HOUSE OF LORDS SPRING OFFSIDE TRAP

An Analysis of the Case of *Shilton v Wilmshurst*

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Background

In the summer of 1982, Nottingham Forest FC were under severe financial pressure. In order to relieve that pressure, the club had to sell one of its players. Southampton FC made an offer for the international goalkeeper, Peter Shilton. A deal was negotiated between the two clubs while the player was on holiday. However, Shilton had at the time a particularly strong bargaining position. When his contract expired (about one year later) then, due to his age, the rules of the Football League would have allowed him a "free transfer". This would mean that he could negotiate his own terms with a transferee club, and Nottingham would receive no transfer fee. Southampton were offering Nottingham a transfer fee of £325,000 for Shilton's immediate transfer. In order to induce Shilton to transfer to Southampton, Nottingham agreed to pay him £75,000. Incidentally, he was also to receive an £80,000 inducement payment from Southampton. The Revenue sought to tax the whole of the £75,000 payment as an emolument from Shilton's employment with *Southampton*. It was accepted that if the payment was not so taxable, it was caught by s.187 TA 1970 (now s.148 TA 1988) as it was paid "in connection with" the termination of his employment with Nottingham.

Finding of Fact

The General Commissioners found against the taxpayer. The crucial finding of fact is (j) at [1988] STC 870h:-

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> "(j) The payment by Nottingham Forest to the taxpayer was an inducement to him to play football for Southampton and as such an emolument flowing from that service which he was to render to Southampton".

In the Higher Courts, it was agreed on both sides that the phrase "an inducement to him to play football for Southampton" meant "an inducement to him to enter into a contract of employment with Southampton". This finding of fact forced the taxpayer to argue the case in the Higher Courts on a very narrow basis. It could have been argued, with some force, that the £75,000 payment derived not from the taxpayer's employment but from his rights under the Football League rules. These were rights which the taxpayer was effectively surrendering by agreeing to enter into another contract of employment. However, the case was not argued in that way before the General Commissioners. Indeed, it is recorded in the Case Stated, at 871j, that it was the taxpayer's contention that:

> "(9) The case of *Jarrold (Inspector of Taxes) v Boustead* [1964] 1 WLR 1357 was not comparable with the present case as in that case the payment received by the taxpayer was in consideration of his giving up his amateur status, i.e., a payment for the permanent loss of amateur status".

This would appear to be an express disavowal of the argument that the payment derived from "something else" other than employment.

High Court and Court of Appeal

The taxpayer's argument, in the Courts, turned on the meaning of the word "employment" in s.181 TA 1970. "Employment", it was argued, did not simply mean "contract of employment". In fact it referred to the relationship of employer/employee. The payment by Nottingham could not be said to be derived from the employment relationship between the taxpayer and Southampton. This is because the payment was made simply to induce the taxpayer to enter into a contract of employment with Southampton and did not relate in any way to the way in which that contract was performed. Thus, in the High Court, Morritt J concluded his judgment, at [1988] STC 878a, by saying:-

> "But in this case Nottingham Forest were only concerned that the taxpayer should enter into a contract of employment with Southampton in order that Nottingham Forest should obtain the agreed transfer from Southampton. Therefore Nottingham Forest had no concern or interest direct or indirect in the performance of that contract.
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> In my judgment, in those circumstances the payment by Nottingham Forest to the taxpayer was not as the Commissioners concluded `an emolument flowing from that service which he was to render to Southampton' nor was it an emolument from his employment by or with Southampton within the meaning of s.181(1) TA 1970".

The taxpayer's argument was also accepted by the Court of Appeal. The Vice-Chancellor (Sir Nicholas Browne-Wilkinson) analysed the authorities in this way:-

> "In order for an emolument to fall within the words of s.181 as being "from" employment, it is not essential that the payment is received

> by way of reward or remuneration for services past, present or future. However the receipt of such a payment by way of reward for services is the paradigm of a taxable receipt: such a case provides valuable guidance to the meaning of the statutory words. The essence of a payment which is a reward for services is that it relates to the performance of the contract by the rendering of services, not merely to the existence of the contract of employment. *Hamblett v Godfrey* shows that other types of payment made by an employer to an employee may equally refer to the performance of the contract of employment. But this represents no departure from the essential characteristic required to make such payments an emolument "from" the employment, namely that they are referable to the performance of the services under the relevant contract of employment and nothing else".[2]

The other judgment was given by Staughton LJ. He was even clearer than the Vice-Chancellor in his interpretation of s.181(1):-

> "In my judgement those cases show where the frontier lies. If a payment is *not* made for being an employee, or does not arise from the existence of the employer-employee relationship, it is not an emolument from the employment. Specifically, I would hold that a payment made to induce a person to accept an office or enter into a contract of employment is not on that ground alone an emolument from the office or employment.
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> One can, I think, extract that conclusion from the language of the statute itself. Employment normally means the state or condition of a person who provides services to another for reward; it may some times mean the appointment or engagement of a person, but that is to my mind a rarer meaning".

Unfortunately, the Crown was granted leave to appeal to the House of Lords.

House of Lords

The approach of their Lordships was, from the outset, very different from that of the High Court or Court of Appeal. Their first question was what is the `something else' in this case?" They were not convinced by the argument which had found favour below. It was plain in argument that their concern was "channelling" of inducement payments from the transferee club via the transferor club, despite the caveat expressed by the Vice-Chancellor at [1990] 1 WLR 382 B-C:-

> "It was not suggested by the Crown in this case that there was an arrangement between Southampton and Nottingham Forest that Nottingham Forest, rather than Southampton, should make the payment of £75,000 to the taxpayer so as to give him the benefit of tax reliefs. If such an arrangement had existed the taxpayer would have received the payment as additional remuneration indirectly from Southampton, the employer, and as such it would have been taxable in just the same way as the £80,000 paid by Southampton to

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[2] [1990] 1 WLR 373, 381 E-G.

> the taxpayer as a signing on fee. In my judgment our decision in this case does not open the gate to the avoidance of tax by transferring the burden of the signing on fee from the transferee club to the transferor club".

Although there was no arrangement, Lord Templeman hinted at the reasons behind the decision at [1991] 2 WLR 538B:-

> "Indirectly, the whole of the £155,000 can be said to have been provided by Southampton. On the transfer of Mr. Shilton there will be shown in the account of Nottingham Forest the receipt of the net sum of £250,000 from the transfer. Nottingham Forest received £325,000 from Southampton and were enabled to pay £75,000 to Mr. Shilton leaving them with £250,000".

Lord Templeman's reasoning (at p.533) is something of a trick with mirrors. First, he states:-

> "S.181 is not confined to `emoluments from the employer' but embraces all `emoluments from employment' the section must therefore comprehend an emolument provided by a third party".

This is, of course, correct and it was never the taxpayer's case that emoluments had to derive from the employer in order to be taxable under s.181. Despite Lord Templeman's assertion to the contrary that pp.536B. Lord Templeman then continues:-

> "S.181 is not limited to emoluments provided in the course of employment; the section must therefore apply first to an emolument which is paid as a reward for past services and as an inducement to continue to perform services and, secondly, to an emolument which is paid as an inducement to enter into a contract of employment and to perform services in the future".

This is the logical flaw. Lord Templeman reasons that because s.181 can charge emoluments provided by third parties, as well as employers, it *must* cover any payment to induce someone to enter into a contract of employment. This rejects the reasoning of the Court of Appeal without addressing the issues at all. The reasons for Lord Templeman's view are to be found on p.537 D-E. These are:-

(i) there is nothing in s.181 or in the authorities to justify the CA's reasoning; and

(ii) there would be difficulty in defining what is meant by "interest".

However, in answer to (i), s.181 and the decided cases are just as consistent with the reasoning of the Court of Appeal as with that of Lord Templeman, and as to (ii), the argument of the Court of Appeal and the taxpayer is more sophisticated than simply relying on a test of "interest" in the performance of services. Fundamentally, one is asking whether the payment in question derives from the employment relationship.

Conclusion

Despite certain weaknesses in the reasoning in the House of Lords, there is no doubt that the test under s.19 TA 1988 is now whether the payment is made for "being or becoming an employee" or for something else. The Revenue apparently hold the view that *Shilton* has radically altered the status of cases such as *Jarrold v Boustead* [1964] 41 TC 701 and *Pritchard v Arundale* [1972] Ch 229. It is clear, however, that one still must ask whether an emolument derives from the employment or from "something else" in the sense described in *Laidler v Perry* [1966] AC 16. *Pritchard v Arundale* was considered in *Shilton* (at p.536). Although the second strand of reasoning (the requirement of reference to services) was rejected by the House of Lords, no doubt was cast on the correctness of the first ground of decision. The House of Lords judgment in *Shilton* does not attempt to classify situations in which a payment is derived from "something else". This is not surprising as *Shilton* was not argued on that basis.

In future, third parties who make payments to induce someone to become an employee must carefully consider exactly why they are making the payment. It may be that the true reason for the payment is not to induce the employee to enter into the contract of employment. If that is the case then obviously this should be made clear in the agreement under which the payment is made.