[2019] UKUT 46 (TCC)

Appeal Number: UT/2017/0118

INCOME TAX and NATIONAL INSURANCE CONTRIBUTIONS – whether payment of premiums on insurance policies earnings from employment

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

Between

MACLEOD AND MITCHELL CONTRACTORS LIMITED
WILLIAM MITCHELL

Appellants

and

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: THE HONOURABLE LORD DOHERTY
JUDGE ANDREW SCOTT

Heard in public at George House, Edinburgh
On 2 November 2018

Representation:
For the Appellants: **Mr Philip Simpson QC, instructed by Saffery Champness LLP**
For the Respondents: **Elisabeth Roxburgh, Advocate, instructed by the Office of the Advocate General**

DECISION

Introduction

1. These appeals concern the appropriate tax treatment of premiums paid by the first appellant, Macleod and Mitchell Contractors Limited ("MMCL"), on several insurance policies. In each case the insured was the second appellant ("Mr Mitchell"), who at all material times was the sole director and shareholder of MMCL. However, until 2013 MMCL and Mr Mitchell understood that the policyholder in each case was MMCL. The First-tier Tribunal found in fact that this was an error, and that the policies ought to have been in the name of, or for the benefit of, MMCL. The error was discovered in 2013, and in 2014 Mr Mitchell assigned the policies to MMCL.

2. Mr Mitchell was assessed to income tax in respect of the premiums paid until the date of the assignation, and MMCL was assessed to pay primary and secondary class 1 national insurance contributions in respect of the same payments. MMCL and Mr Mitchell appealed against those assessments.

3. The First-tier Tribunal dismissed the appeals. While it accepted that it was a mistake that Mr Mitchell was the policyholder, it held that payment of the premiums had relieved him of pecuniary liabilities to the insurers. It followed that the payments were earnings from Mr Mitchell's employment. Alternatively, if MMCL had been entitled to recover from Mr Mitchell the premiums paid up until 2013 (on the basis that they had been paid in error), in deciding not to seek such recovery MMCL "relieved Mr Mitchell of a pecuniary liability" to make that repayment. On that hypothesis too the sums which MMCL failed to recover represented earnings from Mr Mitchell's employment. The First-tier Tribunal also accepted in principle that as a director Mr Mitchell owed fiduciary duties to MMCL and that any benefits received from the policies would be held by him on constructive trust for MMCL. However, in the Tribunal's view the matter was academic since no benefits had in fact become payable in the period prior to the assignation. Moreover, it thought that no constructive trust could arise before Mr Mitchell became aware that he was the policyholder. There had to be "knowing receipt" by him (*Commonwealth Oil and Gas Ltd* v *Baxter* 2010 SC 156).

The relevant legislation

Income tax

4. The charge to income tax on employment income is dealt with by the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"). Section 6 provides that the charge to tax on "employment income" under Part 2 of the Act is a charge to tax on "general earnings" and "specific employment income". It is not suggested that any of the contentious sums here were "specific employment income". Section 7 provides that "general earnings" means earnings within Chapter 1 of Part 3 (which consists of section 62) and amounts treated as earnings (for example, amounts charged under the benefits code under Chapters 2 to 10 of Part 3). Sections 9(1) and 9(2) deal with the charge to income tax on general earnings. They provide:

> "(1) The amount of employment income which is charged to tax under this Part for a particular tax year is as follows.
>
> (2) In the case of general earnings, the amount charged is the net taxable earnings from an employment in the year.

…"

Section 62 provides:

> **"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.
> ..."

5. There was no clear finding of fact by the Tribunal as to whether Mr Mitchell was an employee as well as an office-holder; but since the provisions of ITEPA which apply to employments apply equally to offices (see section 5), nothing turns on this.

National insurance contributions

6. The provisions dealing with national insurance contributions are contained in the Social Security Contributions and Benefits Act 1992 ("SSCBA"). Section 6(1) provides that primary and secondary Class 1 contributions are payable if earnings are paid to or for the benefit of an earner in respect of any employment of his which is employed earner's employment. Section 2(1)(a) defines "employed earner" to include a person who is gainfully employed in Great Britain either under a contract of service or in an office with earnings: and section 122(1) defines "employment" to include, among things, an office. The liability for secondary Class 1 contributions is imposed on the secondary contributor (sections 6(4)(b) and 7); and the liability for primary Class 1 contributions also falls on the secondary contributor as a result of paragraph 3 of Schedule 1. Section 3(1) defines "earnings" and "earner" in these terms:

> "(1) In this Part of this Act …—
> (a) "earnings" includes any remuneration or profit derived from an employment; and
> (b) "earner" shall be construed accordingly.
> ..."

The combined effect of these provisions is that, if the amounts in question are earnings within the meaning of section 3(1)(a), MMCL is liable to both primary and secondary Class 1 contributions on those earnings (whether Mr Mitchell is an employee or office-holder).

Submissions for the parties

7. We heard counsel's oral submissions at the appeal hearing. After the hearing concluded we gave them an opportunity to make written submissions in relation to certain further matters.

Both counsel availed themselves of that opportunity. What follows is an outline of our understanding of counsel's ultimate positions.

Counsel for the appellants' submissions

8. Mr Simpson submitted that any benefit to Mr Mitchell as a result of MMCL's payment of the premiums was not earnings *from* his employment. It was not a reward or return for his services. It was an accident that the liability to pay premiums to the insurers was Mr Mitchell's rather than MMCL's. Reference was made to sections 7(2), 9(2) and 62 of ITEPA; and to *Hochstrasser* v *Mayes* [1960] AC 376, per Viscount Simonds at pp 399-390, and per Lord Radcliffe at p 392; and to *Advocate General for Scotland* v *Murray Group Holdings Ltd* 2018 S.C. (UKSC) 15, [2017] 1 WLR 2767 (*sub. nom. RFC 2012 plc* v *Advocate General for Scotland*) ("*RFC 2012 plc*"), per Lord Hodge JSC at para 35.

9. In any case, Mr Mitchell had been a director of MMCL. At all material times he held the policies as a fiduciary for the company and his liability to the insurers was *qua* fiduciary. Reference was made to Mackenzie Stuart, *The Law of Trusts*, p 37; Wilson and Duncan, *Trusts, Trustees and Executors* (2nd ed.), para 6-64; McLaren, *The Law of Wills and Succession* (3rd ed.), vol II, p 1045. It made no difference that a fiduciary acquired an asset unwittingly. The law would not permit a director to profit from his position: *York Buildings* v *Mackenzie* (1793) 3 Pat. 378; *Hamilton* v *Wright* (1839) 1 D. 668, per the Lord Ordinary (Lord Cockburn) at p.673, (whose interlocutor was restored on appeal to the House of Lords, (1842) 1 Bell's App Cas 574). In those circumstances MMCL's payment of the premiums was not earnings from Mr Mitchell's employment.

10. Another possible basis for reaching the same result was to treat the policies as having been owned by MMCL at all material times. That had been the reality of the position. The cases of *Forrester* v *Robson's Trustees* (1875) 2 R. 755 and *Hadden* v *Bryden* (1899) 1 F 710 provided some support for such an approach.

11. Mr Mitchell did not receive any real or practical benefit from being the policyholder or from the payment of the premiums. At all times prior to the assignation MMCL had been entitled to obtain restitution of the policies (Stair, *Institutions*, I, 8, vi - ix; Bankton, *Institute*, I, 8, *pr* and I, 9, 41). If any benefits had been paid to Mr Mitchell under the policies MMCL would have been entitled to recompense from him (*Gracie* v *Hannay's Representatives* (1832) 10 S. 628). Moreover, since as a director Mr Mitchell owed MMCL fiduciary duties, as soon as he became aware of the situation he held the policies on constructive trust for MMCL (*Commonwealth Oil and Gas Company Limited* v *Baxter*, *supra*). If the scenario had been different and the intention been that Mr Mitchell should be the policyholder but MMCL had mistakenly paid the premiums, MMCL would have been entitled to recompense from Mr Mitchell in respect of the mistakenly paid premiums (*The Edinburgh Life Assurance Company* v *Balderston* (1909) 2 SLT 323; *Morgan* v *Morgan's Judicial Factor* 1922 SLT 247). The benefit to Mr Mitchell would have been matched by an equal and opposite obligation to make recompense, with no overall advantage to him resulting. It would be very odd if Mr Mitchell were to be worse off where, as here, the intention in fact had been that he should not be the policyholder.

12. The relevant legislation should be construed purposively. A realistic view should be taken of the facts: *UBS AG* v *HMRC* [2016] 1 WLR 1005, per Lord Reed JSC at paras 61, 68; *Barclays Mercantile Business Finance Limited* v *Mawson* [2005] 1 AC 684, per Lord Nicholls (delivering the opinion of the appellate committee) at para 32. The purpose of the provisions imposing a charge to income tax on benefits in kind, and of the provisions imposing a charge to national insurance contributions on earnings, is to charge any benefit that the employee

receives in exchange for work done. A "benefit" encompasses any benefit that may be measured in economic terms and which makes the employee better off overall. Mr Mitchell was not better off overall here.

13. The First-tier Tribunal erred in law. First, it failed to consider whether the payment of the premiums arose from Mr Mitchell's employment as opposed to from the mistaken understanding that MMCL was the policyholder. Second, it failed to apply a purposive interpretation to the relevant legislation. Third, it misunderstood and misapplied *Henriksen* v *Grafton Hotel Limited* [1942] 2 KB 184. Fourth, it was wrong to proceed on the basis that MMCL relieved Mr Mitchell of a pecuniary liability when it decided not to seek to recover the premium payments from him. Fifth, it erred in failing to conclude that all rights under the policies were held by Mr Mitchell on constructive trust for MMCL.

Counsel for the respondents' submissions

14. Miss Roxburgh submitted that there was no error of law on the part of the First-tier Tribunal.

15. She accepted that the relevant statutory provisions ought to be given a purposive construction, and that the legislation was intended make an employee liable for any benefit he received by virtue of his employment and which made him better off overall. Here the relevant transaction was the payment of the insurance premiums. Mr Mitchell's obligations to pay the premiums to the insurers arose it seemed because of an error, but nonetheless those obligations had existed. The First-tier Tribunal had been entitled to conclude that MMCL had relieved Mr Mitchell of those liabilities, and that that had been of direct monetary value to him. The payment of the premiums by MMCL, and/or the subsequent waiver by MMCL of the right to recover their value from Mr Mitchell, were benefits or profits from Mr Mitchell's employment.

16. Mr Mitchell did not hold the policies as a fiduciary for MMCL. No trust had been constituted, nor had Mr Mitchell and MMCL entered into any agency agreement. Writing would have been required for MMCL to constitute an express trust affecting property belonging to it (Requirements of Writing (Scotland) Act 1995, s 1(2)(a)(ii)). However, the policies were never MMCL's property. Moreover, for that reason, and because there was no breach of fiduciary duty by Mr Mitchell, the policies were not held on constructive trust by him for MMCL (cf *Commonwealth Oil and Gas Company Limited* v *Baxter, supra,* per Lord Nimmo Smith at para 94; *Jopp* v *Johnston's Trustee* (1904) 6 F. 1028, per Lord Justice-Clerk Kingsburgh at pp 1034-1035; *Style Financial Services Ltd* v *Bank of Scotland (No 2)* 1998 SLT 851, per Lord Gill at p 867). Since the policies had not belonged to MMCL at any time before the assignation, it had had no entitlement to restitution of them. All that it could have sought was recompense from Mr Mitchell for the premiums paid (*The Edinburgh Life Assurance Company* v *Balderstone, supra,*, per Lord Mackenzie at pp 325-326; *Morgan v Morgan's Judicial Factor, supra*, per Lord Hunter at p 250). However, the fact of the matter was that MMCL had not sought recompense. The cases of *Forrester* v *Robson's Trustees* and *Hadden* v *Bryden* were of no assistance. They were not in point and they were clearly distinguishable.

17. Miss Roxburgh accepted that prior to Mr Mitchell's status as policyholder coming to light in 2013 "there is an argument that...the benefit or profit arose from "something else", namely the error, rather than [from] the employment relationship." However, she submitted that that argument could not apply in respect of payments made after MMCL and Mr Mitchell became aware of the true position. Nor did it apply in respect of MMCL's waiver of the right to seek recovery of the premiums paid.

Decision and reasons

The central issue

18. In our opinion the central issue in the case is whether the transactions in question conferred a profit or benefit upon Mr Mitchell that derived "from" his employment with MMCL.

Were the premium payments earnings "from" (or "derived from") Mr Mitchell's office or employment?

19. The effect of sections 6, 7, 9 and 62 of ITEPA is that an amount is taxable as "general earnings" only if it is "from" an office or employment. In our opinion the law in this area is well settled. While many of the relevant authorities (e.g. *Hochstrasser (Inspector of Taxes)* v *Mayes, supra*; *Laidler* v *Perry (Inspector of Taxes)* [1966] AC 16; *Brumby (Inspector of Taxes)* v *Milner* [1976] WLR 1096; *Tyrer* v *Smart (Inspector of Taxes)* [1979] STC 34; *Bray (Inspector of Taxes)* v *Best* [1989] 1 WLR 167; *Shilton v Wilmshurst (Inspector of Taxes)* [1991] STC 88) involved the construction and application of statutory provisions which ITEPA replaced (in particular, Schedule E (latterly contained in section 19 of the Income and Corporation Taxes Act 1988 ("ICTA")), nevertheless they provide highly persuasive guidance in relation to the similar and corresponding provisions of ITEPA and SSCBA. We think it is unnecessary to make extensive citation from the authorities. It is sufficient for our purposes to refer to two judicial observations. In *Tyrer* v *Smart (Inspector of Taxes), supra,* Lord Diplock succinctly encapsulated the position at p 36:

> "The test to be applied is well established. It is whether the benefit represents a reward or return for the employee's services, whether past, current or future, or whether it was bestowed on him for some other reason… Where the benefit is granted by and at the expense of the employer…, the purpose of the employer in granting the benefit to the employee is an important factor in determining whether it is properly to be regarded as a reward or return for the employee's services."

More recently, in *RFC 2012 plc* Lord Hodge JSC noted (at para 35):

> "Income tax on emoluments or earnings is, principally but not exclusively, a tax on the payment of money by an employer to an employee as a reward for his or her work as an employee. As we have seen from the use of the word 'therefrom' in s 19 of ICTA … income tax under Sch E was charged on emoluments from employment. In other words, it was a tax on the remuneration which an employer pays to its employee in return for his or her services as an employee. This concept also underpins the concept of 'earnings' in ITEPA… which in s 9(2) refers to 'taxable earnings from an employment' and in s 62 defines earnings in relation to an employment. Included in that definition in s 62(2)(c) is the catch-all phrase: 'anything else that constitutes an emolument of the employment'. That which was an emolument under prior legislation remains an emolument under ITEPA. What is taxable is the remuneration or reward for services …."

20. In our opinion the premium payments here were very clearly not earnings from Mr Mitchell's office or employment. On the contrary, echoing the language of Lord Diplock, they "were bestowed upon him for some other reason". They were not intended to be a reward, return or remuneration for his services. They were intended to benefit MMCL, not him. They were made on the erroneous understanding that MMCL was the policyholder and that it would be the beneficiary of any policy proceeds.

21. The same analysis applies in relation to SSCBA and national insurance contributions. The payments of premiums were not "earnings". They were not remuneration or profit "derived from" Mr Mitchell's office or employment.

22. In our opinion the First-tier Tribunal erred in law. It failed to focus correctly on the critical questions - whether there was any real benefit to Mr Mitchell from the payment of the premiums; and if there was, whether it arose from his employment. We consider that on the facts found both questions ought to have been to be answered in the negative. We think that the Tribunal misdirected itself (in misplaced reliance on *Henriksen v Grafton Hotel Ltd*) in treating MMCL's intention as an irrelevant consideration. The purpose of an employer in granting a benefit to an employee is an important factor in determining whether it is properly to be regarded as a reward or return for the employee's services (*Tyrer v Smart (Inspector of Taxes)*, supra, per Lord Diplock at p 36). As we discuss below, we also consider that the Tribunal erred in failing to take proper account of the fact that Mr Mitchell was a fiduciary, and that as soon as he became aware that he was the policyholder he had an obligation to account to MMCL for the policies and any proceeds, and to assign the policies to MMCL if and when it demanded their assignation.

The position between the discovery of the error and the assignation

23. In 2013 the error was discovered. Between that date and the assignation MMCL continued to pay the premiums. Miss Roxburgh says two things about that. First, that the payments were made by MMCL in the knowledge that it was meeting liabilities which Mr Mitchell owed to the insurers. The payments arose from Mr Mitchell's employment and not from something else. Second, that once it became aware of the mistake which had been made MMCL could have sought recompense from Mr Mitchell for the premiums already paid. It should be inferred that it had waived its right to obtain recompense. The waiver was a profit or benefit which constituted earnings from Mr Mitchell's employment.

24. In our opinion neither of these submissions is well founded.

25. So far as the continued payment of premiums until the assignation is concerned, we observe that the argument now advanced formed no part of the Tribunal's reasons for its decision. In any case, in our view it is plain that MMCL did not intend to bestow the benefit of those payments on Mr Mitchell as a reward or return for his services as an employee or office-holder. On the contrary, it seems to us that the intention from the inception of the policies until the assignation was always that MMCL would be the beneficiary of the policies and of the policy premiums. That was why the premiums were paid. The discovery of the error did not alter that. The assignation was a mechanism to confer *ex facie* title to the policies upon MMCL to reflect what had always been the parties' objective. The continued premium payments were made in order to provide the benefit of insurance cover to MMCL, just as they had been before the error was discovered. They were not a reward, return or remuneration for Mr Mitchell's services to the company. They were not earnings from his office or employment.

26. In our view that is a complete answer to the contention that continued payment of the policy premiums was earnings chargeable to income tax and national insurance contributions. Nevertheless, we consider it right to make the following further observations.

Benefit to Mr Mitchell?

27. At para 28 of its decision the Tribunal "noted that the benefits which Mr Mitchell enjoyed from [the] insurance policies...were the benefits which might have been paid out to him had an insured event taken place". However, in our view that fails to take proper account of the fact that as a director Mr Mitchell owed fiduciary duties to the company. He had to avoid a situation in which he had, or could have, a direct or indirect interest which conflicted or possibly might conflict with the interests of the company (Companies Act 2006, s 175). As soon as he became aware of the mistake he had a duty to avoid any possible conflict between his interests and those of the company. He had a duty not to make a personal profit from the mistake. He had an obligation to account to MMCL for the policies, and to assign them to it on demand. Although, none of the insured risks occurred prior to the assignation, and no policy proceeds became payable to Mr Mitchell, had they done so they would have been a profit for which he would have been obliged to account to MMCL. That would have been the position whether the insured event occurred before or after the mistake in relation to the policies came to light (since had an insured event occurred before the mistake was discovered, the mistake would have been bound to become apparent during the claims process). It follows in our opinion that Mr Mitchell enjoyed no real personal benefit at any stage from being the nominal policyholder, and that the Tribunal erred in law in suggesting that he did.

Liability to income tax and national insurance contributions because of waiver?

28. The context of the Tribunal's consideration of the waiver argument was Mr Simpson's submission that if the premium payments involved meeting Mr Mitchell's liabilities, there was no real benefit to him because he would have a corresponding liability to repay the premiums to MMCL. The Tribunal reasoned (at para 29) that even if it was accepted that MMCL had the right to recover the premiums from Mr Mitchell, it must have made a decision not to. It continued:

> "...such a decision...was a decision which relieved Mr Mitchell of a pecuniary liability...This does not therefore advance Mr Mitchell's case but merely replaces one source of assessable income by another."

29. We have three comments on this part of the Tribunal's reasoning. First, it is based on the hypothesis that MMCL would have been entitled to recover the premiums from Mr Mitchell. However, on the facts found we do not think that there was such a right to recovery. Mr Mitchell was the named policyholder, but that was a mistake. It was only by reason of MMCL's mistake that Mr Mitchell had obligations under the policies. As explained above, in our view he obtained no real benefit from the policies because he would have been obliged to account to MMCL if any insurance payments were made. Second, MMCL could only have made a claim for repayment of the premiums if it accepted that Mr Mitchell (rather than it) was the rightful owner of the policies. Plainly, that was not MMCL's position, and it seems very odd to proceed as if it was. Third, even if, contrary to our view, the correct analysis is that by refraining to recover the premiums MMCL relieved Mr Mitchell of a pecuniary liability, in our opinion there is no sound basis for concluding that that was a reward, return or remuneration for his services as an employee or office-holder. On the contrary, it seems to us that it was simply part and parcel of the process of unscrambling the consequences of the error which had occurred.

Other arguments

30. Finally, we mention briefly some of the other arguments which were canvassed before us. In light of our decision that the payment of the premiums was not earnings from Mr Mitchell's employment, we do not think it is necessary to say very much about them.

31. We have already indicated that we accept that as a director Mr Mitchell owed fiduciary duties to the company, and what we think the consequences of that were. We also see force in the submission that as soon as Mr Mitchell discovered the error he held the policies as a constructive trustee for MMCL (and would have held any proceeds paid as a constructive trustee): see e.g. Mackenzie Stuart, *The Law of Trusts*, pp 37-38; McLaren, *The Law of Wills and Succession* (3rd ed.), vol II, p 1926 *et seq.*; *Macadam* v *Martin's Trustee* (1873) 11 M 33; *Jopp* v *Johnston's Trustee, supra*; *Smith* v *Liquidator of James Birrell Ltd* 1968 SLT 174; *Southern Cross Commodities Property Ltd* v *Martin* 1991 SLT 83; *Sutman International* v *Herbage,* Outer House, Lord Cullen, 2 August 1991; Stair Memorial Encyclopaedia of the Laws of Scotland, *Trusts, Trustees and Judicial Factors* (Reissue), para 29; Gretton and Steven, *Property, Trusts and Succession* (3rd ed.), para 23.46; Gretton, *'Constructive trusts'* (1997) 1 Edin LR 281 and 408; *CMS Dolphin Ltd* v *Simonet* [2002] BCC 600, per Lawrence Collins J at para 96; *Commonwealth Oil and Gas Company Limited v Baxter, supra* (although we note that the critical issue in that case was whether a stranger to the fiduciary relationship was a constructive trustee in relation to the relevant property - see Lord President Hamilton at para 18, Lord Nimmo Smith at para 94); Macgregor, *The Law of Agency in Scotland,* paras 6-38 to 6-47. While we recognise that the constructive trust argument is worthy of careful consideration, we do not think it appropriate to express any concluded view on it for a number of reasons. First, given our primary conclusions a decision on the point is not essential. Second, we are concerned essentially with a question between the fiduciary and the company, rather than with an interest which a third party claims to have acquired from the fiduciary. In those circumstances whether there was a constructive trust or merely a personal obligation to account does not appear to us to be critical to the outcome. Third, we have not had the advantage of fully developed argument in relation to this issue. Accordingly, we think it preferable that the question whether a constructive trust arises in circumstances like the present should be decided in a case where determination of that issue is essential, and where there has been the benefit of full submissions.

32. Otherwise, we think it suffices to say that we are not persuaded that there was an express trust; or any contract of agency; and that we do not find *Forrester* v *Robson's Trustees*, *supra,* or *Hadden* v *Bryden, supra,* to be of any real assistance.

Disposal

33. For the foregoing reasons we allow the appeals.

Lord Doherty Judge Andrew Scott

Release date: 13 February 2019