employee in conferring any particular benefit.

"47. A third circumstance is where the person entitled to receive the sums paid by the employer does not acquire a vested right in those sums until the occurrence of a contingency. This circumstance is illustrated by the case of

Edwards v Roberts (1935) 19 TC 618, in which an employing company entered into an employment contract to give an employee, in addition to his salary, an interest in a "conditional fund", into which it would make annual payments from its profits, as an incentive for him to advance the company's interests. The employee was entitled to receive the annual income from the fund but had no right to receive any of the capital of the fund other than that which had been held in the fund for five years or more. The contract provided that he would receive the whole fund if he died while still employed by the company or on termination of his employment by the company in specified circumstances. But the contract also provided that the employee would cease to have any right in the conditional fund in circumstances which included his dismissal for misconduct. The trustees of the fund handed over to the employee the investments in the fund when he later resigned with the consent of the company. The employee argued that the sums which the company had paid into the conditional fund formed part of his emoluments in each of the years in which they were paid into the fund. But the Court of Appeal (Lord Hanworth M R, Romer and Maugham LJJ) held that those sums did not constitute his emoluments in those years because he had only a conditional interest in them; instead the value of the investments transferred to him after his resignation were his emoluments in the tax year in which they were transferred to him. The payments in that year reflected his status as an employee at the time when the contingency was fulfilled. In that case the court distinguished the case of *Smyth v Stretton* (1904) 5 TC 36, in which Channell J had construed an employer's scheme, which provided for payments into a provident fund for payment to employees on their retirement, as providing for an agreed application of part of the employee's salary and held that the payments into the fund were therefore taxable as emoluments for services provided in the year of payment into the fund.

48. The recent judgment of this court in *Forde and McHugh Ltd v Revenue and Customs Comrs* [2014] 1 WLR 810, which turned on the wording of provisions in the Social Security Contributions and Benefits Act 1992, is consistent with the approach in *Edwards v Roberts* in holding that sums paid by an employer, other than out of an employee's salary, which were to provide contingent benefits to an employee, did not fall within the charge to NICs on earnings before the occurrence of the contingency and the payment of the benefits. Otherwise, on HMRC's approach to the legislation in question, liability to pay NICs on earnings would have arisen both on payment of sums into the trust and on the later payments of the benefits (if any) from it. Mr Thornhill founds on the case, and in particular on its emphasis in para 17 of the judgment on what the employee received, to support his submission that the payment of remuneration cannot be the payment of emoluments unless the employee is entitled to receive it. But *Forde and McHugh Ltd* was not concerned with the payment of an employee's remuneration to a third party or the provision of that money to the employee without the interposition of any contingency. What the court said in para 17 of that case should be read in its context, which involved

(a) the conferring of only a contingent benefit on the employee and (b) (if HMRC had been correct in their submission) the imposition of a double charge, levied both on the settlement of funds on to the pension trust and on receipt of the deferred remuneration from it. The case did not create or support the principle for which Mr Thornhill contends."

This way in which Lord Hodge deals with two highly important decisions, one a very recent decision of the Supreme Court, is almost unbelievable. In each case the employee had the contractual right to have money paid by his employer, in respect of his employment to a trust under which he was entitled to valuable contingent but indefeasible interest. His position was stronger than that of even the worst case scenario in Rangers, as the employees were merely discretionary beneficiaries.

If the alleged general rule laid down by Lord Hodge were correct, these cases would have been decided the other way. They cannot be explained as an exception to the basic rule. There is nothing in the statutory provisions which could possibly justify holding that there was such an exception. Further, an exception which extended to payments to a trust under which the employee had indefeasible rights which does not also cover payments to a trust under which the employee does not have any such right but is merely an object of discretion makes no sense at all. One would require express statutory language to enact the one but not the other.

"49. In summary, the statutory provision for the taxation of what were in the past called "perquisites and profits", namely section 62(2)(b) of Income Tax (Earnings and Pensions) Act 2003, has confined the tax charge to benefits received by the employee. But there is no such restriction in section 62(2)(a) or (c). In none of the cases, which I have mentioned in paras 42-44, 47 and 48 and on which RFC relies, was the court concerned with the identity of the recipient of the benefit. The focus in each was on the source or the nature of the right which the employee received. Accordingly, the cases do not assist in determining the issue on this appeal."

If a payment to a third party trustee involved a charge to tax on an employee in respect of whom it was made, it would have been quite unnecessary to focus on what the employee in fact received. The only reason the courts in the earlier cases did so focus was because they were clearly of the opinion that payment to a trustee per se was not enough.

At para 50, Lord Hodge considered the advice of the Privy Council in *Hadlee v Comr of Inland Revenue* [1993] AC 524. *Hadle*e, whether right or wrong, was based on a very differently worded New Zealand statute, which gave some credence to a destination principle being in operation, and was fought on very narrow grounds indeed.

Lord Hodge's summary was:

"58. In summary,

(i) income tax on emoluments or earnings is due on money paid as a reward or remuneration for the exertions of the employee;

(ii) focusing on the statutory wording, neither section 131 of ICTA nor section 62(2)(a) or (c) of Income Tax (Earnings And Pensions) Act 2003, nor the other provisions of Income Tax (Earnings And Pensions) Act 2003 which I have quoted (except section 62(2)(b)), provide that the employee himself or herself must receive the remuneration;

(iii) in this context the references to making a relevant payment "to an employee" or "other payee" in the PAYE Regulations fall to be construed as payment either to the employee or to the person to whom the payment is made with the agreement or acquiescence of the employee or as arranged by the employee, for example by assignation or assignment;

(iv) the specific statutory rule governing gratuities, profits and incidental benefits in section 62(2)(b) of Income Tax (Earnings and Pensions) Act 2003applies only to such benefits;

(v) the cases, to which I have referred above, other than *Hadlee*, do not address the question of the taxability of remuneration paid to a third party;

(vi) Hadlee supports the view which I have reached; and

(vii) the special commissioners in *Sempra Metals* (and in *Dextra*) were presented with arguments that misapplied the gloss in *Garforth* and erred in adopting the gloss as a principle so as to exclude the payment of emoluments to a third party."

7. How can one ensure the Decision does not apply?

Bear in mind Income Tax (Earnings and Pensions) Act 2003 Part 7A especially section 554B (earmarking relevant step).

There must be no contractual right for employee to have contribution made to employee benefit trust.

Make contribution to Sub-Fund of employee benefit trust with sufficiently wide class of beneficiaries. This will almost certainly need a Sub-Fund to satisfy accountancy rules.

Do not give the employee a choice between taking cash or having a contribution made to an employee benefit trust.

Try to ensure that a specific contribution (or a specific part of a contribution) is not linked to a specific employee.