[2016] UKFTT 125 (TC)

TC04913

Appeal number: TC/2014/06477 and TC/2014/06478

Income tax – payment to third party – earnings – whether "from" employment – Section 62 ITEPA 2003 – yes – NIC payable – yes – appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

(1) STEPHEN WILLEY **First Appellant**
and
(2) NORTH EAST PIPELINES LIMITED **Second Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE ANNE SCOTT
MEMBER: MOHAMMED FAROOQ

Sitting in public at Kings Court, Earl Way, North Shields on Tuesday 9 February 2016

Emma Glover, Rowlands, Accountants, for the Appellant

Joanna Bartup, Presenting Officer, HMRC, for the Respondents

DECISION

Background

1. On 23 March 2015 the Tribunal issued a Direction that the appeals of Stephen Willey ("Mr Willey") and North East Pipelines Limited ("NEP") proceed together and be heard together by the same Tribunal. Since the appeals are inextricably linked we have decided to issue a joint decision.

2. The appeal for Mr Willey is in respect of a Notice of Assessment for the year ended 5 April 2011 for additional Income Tax due in the sum of £33,025.32 dated 24 April 2014. The appeal for NEP is in respect of a decision in regard to primary and secondary Class 1 National Insurance Contributions for the period 6 April 2010 to 5 April 2011 relating to the earnings of Mr Willey and that in the sum of £14,173.87 and is dated 17 April 2014. Both appeals relate to a payment of £75,000 paid by NEP to HSBC Bank PLC ("HSBC") in that tax year.

3. The appellant has offered a compromise of withdrawal of the claim for Corporation Tax Relief but that was denied by HMRC on the basis that whilst HMRC argue that it is not a deduction under Section 307 Corporation Tax Act 2009 ("CTA") it would be allowable as a payment made under Section 62 Income Tax (Earnings and Pensions) Act 2003 ("ITEPA 2003").

4. The appellant had also asked for use of the Alternative Dispute Resolution process and that too was denied. In regard to the latter point we observe that Rule 3 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 states that Alternative Dispute Resolution is only appropriate where both parties wish to facilitate the use of the procedures. We have no jurisdiction to insist thereon.

5. Accordingly, the substantive appeals proceed.

Agreed background facts

6. The parties agreed that the following facts are not disputed and that in the following terms:-

> "1. Mr Willey is a director and 100% shareholder of NEP Ltd.
>
> 2. An enquiry into the company tax return of NEP for the APE 30 September 2011 commenced on 20 July 2012.
>
> 3. The company accounts contained an entry for "Goodwill" amounting to £75,000. HMRC were advised by the company's accountant, Rowlands, that the goodwill was a *'payment to the bank to release a trading covenant'* and that *'the directors decided to write-off the goodwill over two years as they believed that it had no value after 2 years'*.
>
> 4. A 'Deed of Settlement and Release' between HSBC and Mr Willey was subsequently provided which explained the following:-

(a) On 24 August 2007 Mr Willey entered into a legal mortgage, the subject of the mortgage being a property owned by Mr Willey. On the same date Mr Willey and Mr Andrew Powell signed a deed of guarantee on a joint and several basis in favour of HSBC in respect of the indebtedness of S A Utilities Ltd.

(b) On 21 January 2008, to secure the debt of S A Utilities Limited, Mr Willey entered into a further legal mortgage, the subject being another property owned by Mr Willey.

(c) The payment of £75,000 was in fact made to HSBC to release Mr Willey from the above guarantee and the legal charges over the two properties.

7. S A Utilities Limited is a company of which Mr Willey was a director and 50% shareholder. Mr Andrew Powell was also a director and 50% shareholder. Administrators were appointed on 8 October 2008 and the company was dissolved on 27 March 2014.

8. The bank account of NEP Ltd shows payments of £50,000 and £25,000 to Marshall Glover Solicitors made on 2 December 2010 and 3 December 2010. The Solicitors subsequently transferred these amounts to HSBC.

9. NEP Ltd currently claim that the payment of £75,000 should be allowed as a trading deduction as a Loan Relationship under Section 307 CTA 2009.

10. HMRC do not accept that the amount qualifies as a deduction under Section 307(3)(c) CTA 2009 as it is not an expense '*incurred by the company under or for the purposes of those relationships and transactions*'."

11. The parties were of the view that minimal other evidence was needed yet both fact and law are stated to be in dispute. We therefore heard evidence from Mr Willey. Although there were inconsistences, we are very aware that he was not expecting our questions and it is a long time since the events in question. We found Mr Willey to be a clear and credible witness.

12. The actual position, as we find it, is far less straightforward than the agreed facts.

Our findings in fact

13. SA Utilities Limited ("SA") was a company which engaged in exactly the same type of business as NEP. In 2007, Mr Willey and Mr Powell had hoped to expand that company and for that they required further funding. In order to do so, Mr Willey and Mr Powell signed a Deed of Guarantee on a joint and several basis in favour of HSBC in respect of the indebtedness of SA. The size of that guarantee is unknown. At the same time, the bank required Mr Willey to enter into a second mortgage on his home Beechtrees in Northumberland. The guarantee and the mortgage on Beechtrees were both dated 24 August 2007.

14. HSBC subsequently sought, and obtained, a second mortgage on a flat which Mr Willey owned at Merchants Quay Close in Newcastle-upon-Tyne. Both properties

were owned by Mr Willey personally and there were "ordinary" mortgages extant. That second mortgage on Merchants Quay Close is dated 21 January 2008. Mr Willey has no recollection of paying any interest or making any repayments in regard to those two mortgages.

15. In early 2008 the financial climate had changed and a major customer defaulted on a substantial debt. It became clear that that was what might be described as a "body blow" to SA. Ultimately an administrator was appointed, as indicated above, on 8 October 2008 and by December 2008 in Mr Willey's words the company was effectively "dead". It did not trade again.

16. In the course of 2008 whilst dealing with these problems it had become increasingly apparent to Mr Willey that there were good contracts elsewhere in that sector and that he wished to continue his business, but without Mr Powell. Accordingly, NEP was incorporated and certainly by October 2008 Mr Willey owned the one and only share in the company and he was the only director. Miss Kay Kendall, his partner, was the company secretary. NEP commenced trading.

17. HSBC pursued both Mr Willey and Mr Powell. Both men separately employed an administrator (not the administrator of the company) to negotiate their positions. At the point at which SA failed it owed at least £250,000 to HSBC and, of course, there were other debts and Mr Willey told us that that included approximately £80,000 owed to each shareholder. He stated, and we accepted, that there was no prospect of a dividend for creditors.

18. In Mr Willey's case he was able to negotiate an exit route whereby the mortgages on his two properties were released and he was also released from the guarantee, all for a total consideration of £75,000.

19. At the time both his properties were perceived to be in negative equity or thereby.

20. Since that time his principal private residence, Beechtrees, which was also subject to another mortgage from a different mortgage lender, was sold in 2012 releasing approximately £30,000 of equity after payment of all debts. The property in Merchants Quay Close was sold in 2015 with positive equity.

21. It is clear from the terms of the HSBC documentation that HSBC had retained the right to pursue Mr Powell. Quite appropriately the details have not been disclosed. Mr Willey was clear that although a "deal" was done with HSBC, no definitive date for payment had been negotiated. However, we note that the Deed provides for immediate payment and payment was made on 2 and 3 December 2010 albeit the date of the Deed is indecipherable but appears to be December 2010. Those payments to Marshall Glover (see Agreed Fact 6) were described in the Business Current Account Statement for NEP as "From S Willey". By contrast another payment on 3 December 2010 was described as "From N E Pipelines".

22. In August 2010, NEP had negotiated a contract with a major water company on a rolling programme which was worth in excess of £1m in turnover each year for approximately five years. NEP was contracted to install new water mains based on

mains burst history. (In the years to 30 September 2009 and 30 September 2010, NEP had also had very good contracts since the turnover had been £1,124,623 and £1,634,883 respectively.)

23. The new contracts were based in Yorkshire and Mr Willey and his partner Miss Kendall decided that they wished to move to be closer to the work that was being undertaken. Mr Willey is, and was, of the view that agricultural property is a good long term investment, it has the attraction that there are no commercial rates payable and outbuildings provide comparatively secure storage for equipment which was attractive because of the prevalence of theft in the industry.

24. The farmhouse known as Manor Farm House was purchased by NEP in early 2011 for what the NEP accounts disclose as £1,287,897 for land and buildings. Of course in addition there was also plant and machinery and fittings and fixtures etc. After disposals that was at an additional cost of £323,111.

25. Although NEP was in a very healthy financial state at the end of the year ended 30 September 2010 (Mr Willey said it had been NEP's "best year") it did not have the funds to make such a major acquisition and a loan was negotiated from Barclays Bank PLC ("Barclays"). The total amount of the loan as recorded in the accounts appears to be £993,409. Mr Willey was very clear that there were, and are, no other borrowings by the company because it required none. Clearly there was a significant equity balance. From what we have seen NEP has always been profitable.

26. In point of fact, although Mr Willey told us that there was only a mortgage secured on that property, nevertheless we note from the productions from HMRC which we perused after the hearing, not having been referred to them, that on 20 April 2011 a debenture dated 11 April 2011 in favour of Barclays was recorded at Companies House and on 26 August 2011 a legal charge dated 19 August 2011 was also recorded.

27. HMRC have produced accounts and tax computations for the accounting periods (APE) to 30 September 2010 and 2011. They were in different formats, not easily comparable and we were not referred to them but almost all figures in this decision are derived therefrom. We note that in 2011 there had been a bonus issue of 199,000 shares to Mr Willey who thus owned 200,000 ordinary shares rather than one. In addition, Miss Kendall had been appointed as a director on 15 July 2011 in addition to being company secretary.

28. We noted that the Director's remuneration had been £2,886, £5,722 and £8,026 in the years 2009, 2010 and 2011 and that dividends of £59,500, £50,000 and £50,000 had been paid. We made it explicit to Mr Willey that we were unperturbed about extraction of funds from a company by way of dividend; our interest was in the available funds.

29. The shareholders' (*sic*) funds in the years from and including 2009 were £136,473, £448,840 and £558,946.

30. In 2011, Mr Willey had a director's loan of £61,036 which was repaid in full before the due date for payment of corporation tax of 29 June 2012; a dividend of £44,000 having been paid on 6 April 2012 and there had been other payments into the account. In 2010 he had had an interest free loan of £52,253. There was no loan in 2009.

31. Mr Willey stated that rent was paid to NEP for the farmhouse after the purchase and that all farming profits were reported in NEP. In APE 2011, rent (presumably from Mr Willey and Miss Kendall for the farmhouse) of £1,200 was paid to NEP.

32. It has repeatedly been stated by Rowlands that no documentation was available to confirm the position in regard to the negotiation of, or creation of, the loan from Barclays (sometimes, we assume erroneously, the reference in correspondence by both parties was to HSBC).

33. The only evidence produced was a letter obtained by Rowlands dated 5 September 2013 addressed "To Whom It May Concern" and which read:

> "Dear Sir
>
> **Re: North East Pipelines Limited – Loan Facility**
>
> We are able to confirm that the loan facility provided to North East Pipelines Limited in 2011 was sanctioned subject to Mr Stephen Willey, in his capacity as Director, providing a personal guarantee to cover the liabilities of North East Pipelines Limited to Barclays Bank PLC, limited to the sum of £100,000.
>
> In order for Mr Willey to be able to cover this new commitment he arranged to release himself from any prior obligations which were in place at that time, enabling him to ensure that he could honour this new responsibility going forward."

34. We also note that the copy of the limited guarantee for £100,000 which has been produced is a guarantee by both Mr Willey and Miss Kendall to Barclays Bank PLC "for the liabilities of this customer:- North East Pipelines Limited" and which very surprisingly is not dated.

35. As can be seen from Agreed Fact 3, the £75,000 payment was treated as goodwill in the accounts and written off after two years. However, on 9 January 2013, Rowlands wrote to HMRC in the following terms:

> "On reflection our accounting treatment should have shown the cost as an incidental cost of obtaining loan finance and not as goodwill, however, full relief is available under the loan relationship rules."

36. Mr Willey was very clear that he argued that all decisions, at all times, had been made in the company's best interests. Indeed, he suggested that sometimes that had been to his personal detriment.

The Law

37. Both parties relied upon Section 62(2)(b) ITEPA 2003. That section reads as follows:-

> "**62 Earnings**
>
> (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))."

The appellants' arguments

38. The Notice of Appeal to the Tribunal dated 28 November 2014 states the Grounds of Appeal which are:-

> "(a) Mr Willey had to be released from the HSBC obligation to be put in a position to provide a personal guarantee for the company's debt.
>
> (b) The payment by the company has provided no benefit or earnings to Mr Willey.
>
> (c) The payment did not derive from the employment."

Reference was also made to the appellants' accountants, Rowlands', letter of 18 August 2014. That letter references Section 62 ITEPA 2003 and stated that the payment was not a salary, wage or fee. The payment was made to raise finance.

39. It was also argued for the appellants that:-

(a) The £75,000 paid by NEP was a payment which was made <u>not</u> by reason of Mr Willey's employment. It was not "in relation to an employment". It was made by reason of the company raising new finance. Accordingly, Mr Willey should therefore not be charged with income tax on the £75,000.

(b) The £75,000 payment was not "earnings" under the National Insurance legislation. Accordingly, NEP is not liable to pay Class 1 NIC on that amount.

HMRC's arguments

40. The payment of £75,000 made by NEP was a payment of Mr Willey's pecuniary liability and should be treated as earnings under Section 62(2)(b) ITEPA 2003.

41. Payment was made to satisfy Mr Willey's personal debt. It was not a debt of NEP and NEP were under no obligation to make the payment. The payment is "money's worth" as it was of direct monetary value to Mr Willey.

42. The payment arises from Mr Willey's employment with NEP. As the then sole director he controlled NEP.

43. NEP are required to pay primary and secondary Class 1 NICs under Section 6 Social Security Contributions and Benefits Act 1992.

44. Whilst the appellants claim that the payment has provided no benefit or earnings to Mr Willey, HMRC do not accept this because as a result of the payment made by NEP, two mortgages on Mr Willey's personal properties have been settled.

45. The fact that it is alleged that Barclays required Mr Willey's existing mortgages to be settled in order for the assets to be used as security for new company loans does not alter the fact that the payment by NEP settled Mr Willey's pecuniary liability.

46. The payment was deliberately misrepresented in the accounts as "goodwill".

Onus of proof

47. It is not disputed that the standard of proof is the ordinary civil standard on the balance of probabilities.

48. The onus of proof rests with HMRC to show that the assessment under Section 29 Taxes Management Act 1970 ("TMA") can be made.

49. If HMRC establish that they can make an assessment and the legal basis for that assessment, the onus is then on Mr Willey to show that the amount of the assessment is incorrect.

50. The onus is on NEP to show that the decisions under Section 8 Social Security Contributions (Transfer of Functions, etc) Act 1999 are incorrect.

Discussion

Can the assessment be made?-Yes

51. It is not in dispute that Mr Willey filed his 2010/11 income tax self-assessment return on 16 August 2011 and that therefore under Section 9A TMA, HMRC had until 17 August 2012 to give notice of intention to enquire. At that date HMRC would not have known and could not have known about the £75,000 payment. Accordingly Section 29(5) TMA is satisfied and HMRC were enabled to raise an assessment. That

assessment was made within the ordinary time limit of four years as defined by Section 34 TMA.

Was the £75,000 "earnings"?

52. It was not disputed that the £75,000 was not a salary, wages or fee. Both parties were in agreement that the starting point is to ask whether or not the payment arose from the employment. The appellant relied on Upjohn J in *Hochstrasser v Mayes*[1] wherein Viscount Simmonds quoted with approval Upjohn J before whom the matter first came, stating that he had appeared to "sum up the law in a manner which cannot be improved upon" as follows:-

> "… the authorities show this, that it is a question to be answered in the light of the particular facts of every case whether or not a particular payment is or is not a profit arising from the employment…. not every payment made to an employee is necessarily made to him as a profit arising from his employment. Indeed, in my judgment, the authorities show that to be a profit arising from the employment, the payment must be made in reference to the services the employee renders by virtue of his office, and it must be something in the nature of a reward for services…".

53. Viscount Simmonds goes on to make it explicit that "it is for the Crown, seeking to tax the subject, to prove that the tax is exigible, not for the subject to prove that his case falls within the exceptions which are not expressed in the Statute but arbitrarily inferred from it".

54. On the facts of this particular case the primary question is whether or not the £75,000 is a reward for services and arises "from" Mr Willey's employment. We hesitate to use Latin phrases in Decisions but like Viscount Simmonds we had to decide whether the reason for the payment was the *causa causans* or the *causa sine qua non.* In plain English, why was the payment made by NEP?

55. We have absolutely no doubt that NEP and Mr Willey are well nigh indistinguishable. At all material times he has entirely controlled NEP. As a director, and therefore employee, it was he who made the decisions to purchase the farm, to borrow the funds and to set the level of rental for the four bedroomed farmhouse from NEP.

56. We put it explicitly to Mr Willey that when the £75,000 was paid he knew that there was no prospect of any repayment to him from SA. He agreed.

57. Given the quantum of debt, it can only have been in his personal interest to settle as quickly as possible with HSBC. Quite apart from the guarantee issue, the fact that he was released from the second mortgages (and we do not know the quantum) meant that he as sole owner personally benefitted in money's worth when those properties were subsequently sold since, for example with Beechtrees, the equity was £30,000 as opposed to negative equity. Had the second mortgage not been released then Mr Willey may have received little or nothing. We cannot be definitive since we have been furnished with no figures but the principle is clear. On the balance of probabilities, he achieved a substantial benefit. He must have had to pay his

[1] 38 TC 673

administrator to negotiate this result and it would seem that Mr Powell may not have been released from his obligations. Even the payment of £75,000 for the guarantee alone, given the level of indebtedness, seems an advantageous and pragmatic settlement. It must have been in his interests to settle as soon as the "deal" was done in case matters and markets changed.

58. We were wholly unpersuaded that Barclays had imposed a requirement to settle the HSBC debt. Mr Willey fairly conceded that notwithstanding the terms of the correspondence with HMRC, of course, there had been documentation relating to Barclay's lending. This was post the banking crisis. From our perspective, there is no doubt that there would have been documentation. Nothing contemporaneous has been produced. The letter from Barclays certainly does not say that Barclays required a release from HSBC. On the contrary, that letter is not very helpful to Mr Willey. It states that Mr Willey "arranged to release himself" but certainly does not state that that was a requirement of the lending. It refers to the guarantee being by Mr Willey but, of course, Miss Kendall was equally liable. Pertinently, it states that Mr Willey was "acting in his capacity as Director".

59. In our view that goes to the heart of the matter. At all times he was acting as a Director and therefore employee of NEP. He controlled NEP. He had every reason to compromise the claims from HSBC which were entirely personal to him. There were three and they had nothing to do with NEP. The fact that Mr Powell was not released at the same time points to the possibility that negotiations were not easy.

60. Mr Willey has borrowed monies from NEP on more than one occasion (as opposed to his suggestion that SA owed him funds), and clearly it was his choice, whether or not on advice given, not to borrow the £75,000 but to ensure that NEP paid that sum. Since NEP was in good financial health in 2010/11, and as he controlled it, he had diverse means of finding the funding of the payment to HSBC. He could have looked at loans, dividends and director's remuneration. This was the route that he chose. If we find that the payment is in fact earnings then the Income tax and NIC treatment follow as night the day.

61. Whilst we agree with Ms Glover that many payments to employees are not "from employment" and cannot be treated as earnings, nevertheless on the facts of this case, we find that these two payments were only made because, for entirely personal reasons, Mr Willey needed to settle with HSBC (and in our view as soon as possible since no one would wish an undefined liability hanging over them). NEP only made the payments because Mr Willey was the only director and he could ensure that it was done.

62. To return to both plain English and Latin (the latter only because the case law uses it), the primary reason for the payments was to ensure that Mr Willey's assets were not encumbered and that he did not have exposure to what appears to have been a large guarantee. That was the *sine qua non.* Undoubtedly, the consequence was that, with Miss Kendall, he was able to grant a limited guarantee for NEP for very little more than the sum paid on his behalf to HSBC. It was not debated at any length but, for example that £75,000 could have been paid to (or even put in escrow for) Barclays

which would have been far more secure for Barclays. No explanation was offered as to why that had not been explored.

63. We were not persuaded by the arguments that Mr Willey had not benefitted in any way since he owned NEP outright. He certainly benefitted personally since the two mortgages were released and therefore he had greater equity in those properties, as proved to be the case. Company valuation is an arcane art, as we explained to the parties, but that is not relevant here since the issue is whether or not Mr Willey derived "profit…or incidental benefit of any kind...if it is money's worth" "in relation to an employment".

64. He did.

65. The £75,000 added an unquantified value to his two properties which he later sold. Indeed, it enabled the sales, but furthermore it released him from the prospect of a claim for what he described as being £250,000 or more and all of the possible legal costs associated therewith. He was only able to arrange the payment because he was the sole director of a successful company.

DECISION

66. In summary, we find that on the particular, and indeed, unique facts of this case, the total payment of £75,000 certainly only happened because Mr Willey was an employee of, but more pertinently, the sole director of NEP. What he did was as an employee. We accept that from his perspective there is little or no distinction between himself as director or shareholder and NEP. However, the law makes a distinction.

67. We understand that after the banking crisis all of the banks looked for as much security as possible. However, the minimal level of guarantee obtained in this case, with substantial collateral asset backing and no other borrowings and from two directors, not one, taken with the terms of the only letter provided simply does not establish that the lending was only achieved because of the payment to HSBC.

68. Mr Willey arranged the payments. They happened because he was a director of NEP. Correctly in the bank records they were described as emanating from him as opposed to other payments from the company. They were never for goodwill. They were for his benefit. They were for "money's worth".

69. In all of these circumstances, the payments must be treated as "earnings" within IPETA 2003 and therefore NIC is exigible.

70. Therefore, for all these reasons, these appeals both fail.

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

"Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

ANNE SCOTT
TRIBUNAL JUDGE

RELEASE DATE: 22 FEBRUARY 2016