TC06897

Appeal number: TC/2013/01822

INCOME TAX AND NATIONAL INSURANCE CONTRIBUTIONS (NICs) - discovery assessments - directions that the appellant be made personally liable for under-deductions of PAYE and a decision that the same applies to under-payments of NICs - appeal allowed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

MICHAEL JOHN FEBREY **Appellant**

- and -

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

TRIBUNAL: JUDGE NIGEL POPPLEWELL
MR WILLIAM HAARER

Sitting in public at Bristol on 13-15 November 2018

Mr George Rowell, Counsel, for the Appellant

Mr Paul Shea of HM Revenue & Custom's Solicitors Office for the Respondents

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BACKGROUND

1. This case concerns income tax and NICs. It is HMRC's case that for the tax years 2005/2006, 2006/2007 and 2007/2008 the appellant received employment income from a company called Febrey Limited (the "**Company**"). No PAYE tax ("**PAYE**") or NICs were deducted from those payments. The appellant is liable to pay that under-deducted PAYE and those under-paid NICs under directions to that effect in relation to the PAYE and a decision to that effect for the NICs since he knew that the Company had wilfully failed to deduct that PAYE and pay those NICs to HMRC.

2. This case has been remitted to us for a rehearing following a direction to that effect by the Upper Tribunal on an appeal following a previous FTT decision. We have read neither that Upper Tribunal decision nor the previous FTT decision before coming to and releasing this decision.

THE ISSUES IN A NUTSHELL

3. HMRC have issued discovery assessments for the tax due for 2005/2006 and 2006/2007 (the "**Discovery Assessments**"). And have amended the appellant's self-assessment tax return for 2007/2008. They have made comparable adjustments which affect the appellant's NICs position.

4. As a result of these, HMRC's view is that the relevant payments/earnings, the PAYE under-deducted, and NICs for which the appellant is now liable is as per the table below:

Year	Relevant payments/earnings £	Tax under-deducted £	NICs £
2005/2006	£103,000	£33,157.50	£3,767.00
2006/2007	£172,000	£60,532.40	£4,520.15
2007/2008	£300,000	£111,414.40	£5,909.25

5. HMRC's justification for these figures is:

(1) For 2007/2008 the appellant had an employment contract entitling him to £300,000 per year. On the evidence the contract applied not just to the tax year 2007/2008 but to 2006/2007.

(2) The appellant was paid £300,000 by the Company in 2007/2008 as evidenced by the appellant declaring this amount as employment income in his tax return for 2007/2008.

(3) The records of the Company for an 18 month period from September 2005 to March 2007 show the appellant received payments of approximately £355,000, of which about £80,000 was paid to another company.

(4) So rounded down, the appellant received £275,000 in the tax years 2005/2006 and 2006/2007.

(5) The Company accounts show dividends of £173,000 and consultancy fees of £120,000 paid during that period which seem to corroborate the £275,000 figure.

(6) The appellants have split £275,000 as to £103,000 for 2005/2006 and £172,000 to 2006/2007. It is, according to HMRC, employment income.

(7) PAYE tax and NICs can be recovered from the appellant since in their view, the appellant knew that the Company had wilfully failed to deduct PAYE tax from these payments and pay NICs on those payments to HMRC. A Direction to this effect in respect of the PAYE was made by HMRC on 10 October 2012, and a decision to that effect was made on the same date in respect of the NICs (together (for simplicity's sake) the "**Directions**").

6. The appellant's position is that:

(1) There was no employment income for 2005/2006 and 2006/2007. The employment contract referred to above was effective only for the tax year 2007/2008.

(2) The amounts drawn by the appellant in these tax years, came not from the Company but from an associated company, Febrey Concrete Structure Limited ("**FCS**"). They were drawings of dividends previously paid (and credited to a loan account) or on account of dividends which were anticipated would be paid.

(3) The amounts of £173,000 and £120,000 mentioned above were included in the 18 month accounts which had been compiled purely for the purpose of satisfying the Company's bank of its financial liability. They were made simply to reduce amounts that would otherwise be shown as a director's loan. They were never paid either to the appellant or to FCS. The other records of the Company on which HMRC rely reflect a misunderstanding of the records and there are some odd entries in them, about which the appellant knows nothing.

(4) Since there was no employment income for the tax years 2005/2006 and 2006/2007, there was nothing on which the Discovery Assessments could bite.

(5) In 2007/2008 the appellant received employment income from the Company but it was much less than £300,000. He was not the controlling mind of the Company. If the Company had wilfully failed to deduct tax from any employment income that it had paid him or failed to pay HMRC the NICs on it (which, in both cases, is denied) the appellant did not know that.

OUR VIEW

7. For the reasons given later in this Decision, it is our view (shortly stated) that:

(1) The appellant had no employment income from the Company for the tax years 2005/2006 and 2006/2007.

(2) For the tax year 2007/2008, the appellant did receive employment income from the Company but this was an amount much less than the £300,000 to which he was entitled under his service contract. The Company failed to deduct PAYE tax and NICs from payments of employment income made to him for that tax year, but that failure was not wilful and the appellant had no knowledge of the failure.

THE LEGISLATION

8. The relevant legislation relating to the Directions and the Discovery Assessments is set out in the appendix to this Decision.

9. In this Decision where we refer to employment income we mean taxable earnings from an employment determined in accordance with section 10(2) of ITEPA.

10. When we refer to a deduction of income tax or payment of NICs, these are shorthand for the deductions referred to in regulation 72 of the PAYE Regulations, or payments referred to in paragraph 3(1) of Schedule 1 to the SSCBA and in Regulation 86 of the NICs Regulations.

11. Where we refer to payment of employment income we do so in the context of the extended definition of payment in section 686 ITEPA.

THE ISSUES AND WHO HAS TO PROVE WHAT

12. There are a variety of issues at large in this case. We set them out below:

2005/2006

13. Is the Discovery Assessment for this tax year valid in the first place? Is there an insufficiency of tax in the appellant's return by dint of the fact that he received employment income in this tax year?

14. If so, is the Discovery Assessment for this tax year in time?

15. If it is a valid Discovery Assessment and is in time, do the Directions apply?

16. If they do, then what is the correct amount of taxable income to which they apply?

2006/2007

17. Is the Discovery Assessment for this tax year valid in the first place? Is there an insufficiency of tax in the appellant's return by dint of the fact that he received employment income in this tax year?

18. If it is a valid Discovery Assessment, do the Directions apply?

19. If they do, then what is the correct amount of taxable income to which they apply?

2007/2008

20. The appellant accepts that he did receive employment income this year so the two issues are:

(1) Do the Directions apply?

(2) If they do, then what is the correct amount of taxable to income to which they apply?

Who has to prove what?

21. In our view it is for HMRC to show that the Discovery Assessments are valid. To do this they need to show that there is an insufficiency of income in the returns for 2005/2006 and 2006/2007. In the context of this case, they must establish, on the balance of probabilities, that the appellant was paid employment income in each of these two tax years. They must also show that the Discovery Assessment is in time for 2005/2006.

22. HMRC must also establish, again on the balance of probabilities that the Directions apply to transfer the alleged liability for PAYE and NICs to the appellant.

23. If they can establish the foregoing, then the burden switches to the appellant who must show, on the balance of probabilities that the amounts assessed and which are subject to the Directions are incorrect; and he must provide evidence which will enable us, on the balance of probabilities to determine the correct amount of employment income to which the Directions should apply.

EVIDENCE AND FACTS

24. In addition to the bundles of document with which we were provided, oral evidence was given by the appellant and Mr Robin Haigh ("**Mr Haigh**") of Trenfield Williams, Chartered Accountants, who had provided services to the appellant, the Company and FCS during the periods under appeal.

Susan Elston

25. We were provided in the bundles with a witness statement compiled by Susan Elston, the HMRC case worker who was responsible for issuing the Directions. Unfortunately, due to illness, she was unable to attend the hearing. We asked for the parties representations as to whether we could and should admit this statement and/or the weight which should be attached to it. Mr Rowell made some initial protestations but did not follow these up in his closing submissions. It is clear that the appellant takes no issue regarding the mechanics of the issue of the Directions; his issue is that they simply don't apply to him. So we have decided to admit her statement.

The appellant's new evidence

26. On the second day of the hearing, Mr Rowell made an application that the appellant be permitted to submit further documentary evidence in support of his case. The documents in question had recently been found by the appellant in his mother's garage and were allegedly relevant to the date of his relationship breakdown with his former partner, Ms Anne Rogers ("**Ms Rogers**"). Mr Shea objected. This was very late in the day; the appellant has had ample time to prepare for this case; he has a history of failing to comply with time limits; the documents are of limited probative value. We agreed with Mr Shea in this respect and declined the appellant's application.

The procedural background

27. From the evidence we find the following as facts:

(1) On 7 January 2010 HMRC opened enquiries into the appellant's 2007/2008 tax return.

(2) On 30 March 2011 HMRC issued the Discovery Assessments.

(3) On 28 April 2011 the appellant appealed against the Discovery Assessments.

(4) On 10 October 2012 HMRC made the Directions.

(5) On 7 November 2012 the appellant appealed against the Directions.

(6) On 14 December 2012 HMRC formally withdrew the PAYE tax credit in accordance with the Directions in regard to the appeal against the 2005/2006 and 2006/2007 Assessments.

(7) On 21 January 2012 HMRC closed the 2007/2008 enquiry and amended the appellant's self-assessment return.

(8) On 5 January 2013 the appellant appealed against the 2007/2008 closure and amendment notice.

(9) On 8 February 2013 HMRC issued a statutory review conclusion upholding the decisions.

(10) On 8 March 2013 the appellant notified his appeal to the Tribunal.

The unchallenged evidence and findings of fact

28. Some of the oral evidence given by the appellant and Mr Haigh was unchallenged; some was challenged. We set out in this section the unchallenged evidence which we find as facts and deal with the challenged evidence and our corresponding findings of fact later in this Decision.

Mr Febrey's evidence

Background

29. Mr Febrey was born on 1 January 1967 and throughout his adult life has worked in the building trade and developed a specialisation in concrete form work. He left education at the age of 16 and has no formal management or accounting qualifications. Between 1983 and sometime between the Autumn of 2006 and April 2007 (more of this later) he was in a long term relationship with Ms Rogers with whom he has two children; namely Luke and Alex.

30. The Company was formed in May 1988 to trade as a contractor in the construction industry. It was formed with an issued share capital of 100 shares, 99 of which were owned legally and beneficially by Ms Rogers, the other being legally owned by Mr Febrey but on bare trust for Ms Rogers. This was necessary to comply with the Company Law in force at the time and to ensure continuity if anything happened to Ms Rogers.

31. The appellant was responsible for the day to day running of the business. Ms Rogers was initially the Company's sole director, but she resigned her directorship on 1 July 2001 and the appellant was appointed in her place.

32. A second company, Arbormace Limited was formed in May 1988. Initially the intention was that this company would take on the riskier building contracts, so that the Company itself would not be at risk if anything went wrong. Arbormace Limited's name was later changed to Febrey Concrete Structures Limited (i.e. FCS).

33. The appellant and Ms Rogers each owned 50% of the shares in FCS (there were two shares in issue and each owned one, legally and beneficially). Ms Rogers was its sole director until 25 April 2007 at which point she resigned and the appellant was appointed as sole director in her place.

34. In March 2007 the appellant formed another company, the Bentley (Clifton) Limited (the "**Bentley**") to operate a restaurant on Princess Victoria Street in Bristol. The appellant was the sole shareholder. The directors were the appellant and Luke. The restaurant started trading in June 2007. The appellant started this business to establish a more secure and reliable income for his family given that the construction industry is erratic with large claims and potential contractual issues creating a high risk.

35. The Company's business prospered and expanded. It's turnover rose from £212,000 in its first trading year to 30 September 1994 to £2,364,000 in the year to 30 September 2000; then to £9,123,698 in the year to 30 September 2005 and reached a peak of approximately £20m in the 18 month period to 31 March 2007. By that stage it had around 400 subcontractors and employees.

36. In view of the appellant's experience and background his role was focused on the "customer facing" and operational side of the business. He concentrated on managing the Company's construction contracts and winning new business.

37. By 2007 there were 10 employees carrying out administrative functions in the Company's office including an accounts team, headed by a qualified accountant, Matthew Home ("**Mr Home**"). The appellant had very limited involvement in the administrative side of the business. Mr Home and his subordinates handled all financial and accounting matters including the operation of the Company's payroll system. As director of the Company, however, the appellant signed financial documents such as the annual PAYE returns when presented to him.

38. The accounts staff used the Sage accounting software to process income and payments. The appellant's evidence was that the Sage files were saved on a particular computer in the office to which only Mr Home and the other accounting staff had access. There was no system of shared files on an office wide server or online hosting. He did not have direct access to the Sage records himself and was not qualified to use Sage or other accounting software.

39. Ms Rogers and the appellant were the only signatories on the Company's bank account although in practice the appellant was the only one who used it. Mr Home was authorised to make BACS or CHAPS payments but had no authority to sign cheques. The usual procedure was for the accounts staff to prepare a pile of blank cheques (mainly to suppliers) for the appellant to sign approximately once a week (although the frequency could vary depending on his movements). Sometimes there would be as many as 50 cheques to sign on each occasion, so the Company usually ran through at least four cheque books a month. In addition to the cheque books managed by the staff the appellant always kept a cheque book for cheques he wrote out himself. He would write "MF" and the date on the front.

40. He used the MF cheque book to make payments on behalf of the Company and the Bentley. Such payments were usually of a large or irregular nature. Typically they would be for one off purchases of equipment or building materials where the supplies were urgently required and the Company had no credit account with the supplier. In such cases the appellant would write out a cheque straight away and put it in the post. Another reason why he sometimes used this cheque book was that the Company's ordinary cheque books had run out. Typically the MF cheque book would last several months.

41. In addition to the in-house accounts staff the Company had an external accountant, Mr Haigh of Trenfield Williams. His main role was to prepare the Company's annual statutory accounts and tax returns as well as the personal tax returns of the appellant and Ms Rogers. He advised the appellant, Ms Rogers, the Company and FCS on tax issues and tax planning generally.

42. In the 1990's Mr Haigh put in place a tax-efficient structure for Ms Rogers and the appellant to share the available profits of the business. In summary, this meant the appellant drawing a minimal salary from the Company up to his tax and national insurance free threshold. The appellant also supplied his skills and expertise to FCS and FCS supplied the appellant's services to the Company for which FCS charged a fee. FCS paid dividends to the appellant and Ms Rogers of amounts within their respective basic rate tax bands. In particularly good years, Ms Rogers also took a dividend from

the Company. But more often the only dividend paid was the one paid by FCS. The dividends were credited to the appellants' and Ms Rogers' respective "current" accounts with the Company rather than being paid in cash to their respective bank accounts.

43. The appellant and Ms Rogers took regular drawings from the Company's bank account to fund their day to day living expenses. Between 2005 and early 2008 Ms Rogers drew £600 a week and the appellant drew £400 a week. His drawings were paid by BACS to his Halifax account. Ms Rogers' drawings were transferred to an account in the joint names of the appellant and Ms Rogers at Lloyds Bank. Although nominally a joint account, in reality Ms Rogers used it virtually exclusively. Besides the cash drawings, the appellant and Ms Rogers routinely used the Company's bank account to pay the mortgages on their jointly owned home, 4 Ivywell Road, Bristol, and a jointly-owned investment property, Flat 102 Royal Parade, Clifton, Bristol. There were also personal drawings from the Company's bank account on a very limited number of other occasions. For example on 1 November 2005 the appellant made a cheque payment of £32,419 for the deposit to purchase a flat in his name at 3A Rockleaze Road, Bristol.

44. All personal drawings were recorded by the in-house accounts staff soon after they happened and were later notified to Mr Haigh when the annual accounts came to be prepared. At this point the dividends were set against their current account balances which prevented outstanding loan balances from being carried over from year to year.

45. There were no formal board minutes or shareholder resolutions relating to these arrangements or payment of the dividends. As the appellant was a sole director and Ms Rogers the sole beneficial shareholder (of the Company) they did not see any need for any level of formality at the time and they were not advised that any such documentation was required. The arrangements were operated consistently by Ms Rogers and the appellant from the 1990's until 2007 and are reflected in the annual accounts of the Company and FCS and the personal tax returns of the appellant and Ms Rogers.

The demise of the Company

46. The pace of expansion of the Company between the early 2000's until 2007 put severe pressure on the Company's administrative and accounting systems which resulted in the 30 September 2006 year end being missed and its accounting period being extended until 30 March 2007.

47. The Company encountered increasing financial difficulties in the second half of 2007. The price of steel for projects which the Company had secured was increasing, which was a problem because the projects were for fixed prices, so any increase in the price of steel had to be subsumed by the Company. Debtors were paying the Company more slowly and the economy was starting to slow prior to the financial crash in 2008. The Company's level of profitability was not keeping pace with its turnover and it became heavily dependent on its overdraft with the Bank of Scotland (the "**Bank**") to provide working capital. Its overdraft typically stood at over £1.5m

48. In October 2007 the Bank expressed serious concern about the Company's viability and asked to see accounts for the 18 month period between 30 September 2005 and 30 March 2007 (the "**18 month accounts**") as a condition of continuing to lend financial support. The appellant understood that other construction and property development businesses with the Bank were also being put under pressure to reduce borrowings.

49. The appellant asked Mr Haigh to prepare the 18 month accounts which he did. These, as far as the appellant understood, were prepared from the Company's Sage records, and were compiled with a view to demonstrating the Company's continuing profitability to the Bank. They were not final audited accounts and were not intended to be filed with Companies House nor HMRC for the purposes of Company or personal taxation. They were never signed off or filed.

50. At the Bank's request, the Company commissioned the accountants PWC to report on its financial viability. PWC provided the Bank with a report in late 2007 which advised the Bank to continue funding the business.

51. A one page summary of the PWC's report of the key financial data relating to the Company which was designed to secure funding from other banks or investors, was provided to the appellant who used it with a view to obtaining funding from the Clydesdale Bank and other lenders. These were unsuccessful and the Company remained dependent on the Bank.

52. It seemed, initially, that the Bank was satisfied with the information provided to it and as late as January 2008 the appellant expected that the Bank would continue to support the Company and that the Company would continue, at that stage, to trade for the foreseeable future. However, on 8 February 2008 the Bank appointed Grant Thornton LLP ("**Grant Thornton**") to examine the Company's financial situation. A few days later Grant Thornton reported to the Bank that the Company was insolvent and the Bank called in its secured overdraft. This deprived the Company of its working capital, so it instantly had to cease trading. The Bank appointed Grant Thornton as administrators on 15 February 2008.

Grant Thornton

53. Grant Thornton seized all of the records and computer systems in the Company's office as soon as they were appointed. These records included all the records of FCS and some personal records as well, as they had been stored in the same location and had never clearly been separated from the records of the Company. They refused to allow the appellant access to these records. Grant Thornton immediately dismissed all but two of the Company's employees and set about disposing of its assets. Its trading premises, plant and vehicles are all sold off. Its work in progress was realised for a fraction of its book value. The administration was converted into a liquidation on 21 November 2008. All the net proceeds of the realised assets were distributed to the Bank and the unsecured creditors received nothing.

54. The Company was eventually dissolved on 28 November 2014.

Mr Haigh's evidence

Background

55. Mr Haigh is a chartered accountant, a member of the Institute of Chartered Accountants in England and Wales, who qualified as such in 1976 and has been in practice as a principle in Trenfield Williams since 1983. He has also lectured at the University of Bristol on accountancy matters, company law and statistics.

56. His role in relation to the appellant's business has been to provide a range of accountancy and associated services to the trading companies with which the appellant has been associated, to the appellant himself and to members of his family, and to Ms Rogers. His introduction to the Febrey family came from the (then) Midland Bank. Mr Haigh and Trenfield Williams provided the conventional range of services with which small firms of practising accountants typically support small family businesses: accounts production, auditing, company and personal tax compliance, tax planning and a degree of financial advice. In this context, Trenfield Williams acted for the Company since its incorporation in May 1988 and was responsible for completing and auditing company accounts from the basic records provided by the directors, dealing with corporation tax matters generally, providing general advice to relevant trading companies and to the appellant and Ms Rogers personally and assisting with the completion of their tax returns. It also included advice about the most efficient approaches for transferring income and value from the companies to the individuals.

57. Trenfield Williams acted for Feb Form Construction Limited in which Michael Febrey and his father were the key personnel. Feb Form Construction failed in the early 1990's and following this failure the Febrey family's activities in the concrete form work industry diverged; the appellant's father establishing his own independent business and the appellant and Ms Rogers starting their own business in the name of the Company.

58. Feb Form Construction's failure was the reason why the appellant was not a shareholder in the Company, nor was he, (at least initially), a director of the Company.

59. The Company was formed in 1988 to be available as a fall back or safety net in case there were problems with Feb Form Construction or if the appellant and Ms Rogers preferred to pursue their business independently of the appellant's father. In fact the Company remained dormant until October 1993 when it, in effect, succeeded (to a very modest level) to the business that had been formerly run by Feb Form Construction.

60. The reason that the appellant was appointed director in July 2001 was because the difficulties arising from the failure of Feb Form Construction had abated and for presentational reasons it was better for clients to see the appellant as running the Company since he was known to have considerable personal and family experience in concrete form work.

61. Arbormace Limited (now FCS) was formed with two objectives. It was intended to deal with smaller contracts and those which were thought to be particularly risky. And, by introducing the appellant as a shareholder, it would enable profit extraction to

be more tax efficient by acting as a vehicle that allowed him to participate equally in dividends. Dividends from the Company had to go exclusively to Ms Rogers as sole beneficial shareholder. The appellant provided technical and management services to the Company through FCS and appropriate fees were charged by FCS to the Company.

62. The appellant and Ms Rogers were keen to ensure that their business arrangements were structured so that they extracted funds for their own use and benefit with as little tax drag as was possible legitimately. With this in mind, and in consultation with Trenfield Williams, they adopted the following strategy:

(1) Modest salaries were allocated to the appellant and Ms Rogers which was just sufficient to make efficient use of personal allowances and to protect benefit and pension entitlements. These salaries were allocated from the Company.

(2) All further income was extracted by way of dividend (within each company's legitimate capacity to pay dividends). In practice these dividends were paid by FCS.

(3) The benefit of this approach was that it reduced employers and employees NICs. It was also helpful that dividends could be shared more or less equally between the appellant and Ms Rogers to minimise the incidence of higher rates of personal taxation.

(4) This strategy was adopted by the Company from the start and is evidenced in its accounts for the years of 30 September 1994 and in its subsequent accounts. It was applied consistently until the appellant and Ms Rogers became estranged. The introduction of FCS in 1998 allowed higher levels of personal income to be shared equally.

(5) At times, more money for personal use might be drawn from the business than had been made available as dividends and salary with the effect that the companies were making loans to their directors/participators. When this was the case, interest was charged at the rates prescribed in relevant tax legislation so that no benefit in kind charge arose.

(6) From 1 June 2001 such arrangements were managed entirely through FCS because it was felt better that they should not feature in the public accounts of the Company which could be subject to scrutiny as part of contract tenders and, (as the Company grew) by lenders. As is often the case with small family companies such as the Company and FCS, administrative arrangements tended to be informal. This was particularly true for matters involving the appellant and Ms Rogers personal engagement with the business such as income extraction. In this case the identification and approval of dividends occurred without formality (usually as a result of a discussion between Mr Haigh, Ms Rogers and the appellant with an eye on the cash flow position of the business) but was evidenced in published accounts signed by the directors and filed at Companies House.

63. Annual dividends credited to the holding on current account were £67,000 on 6 April 2002, £25,000 (from the Company) and £11,000 (from FCS) on 6 April 2003, £117,500 on 6 April 2004 and £75,000 on 6 April 2005

64. No dividend was credited to the account on 6 April 2006 (or in subsequent financial years) since initially the Company's attention was on other things (the financial difficulties of trading at that time) and thereafter, both the Company's financial difficulties and the subsequent administration.

65. The holding account included entries for both the Company and for FCS. Little distinction was made in that holding account when the entries were inputted, between payments and extractions out, and the reconciliation of such payments and extractions from FCS (on the one hand) and the Company (on the other) was subsequently undertaken at the end of year analysis.

66. An example of the interaction between the financial statements of the Company, FCS, and the tax returns of the appellant and Ms Rogers, can be illustrated by an analysis of the position for the 2005/2006 tax year.

67. For that year, the Company's accounts for the year to 30 September 2005 show that FCS charged it £120,000 for project management services provided during the year and that £28,270 was owed to FCS at the end of that year.

68. The accounts for FCS for the year to 31 July 2005 show turnover of £100,000 which consisted entirely of fees paid to it by the Company. After corporation tax of £19,234 was paid, it made a profit of £81,999.

69. FCS declared an interim dividend of £75,000 on 6 April 2005 which was split equally between the appellant and Ms Rogers.

70. The appellant and Ms Roger's tax returns show that they declared this dividend income, and liability for tax thereon, in the returns for the tax year 2005/2006.

71. As the Company recruited staff and thus had its own accounting function, the role of Trenfield Williams became more like auditors and they became decreasingly active in the day to day involvement with the financial activities of the Company.

Sage

72. In its early years the Company did not keep full double entry accounting records. But from July 2000 and as the size and complexity of the Company's activities developed, proprietary accounting software was introduced by the Company. This was of the Sage Sterling/Line 50 lineage ("**Sage**"). This is widely used in small and medium size businesses and was adequate for the Company. At much the same time, professional accounting staff were recruited and entrusted with the operation of the Company's financial and accounting systems. Prior to Mr Home, there was a previous accountant and financial controller called Christopher Turner who was in post until at least the middle of 2005.

73. Input into the Company's Sage system was undertaken exclusively by the Company's personnel; but Trenfield Williams was given a copy of the Company's Sage back-up file which they could and did use as part of the preparation and audit of the Company's accounts.

74. Although they did not take any part in operating the Company's accounting system, the appellant and Ms Rogers made many transactions on its behalf and also on their own account using Company resources. Whilst the purpose of some of these transactions was readily apparent, this was not always the case so the Company's accounting staff posted all such transactions to a specific Sage nominal ledger account, specifically 1120, entitled "Directors account". This was intended to be analysed subsequently, so that personal extractions on the one hand and Company transactions on the other could be separated. In practical terms this separation usually, but not always, took place when the annual accounts were prepared. This Sage nominal ledger account was not a director's loan account as it included transactions on behalf of the Company as well as extractions for the appellant and Ms Rogers personal benefit.

HMRC enquiries

75. HMRC opened an enquiry into the appellant's 2007/2008 tax return within the 12 month enquiry window. This enquiry was subsequently extended to include the 2005/2006 and 2006/2007 tax years. Trenfield Williams acted as the appellant's agent throughout this enquiry.

76. During that enquiry a number of meetings were held between the appellant and Mr Haigh (on the one hand) and HMRC's investigating officer, Mr Paul Henry ("**Mr Henry**") on the other.

77. Notes of the various meetings were submitted by Mr Henry to the appellant and Mr Haigh for their comments.

The Challenged Evidence

78. The appellant and Mr Haigh gave oral evidence, referring where appropriate to documents in the bundle, on which they were challenged by Mr Shea. This evidence related to:

(1) The appellant's 2005/2006 and 2006/2007 tax returns.

(2) The 18 month accounts.

(3) The Grant Thornton records.

(4) The £300,000 service contract; its date of execution; its effective date; and the amounts actually paid to the appellant pursuant to it.

(5) The appellant's 2007/2008 tax return and the white space disclosure.

(6) The payments under the service contract and the arrangements within the Company for deductions of tax and payments of NICs in respect of those payments.

(7) The figures submitted by the appellant of the correct amount of value he extracted from the Company for the years under appeal.

The 2005/2006 and 2006/2007 tax returns

79. The appellant's tax return for the tax year 2005/2006 declared employment income from the Company of £4,900.

80. The appellant's tax return for the tax year 2006/2007 declared employment income from the Company of £5,050.

81. Although neither of the copies of these returns in the documents bundle included the endorsement that the information given in the return is correct and complete to the best of the taxpayer's knowledge and belief, it has not been suggested by the appellant that such endorsement does not apply.

82. The appellant's evidence is that he drew £400 per week during the tax years 2005/2006 and 2006/2007. Mr Haigh's evidence endorses this.

83. So how come, asks Mr Shea, the appellant signed off a tax return for 2006/2007 declaring income of £5050, far below the annualised weekly drawings (£20,800) for those years? The appellant's explanation is that he relied on his professional advisers. Those professional advisers (Trenfield Williams) were responsible for all his financial/tax matters and if that is what they put in his return, and that is what he signed, then that is what he thought he was taxable on. If that was in the return, then that is his view of what is taxable employment income was for those tax years.

The 18 month accounts

84. As can be seen from [49] above, Trenfield Williams were instructed by the appellant to produce a set of draft accounts for the 18 month period between September 2005 and March 2007 ie. the 18 month accounts. This was solely as a basis for the Company's discussions with the Bank with which Trenfield Williams were not involved.

85. Mr Haigh's evidence is that Trenfield Williams' approach to these accounts was not inquisitorial and there were certainly no audit considerations. The numbers in the Company's own Sage trial balance were accepted uncritically but there was some "tidying up" both of presentational matter and of net extractions and spending by and at the behest of the appellant and Ms Rogers.

86. The 18 month accounts were intended to present an optimistic financial position of the Company. When Trenfield Williams analysed the Sage accounts they saw there was a substantial amount owed by the appellant and Ms Rogers to the Company, and that tidying up was needed for presentational reasons. This tidying up involved an entry in those accounts identifying that a dividend had been paid of £173,000 and that a further £120,000 was payable to FCS as FCS Consultancy (in the "journals") addendum to the accounts) on 31 March 2007.

87. This meant that the 18 month accounts shows an amount due to the directors of £947 as at 31 March 2007.

88. It was Mr Haigh's evidence that he had no evidence that the dividend had been declared or paid and that the £173,000 was presentational. There were no entries of this £173,000 in the Company's Sage software.

89. It was Mr Febrey's evidence that notwithstanding the entry in these accounts of dividends paid £173,000, he did not believe that he had ever paid either to himself or to Ms Rogers and either by extraction or by a book entry, all or any part of this £173,000 dividend.

The Grant Thornton sage records

90. HMRC have based their Discovery Assessments on company records for an 18 month period. These are not (or we do not believe them to be) the 18 month accounts. These records are a series of sheets comprising journal entries which are included in the documents bundle (the "**Grant Thornton Sage Records**").

91. According to HMRC these show that the appellant received payments of £355,281 posted to his account with the Company. HMRC say the account is a directors loan account. They have identified £80,083 of this amount as comprising payments on behalf of another company (identity unknown) and so have reduced the posting (rounded down) to £275,000.

92. The provenance of the Grant Thornton Sage Records is uncertain. They comprise two "groups" of numerical records. On the first page of the first group the words "Febrey DLA" have been hand written across the top. These records show a series of payments in and out. On the first page of the second group of records the words "Directors Loan Account" have been hand written across the top. This second group of documents appear to be printouts of further receipts and payments into and out of the account.

93. It is this account which the appellant says is the holding account which includes payments made on behalf of the Company and on behalf of FCS. It is not a directors loan account. The handwritten "Febrey DLA" (and the appellant surmises that DLA standard for directors loan account) and Directors Loan Account were not written by him and he surmises were written by somebody at Grant Thornton. That person had no insight into the fact that the accounts included payments on behalf of the Company and FCS.

94. And this has confused HMRC who have not themselves recognised the dual nature of the payments and the fact that this is not a directors loan account.

95. Mr Shea was unable to shed any light on these matters.

96. Furthermore, on one sheet in the second group of records, the following entries are included:

Date	**Description**	**Amount**
06/04/2007	M Febrey salary to 6 April 2007	£235,000
05/05/2007	MF salary m/e 5 May 2007	£13,000

05/06/2007	MF salary m/e 5 June 2006	£13,000
05/07/2007	MF salary m/e 5 July 2007	£13,000
05/08/2007	MF salary m/e 5 August 2007	£13,000
05/09/2007	MF salary m/e 5 September 2007	£13,000
05/10/2007	MF salary m/e 5 October 2007	£13,000
05/11/2007	MF salary m/e 5 November 2007	£13,000
05/12/2007	MF salary m/e 5 December 2007	£13,000
05/01/2008	MF salary m/e 5 January 2008	£13,000
05/02/2008	MF Salary M/E 5 February 2008	£13,000

97. HMRC seem to suggest (but see [148-149] below) that these numbers reflect employment income posted to the appellant's directors loan account and on which he was able to draw.

98. The appellant's evidence is that he does not recognise any of these credits. The entries were not made by him or by anyone else at his request. Mr Haigh, on behalf of the appellant, has asked HMRC to obtain copies of the accounts software and data back-ups from Grant Thornton but HMRC have failed to provide this. So the appellant says that he is unable to prove exactly who made the entries. He can only assume that the entries were made by Mr Home or other accounts staff as they are the only people who had access to the Sage system.

99. The appellant's evidence is that the credit of £235,000 makes no sense at all because he did not have a salary entitlement before April 2007. The credits of £13,000 from May 2007 onwards are consistent with the fact that he had a salary entitlement and the amounts are fairly close to (although less than) what he would have expected to receive after tax and national insurance. But he was not involved in entering these credits in the Sage system and had no knowledge of them until HMRC provided the print outs during their enquiry.

100. Mr Haigh's evidence is that the data in the Grant Thornton Sage Records is clearly based on Sage material but it is not a direct extract and shows every sign of having been worked on, Mr Haigh thinks in Excel, before it "emerged".

101. As regards the entries set out above, Mr Haigh is unable to say (since he does not have access to the electronic Sage files which Grant Thornton worked on) where the debits that matched these credits to the account were posted. In his witness statement, he states that the month by month credits of £13,000 are rather less than the £15,000 that the appellant's £300,000 salary paid monthly with a maximum 40% tax deduction that would produce. However, the £235,000 on 6 April 2007 "Defies explanation. It bears no relation to anything known to me in all the years I have acted for Michael Febrey and the companies with which he was associated".

102. In his oral evidence, Mr Haigh stated, somewhat graphically that the £235,000 figure landed from the "dark side of the moon".

The Service Contract

103. In his evidence the appellant stated that he and the Company entered into a service contract in or around April 2007 (the "**Service Contract**"). The existence of the Service Contract is accepted by HMRC but no-one has been able to find a copy of it. The only term of it which is certain is that it was for an annual salary of £300,000 per year. We do not know if this was payable annually, monthly or weekly, although the appellant's evidence is that he drew (or continued to draw) £400 per week against his annual entitlement. We do not know how long the Service Contract was to last for. We do not know what other terms it contained. The appellant has stated that he downloaded copies of several contracts from the internet and then signed an appropriate one himself, and on behalf of the Company. This was kept with the Company's records and was seized (and presumably destroyed) by Grant Thornton. He did not keep a copy.

104. The appellant's evidence is that he downloaded five or six versions of service contracts from the internet in the Autumn/Winter of 2006/2007 and signed the least legalistic one in April 2007. He also said that one reason that he entered into it was to ensure his and his family's security. It was entered into at a time when his relationship with Ms Rogers was disintegrating and Ms Rogers was, at that time, seeing a gentleman who was a likely competitor for the appellant's position with the Company. So in order to make it unattractive for Ms Rogers as sole shareholder to remove him from his involvement with the Company, the appellant blighted the Company with a £300,000 poison pill service contract. The appellant also confirmed that he had chosen a salary of £300,000 a year partly to enable him to cope with his financial commitments and partly because he felt this was appropriate and defenceable for the chief executive of a substantial and, initially at least, thriving company at a time when executive rewards were still buoyant. In answer to a specific question from the Judge, the appellant said that the state of his loan/holdings/current account with the Company had nothing to do with the choice of £300,000 as an annual salary, and we find this as a fact.

105. There was considerable debate about the date of the breakdown of the appellant's relationship with Ms Rogers. It is HMRC's case that this happened in the Autumn of 2006 and justifies their claim that some of the income in 2006/2007 came from the Service Contract. The appellant's evidence is that it was actually entered into and acted upon on and from April 2007.

106. Mr Shea makes the following points based on the documentary evidence:

(1) In a letter dated 16 March 2011 written by Mr Haigh to Mr Henry, Mr Haigh states that:

> "The service contract was established in Autumn 2006 at the time of Mr Febrey's "separation" from Anne Rogers. It was drawn up within his executive authority as the Company's sole director to establish and protect his right to an income from and employment by the Company following his "estrangement" from its sole shareholder who was otherwise in a position to deny him both income and employment".

(2) That letter had been approved by Mr Febrey prior to it being sent to Mr Henry.

(3) The notes of the meeting between the appellant, Mr Henry and Mr Haigh on 9 April 2010 record that:

> "MF explained AR was his partner, but unfortunately they split up in mid/late 2006…..".

(4) In Mr Haigh's letter to Mr Henry dated 16 November 2010, Mr Haigh says:

> "Mr Febrey and Ms Rogers were not together in 2007/2008. He comments that he regards such personal questions as inappropriate (not to say improper and impertinent!) and intrusive and, as the Scots would say, outwith the scope of an enquiry such as this. In fact the "separation" was in April 2006."

(5) Mr Febrey's evidence was that his relationship with Ms Rogers was becoming increasingly difficult from late 2005 onwards. In November 2005 he had purchased a flat in Bristol; he had access to another flat at that time, and between late 2005 and the Spring of 2007 he spent several months living at one flat and moving later to the other (where he lived with his son Alex). This is consistent with a relationship break-up in 2006.

(6) And so the appellant's evidence that the Service Contract was intended to protect him on the breakdown of his relationship with Ms Rogers, and that his relationship with Ms Rogers broke-up in 2006/2007, makes it likely that the Service Contract was entered into and actioned in 2006 and not in April 2007 which the appellant asserts.

107. When faced with this documentary evidence, the appellant's response was (essentially):

(1) He had discussed the possibility of putting the Service Contract in place to protect his position with Mr Haigh sometime between Autumn 2006 and April 2007.

(2) His relationship with Ms Roger at that time veered from the amicable to the volatile. And although he laid the ground during the amicable period, he only put the Service Contract into effect once the relationship became volatile and that was not until April 2007.

(3) He should only be taxed on the money which he drew down under the Service Contract and he did not draw anything down under that until 2007/2008.

108. Mr Haigh's response was:

(1) The fact that he did not respond to the notes of the meeting of 9 April 2010 by contradicting the assertion that the appellant's separation from Ms Rogers was

in mid/late 2006 did not mean that he accepted it then (and does not do so now). He did not contradict every inaccuracy.

(2) Although the letter of 16 March 2011 was approved by Mr Febrey, it was carefully worded. Even if the Service Contract had been "established" in the Autumn of 2006 it was not acted upon until April 2007.

(3) It was his view that Mr Febrey should only be taxed on what he actually drew down under the Service Contract and he did not start drawing anything down under that Service Contract until the tax year 2007/2008.

The appellant's 2007/2008 tax return and the white space disclosure

109. The appellant's 2007/2008 tax return declares an income from the Company of £300,000 and tax taken off that amount of £111,414.40.

110. In that return, a white space disclosure was made which reads:

> "My only income in 2007/2008 was a very substantial salary from Febrey Ltd of which I was a director but in which I was not a shareholder…… Febrey Limited went into administration in March 2008 and all its records are in the hands of the administrators. Unfortunately, I have been unable to procure a P60 from them and so I do not have precise pay and tax deducted figures to include in this Return. I do know, however, that my pay was taxed fully at source using the appropriate PAYE code (522L) and so, as it was only my only source of income for the year, I will have been taxed fully and correctly at source and there will not be a balance of tax either owing or overpaid arising from this return. Therefore, there will be no tax consequences because of any error in the figures I have included here."

111. It was Mr Haigh's evidence that this return was dealt with in January 2009 after the Company had entered into administration and without access to any relevant records. This was largely the reason for the disclosure. The appellant was not provided with a P60 or sight of the Company's 2007/2008 P35. He had been told by Mr Febrey that the latter had instructed Mr Home to pay his salary monthly on a conventional basis, implying monthly credits of after-tax pay to his director's account.

112. Even if the appellant's received only 10/12^{ths} of the salary before the Company went into administration, it wouldn't have affected the tax and NICs due since they should have been properly deducted at source and paid to HMRC by the Company. Mr Haigh had no records which evidenced actual payments of the salary under the Service Contract. The white space disclosure was made in the knowledge that HMRC might open an enquiry into the appellant's tax affairs.

113. The appellant's evidence was that he had not done any calculations of his drawings and his belief was that he was only going to be taxed on what he had actually received. It was likely that he knew that that wasn't £300,000 since he had not drawn anything like as much. The £300,000 was to deter Ms Rogers from replacing him and he never expected to get the £300,000 at any stage. He didn't need it and, as the Tribunal

has seen, in previous years he was only taking out about £50,000 or £60,000 which was all he needed or wanted.

Payments under the Service Contract

114. As mentioned at [111] above it was Trenfield William's view based on what they had been told by the appellant that the payments of salary made by the Company to the appellant under the Service Contract were made on an after tax basis. The white space disclosure reflects this.

115. The appellant's evidence in chief on this was very simple and straightforward.

> "I told Mr Home about the contract and asked him to ensure that it was correctly administered for tax and accounting purposes".

116. Unsurprisingly he was cross examined by Mr Shea as to what he meant by this statement, and in response, gave the following additional evidence.

117. The appellant understood that he would only be liable to PAYE if he actually received payments, and simple entitlement to a salary of £300,000 did not mean that he had a tax liability on that.

118. He cannot remember what he told Mr Home, word for word, but it was along the lines that there was at that time a formal employment contract with the Company and that he was now formally an employee of the Company having separated from Ms Rogers and could Mr Home treat him as such and so deduct tax as required now that there was a contract in place. Mr Home never saw the Service Contract, but the appellant is pretty sure he would have told Mr Home that the salary was £300,000. He didn't tell Mr Home the frequency that Mr Home should operate PAYE, and assumed that Mr Home would have processed the payments in the usual way. The Company had both a weekly and monthly payroll. His recollection was that he had given this instruction to Mr Home in the accounts office where the appellant had stood by the door. He had never confirmed these instructions in writing. He had never had a payslip.

119. He thought this "discussion" with Mr Home would have taken place around the time that he stopped cohabiting with Ms Rogers which started about the end of 2006 and continued over a period so that by the time it got to March 2007 he would have moved out. So he thought this was around the time that he would have told Mr Home about the Service Contract and how it should be processed through the payroll.

120. There were no notes of the discussion and the appellant cannot remember anyone else being in earshot. He would have expected Mr Home to keep his affairs confidential including his salary. He had no idea about how to operate a payroll and would therefore have been unable to instruct Mr Home as to how to maintain that confidentiality. Mr Home was a senior, competent and qualified person, so the appellant had confidence that he would carry out instructions. He had never had any cause for concern that he wouldn't and he had never had any problems with him in the past. Mr Home did not ask any questions regarding the frequency with which the appellant should be paid.

121. He had drawn £400 per week against his entitlement to dividends and he continued to do so, but as an employee rather than as a shareholder. His view was that Mr Home would simply operate PAYE and national insurance on those payments. He expected that the salary would be made available to him when he needed it. The appellant had access to the bank accounts but Mr Home was responsible for processing the payments.

122. He never thought payslips were important notwithstanding other employees received them. He did not ask for or receive one.

123. He could not comment on why Grant Thornton had not included him as an employee on the P35 they had submitted for the Company. He wouldn't know where to look to confirm or demonstrate that his salary had gone through the payroll of the Company. He left that all to Mr Home. He never asked Mr Home if he could see the payroll system in action, nor did Mr Home ask for evidence of his entitlement. He was trying to get business in and managing projects that the Company had already secured. He left it to Mr Home, as a qualified professional, to administer, properly, the PAYE and national insurance deductions. He cannot account for the fact that the only person missing from the payroll list submitted by Grant Thornton was himself. He re-emphasised that Mr Home had never been insubordinate; he had good credentials and did what needed to be done. Although he had a contract for £300,000 he only drew about £56,276.

The appellant's alternative figures

124. For the purposes of this appeal the appellant has undertaken an analysis of what was, in his view, the correct amount of income that he had extracted from the Company in each of the tax years under appeal.

125. This exercise had been initiated by Trenfield Williams who produced a spreadsheet based on the Sage back-up files of the Company. Trenfield Williams then undertook an exercise such as that which would have been usually done at the end of the Company's account year, i.e. splitting the holdings account figures into what were obviously personal extractions (on the one hand) and business payments (on the other) and then going further and splitting the personal extractions between the appellant and Ms Rogers.

126. These were then sent in draft to the appellant who worked on them, identifying further known business and personal extractions which would not have been obvious to Trenfield Williams. This process happened several times. The resulting figures are, in the appellant's view, more likely to be correct than those figures which form the basis for the tax and NICs now claimed from the appellant. The appellant's preferred figures are that his income for 2005/2006 was £53,406.71, for 2006/2007 it was £54,985.91 and for 2007/2008 it was £56,276.29.

THE RELEVANT CASE LAW

Relevant payments

127. The Directions apply in circumstances where an employer has failed to deduct tax (or pay NICs) from "relevant payments".

128. Relevant payments mean payments of, or on account of, net PAYE income which in turn includes PAYE employment income. PAYE employment income is defined in Section 683 ITEPA as being "taxable earnings from an employment in a year".

129. There are two issues here. Firstly, do the sums extracted from FCS and/or the Company during the years under appeal comprise employment income of the appellant. If so, were those extracts paid to him and if so when.

Earnings from an employment

130. The leading case on this is still *Hochstrasser v Mayes* [1960] AC 376. It is a House of Lords Decision. In that Decision their lordships cited with approval the principle set out by Mr Justice Upjohn (as he was then) who gave the first instance decision. He said as follows:

> "In my judgment 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. Disregarding entirely contracts for full consideration in money or money's worth and personal presents, in my judgment 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 past, present or future."

131. So it is clear that payments can be made by an employer to an employee which are not treated as being taxable earnings from an employment

Timing of payments

132. The provisions of section 18 and 686 ITEPA deal with the time when general earnings (section 18) and PAYE income (section 686) is treated as being made or received. There are three rules (see the appendix which sets out section 686(1) ITEPA). Rule 1 is the time when the payment is made. Rule 2 is the time when the person becomes entitled to the payment.

133. There is little authority on the meaning of Rule 2. This was acknowledged in the Upper Tribunal Decision of *UBS AG and DB Group Services (UK) Limited v HMRC* [2012] UKUT 320 ("**UBS**") whereat [61].

> "61. At the heart of this part of the case is a question of construction which, although nowhere articulated in the decision of the FTT, was the subject of considerable debate before us. That question is whether the words "entitled to

> payment" in Rule 2 of section 18(1) denote only a present right to present payment, or whether they are wide enough to include a right to payment in the future (which may or may not be subject to defeasance or contingencies). UBS argues for the former interpretation, while HMRC argue for the latter. Surprising though it may seem, there appears to be no direct authority on the point.
>
> 62. In our view there are several powerful reasons which indicate that the former interpretation is correct."

134. For the purposes of this Decision we have not set out all four reasons given by the Upper Tribunal, merely the first one. It is set out below:

> "63. In the first place, as Lord Hoffmann explained in MacDonald v Dextra Accessories Ltd [2005] UKHL 47, [2005] STC 1111 at [2] to [3], until 1989 the emoluments of an office or employment were taxed under Schedule E as income of the year of assessment in which they were earned, and it did not matter when they were paid. Section 37 of the Finance Act 1989 then inserted new sections 202A and 202B into ICTA 1988, and changed the basis of assessment under Schedule E from the year in which emoluments were earned to the year in which they were paid. In other words, the earnings basis of liability was replaced with a receipts basis. Section 202A(1)(a) provided that income tax should be charged under Schedule E "on the full amount of the emoluments received in the year in respect of the office or employment concerned", while subsection (2)(a) confirmed that this Rule applied "whether the emoluments are for that year or for some other year of assessment". Section 202B then explained the meaning of "receipt", with paragraphs (a) and (b) of subsection (1) corresponding to what later became Rules 1 and 2 of section 18(1) of ITEPA. It seems to us inherently unlikely that, having chosen to depart from the earnings basis (under which earnings could be chargeable to tax in a tax year earlier than that in which they were received), Parliament should then have gone to the other extreme, and imposed liability to tax when the entitlement arose to a future payment which might not become payable until a subsequent tax year, and when the entitlement itself might be defeasible, or subject to conditions, in the meantime, as a result of which the future payment might in fact never materialise.
>
> 64. It is far more probable, in our view, that section 202B(1)(a), and later Rule 1 in section 18, were intended to lay down the basic rule that actual payment of the earnings was to be treated as receipt, while Rule 2 catered for the position where a present right to present payment of the earnings had accrued, but for whatever reason actual payment was delayed or withheld. It is easy to see the rationale for a limited provision of that nature, because a right to immediate payment would have crystallised, and in the absence of the rule it would be open to the parties to manipulate the timing of the receipt, and thus potentially the year in which it would be taxed and the rate of tax to which it would be subject, by the simple expedient of a delay in payment."

135. What we take from this is that PAYE income is to be taxed when it is actually received, and in the amounts so received.

Knowledge of wilful failure to deduct

136. In the Upper Tribunal Decision of *West* (*West v Revenue & Customs Commissioners* [2018] UT 100). The Upper Tribunal (see [40] of its Decision) approved the FTT's approach towards knowledge of wilful failure to deduct. The FTT had adopted a three-fold test. It was for HMRC to show that:

> (1) The employer did not deduct PAYE;
>
> (2) The failure was wilful and deliberate;
>
> (3) The employee received the remuneration *knowing* that the employer had wilfully failed to deduct the tax.

137. The Upper Tribunal (at [62]) also recognised that the taxpayer's state of mind is purely subjective and that knowledge is actual knowledge.

> "62 – Mr Slater argued that Astral could not have deliberately failed to deduct PAYE, and Mr West could not have known that the Company had deliberately failed to deduct the tax, because Mr West himself believed that the Company had deducted tax. Mr West's belief, Mr Slater submitted, and we accept, is a purely subjective question. As May J put it in *McVeigh* [1996] STC 91 at 96…. referring to *R v IRC, ex p Chisholm [*1981] STC 253, … "Knowing" means knowing, not "ought to have known" and "wilfully" means "intentionally or deliberately""

138. In the case of *R v Inland Revenue Commissioners ex p Cook* [1987] STC434, Mr Justice Nolan (as he was then) said

> "So far as the meaning of the word "wilfully" is concerned, Counsel for the taxpayer has also referred me to the remarks of Salmon LJ in *Frederick Lack Limited v Doggett*… Salmon LJ quoted an earlier remark of Wilberforce J (as he then was) about the meaning of the word "wilful" in the context of "fraud or wilful default". What Wilberforce J had said was that "…it is clear that what I have to find is some deliberate or intentional failure to do what the taxpayer ought to have done, knowing that to omit to do so was wrong…
>
> For my part I see little to choose between these two references to the meaning of the word "wilful". I take it that if there is evidence of culpability or blame worthiness or wrong, deliberately or intentionally carried out, then the word "wilful" can be properly applied to it".

DISCUSSION

139. For the tax years 2005/ 2006 and 2006/2007 the basis for the assessments of £103,000 and £172,000 respectively seems to be:

> (1) An examination of the "director's loan account" supplied by Grant Thornton in part of the Grant Thornton Sage Records from which HMRC have identified £355,281 of extractions. HMRC considers that of these, £80,000 or so reflect payments to another company (and so not extractions to the appellant).

The resulting amount of approximately £275,000 (rounded down), HMRC say, are all payments to the appellant. The appellant says no. A large number of these payments relate to business payments. The appellant's position is that he only extracted the amounts set out in [126].

(2) The £275,000 has then been divided between 2005/2006 and 2006/2007 tax years in the amounts set out in [139].

(3) These figures are supported by evidence of a dividend of £173,000 which the 18 month accounts indicate was paid. Those accounts also show a further £120,000 payable to FCS. HMRC seems to suggest (although it is not all together clear to us the precise nature of this suggestion) that the payments were actual payments by the Company to the appellant. Obviously the £275,000 mentioned at [139(1)] above is somewhat smaller than the £293,000 which the dividend and consultancy figures amount to. If they are relying on those figures as payments to the appellant, we are uncertain as to why they have not used that number rather than the £275,000.

(4) The Service Contract was entered into and actioned in October 2006. (This is Mr Shea's submission). This is further evidence of why the amounts are apportioned to the 2006/07 tax year is employment income.

140. We reject HMRCs submissions on this point for the following reasons:

(1) It is clear from *Hochstrasser v Mayes* above that HMRC need to show that the payments were made by reference to the services which Mr Febrey rendered to the Company. And, significant here, is the fact that not every payment made to an employee is necessarily made to him as a profit arising from his employment.

(2) We have set out at some length at [62] above details of the structure which was put in place by the appellant at the suggestion of Mr Haigh in or around 1994. The appellant supplied his services to the Company for which he was paid a modest salary. He also supplied his services to FCS who on-supplied them to the Company in consideration for a management fee of approximately £10,000 a month. This was to enable extractions from the Febrey empire to be made on a tax efficient basis. There is nothing wrong with drawing chunks of money from a company or a partnership on account of future credits of dividend or profit which might be made. This happens all the time in small companies and partnerships. There is then a reckoning at the end of the year and either dividends are declared (and paid or credited) or profits are declared (and paid or credited). If a director has drawn out more during the year than is in credit to him in his loan account, then there are provisions in the tax code to penalise him.

(3) So the strategy adopted by the appellant and the Company and FCS at Mr Haigh's suggestion is a thoroughly sensible one. It was designed to be tax efficient. HMRC make no criticism of this. Dividend payments or credits were made with an eye on the financial position of the business, the distributable reserves of the relevant company, and the tax positions of the appellant and Ms

Rogers. The appellant sensibly took advice from Mr Haigh and Trenfield Williams who completed his tax returns which the appellant then signed. He was entitled to rely on them. In answer to Mr Shea's question at [83] above, that the amount that the appellant had drawn down on account of the dividends was a great deal more than, annualised, the amount of employment income he declared in his tax returns, the answer might be that the appellant thought that there was no further tax to pay. He had been advised that the structure was to ensure tax efficiency. At that time (we understand Mr Haigh to be saying) there was no further tax on dividends provided they were of an amount within the appellant's basic rate tax band. So if the appellant thought that what he was drawing was on account of a dividend on which there would be no further tax to pay, we see no issue as to why the appellant should have thought that his tax return should include that income as additional taxable employment income.

(4) What the appellant was extracting were amounts on account of dividends from FCS. He was drawing a modest salary from the Company, as his tax returns show, but the vast majority of the payments made to him, for the reasons given in evidence by the appellant and Mr Haigh, were attributable to dividends either declared or to be declared.

(5) Mr Shea's criticism that there are no records reflecting the declaration of these dividends is partially valid. But we would observe that this was the case for many of the previous years and HMRC do not appear to have impugned dividends paid for those years prior to the tax years under appeal. But interim dividends do not have to be declared. Under Article 103 of Table A, which articles were adopted by the Company and by FCS, an interim dividend only has to be paid. There is no need to formally declare an interim dividend. The dividends were then reflected in the accounts. HMRC do not appear to be alleging that the dividends were a sham, or that they were disguised in employment income along the lines litigated in P A Holdings. We find as a fact that the payment/credit of the dividend of £75,000 on 6 April 2005 was a genuine dividend and was paid to the appellant and Ms Rogers by FCS. We also find as a fact that had it not been for the difficulties of the Company in later years a dividend would have been declared on 6 April 2006 (see [64]).

(6) On the basis of the evidence given by the appellant and Mr Haigh, we also find as a fact that the "dividend" of £173,000 identified in the 18 month accounts and the £120,000 of [consultancy] fees paid to FCS were just paper transactions and no actual payment of the dividend or the consultancy fee was made.

(7) The methodology adopted by HMRC of taking the director’s loan accounts supplied by Grant Thornton and using that as the basis for the discovery assessments is not an unreasonable starting position. But as has been explained by the appellant and Mr Haigh, and as we find as a fact, these records are not a record of extractions solely by the appellant and Ms Rogers. They do not reflect a loan account in the purest sense. It is a mixed account, through which business transactions were also processed. At the end of the year, what usually happened was that the rationalisation of the figures and the personal extractions were then

"transferred" to a genuine director's loan account. This didn't happen as regards to the 18 months accounts for the reasons given by the appellant [see [46] above]. We accept this. And when the appellant and Mr Haigh then put their minds to undertaking a similar exercise for the purposes of this Appeal, they came up with the figures of £53,406.71 for 2006/2007. We find as a fact that these figures are more likely to be accurate than those of £102,000 and £173,000 used by HMRC in the Discovery Assessments.

(8) But these amounts are not attributable to Mr Febrey's employment with the Company. HMRC might say that these extractions have to have a source. Since no dividends were actually paid for 2006/2007, they cannot be dividends. We appreciate the point. But they can be drawings from FCS on account of anticipated dividends. This is what had happened for years when the strategy adopted by the Company had been put in place. Indeed the holding account included transactions for both the Company and FCS. The accounts might have been overdrawn given that no dividend was actually paid for 2006/2007 or 2007/2008 but does not make the extractions employment income.

(9) Given the unchallenged evidence of the relationship between FCS and the Company, we think that if the extracts evidenced by the loan accounts could conceivably be treated as salary, it is more likely that it was a salary from FCS to whom Mr Febrey supplied his expertise and which was then on-supplied to the Company in consideration for the fee of £120,000 or so per year. FCS was taxed on this. The post-tax profits were then available for payment to the FCS shareholders as dividends. We do not think that these extractions could be then categorised as employment income from the Company. Whilst the appellant accepts that the money he extracted from the Company and FCS was because he was providing services, that does not mean that the dividends or amounts on account of dividends can be re-categorised as employment income. The employment income, we find, which the appellant was paid by the Company is in the amount set out in his tax returns.

(10) There is a clear distinction between the payments from the Company (salary of a very modest amount) and payments from FCS (dividends of more substantial amounts). This is a very real distinction and HMRC's analysis seeks to blur it and conflate the two into a single payment from the Company. The evidence does not support this approach.

(11) Even if the Service Contract was entered into in the tax year 2006/2007, we do not believe it was "actioned" until April 2007. By "actioned" we mean that Mr Febrey drew out amounts from the Company on account of his entitlement to an annual salary of £300,000 under the Service Contract.

(12) We accept the appellant's evidence and that of Mr Haigh that although there was a discussion about the feasibility and practicalities of entering into a service contract in the Autumn of 2006 and into 2007, the Service Contract was not actually actioned by the Company and Mr Febrey until April 2007. We agree with Mr Shea that the documentary evidence supports the likelihood that the

Service Contract had been signed earlier than April 2007 and we find this as a fact. It is our view that it was actually signed by the appellant on his own behalf and on behalf of the Company in the Autumn/Winter of 2006/2007. But we accept the appellants evidence that the conversation he had with Mr Home at which he told Mr Home about the Service Contract, and in which he asked Mr Home to make the appropriate deductions of tax, did not take place until April 2007. We consider this in more detail below. But as regards to the tax year 2006/2007, our view on the evidence is that none of the payments made to the appellant in that tax year were payments to which he was entitled under the Service Contract.

(13) They were payments on account of dividends which were then never paid. This might have caused his director's loan account to become overdrawn. But that comprises a debt which the Company could have recovered. It was a taxable benefit for which the tax code makes specific provision.

141. Drawing these threads together, our analysis is as follows:

(1) PAYE income is earnings "from" an employment.

(2) *Hochstrasser v Mayes* makes it clear that:

(a) Not every payment made to an employee necessarily arises from his employment; and

(b) To arise from his employment, a payment must be made as a reward for services rendered by the employee.

(3) The amounts credited to the appellant's holding account and subsequently to his loan account were not on account of services provided to the Company in the appellant's capacity as employee. They were on account of dividends that he had received and anticipated receiving in his capacity as shareholder of FCS.

(4) The deemed payment provisions in section 686 ITEPA are not engaged for 2005/2006 or 2006/2007 because we have found that there is no PAYE income in the first place.

(5) The reason why this is the case for 2006/2007 notwithstanding that we have found that it is more likely than not that the Service Contract was entered into in the Autumn/Winter of 2006/2007, is because, as the case of UBS shows, the appellant is only entitled to PAYE income if he has the present right to present payment.

(6) It is the appellant's evidence, which we accept, that he did not draw down any sums under the Service Contract until April 2007. Until then, although he had an overarching entitlement under the Service Contract to an annual salary of £300,000, he had no present right to present payment of any part of that. The line in the sand is, in our view, when he told Mr Home in April 2007 of the existence of the Service Contract; the appellant's entitlement to an annual salary of £300,000 under it; that the appellant anticipated that he would draw against this figure, amounts as needed; and that he told Mr Home that from that time payments to the appellant should be processed through the payroll.

(7) The appellant then continued to draw down £400 per week as he had been doing for a number of years. All that had changed, however, is that the source of these drawings was his Service Contract rather than on account of payment of future dividends.

(8) So it our view that there was no PAYE income until the tax year 2007/2008.

142. It is our conclusion that for the tax years 2005/06 and 2006/07, the amount of employment income that the appellant received from the Company is that which is set out in his tax returns for those years. The additional amounts of £103,000 for 2005/06 and £172,000 for 2006/07 which are the subject of the Discovery Assessments (and indeed the Directions) were not income from employment. They were not relevant payments for the purposes of the Directions. And so we allow the appellant's appeal against the Discovery Assessments for those two tax years.

2007/2008

143. For 2007/2008 the issues are different. It is accepted that the appellant received PAYE income in this year. The issues concern:

(1) The correct amount of PAYE income he received; and

(2) Whether the Directions apply to that income.

The amount of PAYE income

144. It is HMRC's case that the amount of income that the appellant received in this year is £300,000. This is the annual salary to which he was "entitled" under his Service Contract. This is true even though, if it was entered into in April 2007, the amount he received could not have been £300,000 if he was "paid" monthly or weekly since the Company went into administration in February 2008.

145. But HMRC also say that the appellant's tax return, completed and signed by the appellant, self-assesses £300,000 as his employment income from the Company in this year and also declares that tax of £111,414.40 has been deducted from it.

146. We are sympathetic to HMRC's submission on this point and agree with them that the self-assessed sum of £300,000 is an entirely reasonable basis for their assessment for the 2007/2008 tax year.

147. However, it is our view that this is not the correct amount of PAYE income either paid to the appellant or which he received in this tax year. We say this for the following reasons:

(1) We have found at [140(12)] above that the appellant did not draw down against his Service Contract until April 2007. The appellant's present right to present payment did not, therefore, start until then. And so as a matter of law, notwithstanding the amount actually self-assessed by the appellant, the sum of £300,000 is not the PAYE income paid to him. The correct amount is set out in [147(7)] below.

(2) The appellant's evidence is that he thought he was only liable to tax on the amounts he actually received or were paid to him or for his benefit. Mr Haigh said the same. In this they were both correct as *UBS* shows. It therefore seems somewhat odd to us that the appellant signed off a tax return self-declaring taxable employment income of £300,000 which he knew he had not received.

(3) But *UBS* shows that this was wrong, no matter what the appellant had self-declared.

(4) And, if this were not sufficient, the employment income was not declared on an unqualified basis. To the contrary the appellant made a white space disclosure, drafted by Mr Haigh; the reason for this was that although the appellant had told Mr Haigh that he had executed the Service Contract and had told Mr Home to pay him as if he was an employee from April 2007, Mr Haigh had no records to substantiate the amounts actually paid.

(5) So he drafted a white space disclosure for the appellant to include in his return knowing full well that this might generate an enquiry into that return. The white space disclosure made clear that the appellant was not sure of the precise pay and tax deducted figures as he did not have the relevant records. And it also made clear that given that the appellant thought that his only income for that year was the employment income he had received from the Company, and his view that tax had been properly and fully deducted at source, there would have been no further tax to pay in any event.

(6) This disclosure is consistent with the appellant's evidence that he relied on Trenfield Williams to ensure that he complied with his obligations in respect of tax. He thought there was tax due only on the amounts received. He qualified the headline figure of taxable salary of £300,000 in his 2007/2008 tax return by way of the white space disclosure.

(7) As to the correct amount, we have said in respect of 2005/2006 and 2006/2007 we prefer the figures suggested by the appellant as a result of the reconciliation exercise undertaken as described in [124]-[126] above for the purposes of this appeal. We also feel the same about the figure of £56,276.29 which that exercise has suggested is the appellant's correct amount of PAYE income paid to him for 2007/2008. Mr Shea has asked us to treat this exercise and the appellant's methodology with some suspicion and that perhaps not all of the business expenses which Mr Febrey has identified were indeed business expenses rather than personal extractions. He asks how Mr Febrey can be so certain into which category they fell when all he had was some cheque book stubs, and that these payments were made many years ago. But we have seen Mr Febrey give evidence and we have heard what he had said. It is our view that he has made an honest, reasonable and genuine attempt to categorise payment in the "raw" data supplied by Trenfield Williams into personal and business extractions and payments.

148. One further oddity remains as regards the basis for the assessment for 2007/2008. In the original assessment for this year, HMRC did not use the £300,000. They used the £365,000 based on the second batch of Grant Thornton Sage Records (see [96]-[97] above). It is not clear to us, nor to the appellant what status the £365,000 now has in the respondent's case, nor the role played by the Grant Thornton Sage Records. HMRC do not appear to rely on it in their skeleton. Nor did Mr Shea make much of them in this submissions.

149. Our view is that given their provenance is unclear; the appellant's evidence and that of Mr Haigh is that they have simply no idea where these numbers came from nor who made the relevant journal entry; the fact that Mr Shea could shed no light on the process, and that simply putting numbers on a piece of a paper tell us nothing about any underlying transaction, we are giving no weight to these Grant Thornton Sage Records. As far as we are concerned they gave the appellant no entitlement to the figures recorded nor do we think that they fall within Rule 3 of section 686 ITEPA. In our view they are not evidence of payment or receipt of PAYE income for the appellant for the tax year 2007/2008.

The Directions

150. Given that we have found that the appellant received no PAYE income in 2005/2006 and 2006/2007 and so received no relevant payments, the Directions cannot apply for these two tax years. But they can, potentially, for 2007/2008.

151. We remind ourselves that it is for HMRC to establish that:

(1) The Company did not deduct PAYE from the payments;

(2) The failure to deduct was wilful and deliberate;

(3) Mr Febrey received his payments knowing that the Company had wilfully failed to deduct PAYE;

152. We also remind ourselves that Mr Febrey must actually know that the Company had wilfully failed to deduct the tax and that wilful failure means a deliberate or intentional failure;

153. HMRC needs to show that the Company's failure to deduct PAYE was intentional and deliberate and that Mr Febrey received his payments knowing that the Company had intentionally or deliberately failed to deduct the PAYE. These are high hurdles.

154. To overcome them, Mr Shea made the following points:

(1) As sole director and chief executive of the Company, which ran a payroll for its employees, the appellant had ultimate responsibility for ensuring that PAYE and NICs were deducted from all relevant payments including those to him. He was aware of this. He was the "controlling mind" of the Company. The fact that he employed people to deal with the practical aspects of the payroll is neither here nor there. His duties as director include a responsibility of ensuring that a payroll is properly run and tax properly deducted from payments made to

employees. The case of *West* is important here and illustrates that someone who is the controlling mind of a Company cannot simply delegate the function to a third party and absolve themselves of the responsibility to ensure that appropriate deductions are made.

(2) He received no pay slips. On the appellant's evidence, there was a significant change to the basis on which he was paid in April 2007 following the meeting with Mr Home. His evidence is that he told Mr Home to put him on the payroll. If this was the case, he could reasonably have expected to receive payslips like any other employee. He received none. He should have made sure that he received them and was therefore in a position to check whether tax and national insurance was being deducted. It is untenable for the appellant to say that he did not expect to get payslips. All his other employees got payslips.

(3) Mr Shea does not accept, notwithstanding Mr Febrey's evidence, that the discussion with Mr Home took place as the appellant alleges or at all. If it did take place, then it was likely that Mr Home would have been extremely busy given the commercial position of the Company. The meeting was not followed up with any written instruction. The meeting was not recorded in writing. The appellant should have made sure that the payroll was run properly, even though HMRC's case does not rely on the appellant knowing how, operationally, how a payroll should be operated. The lack of knowledge is irrelevant. He was the employer and he deliberately caused money to move out of the Company without deduction of tax.

(4) The administrators did not provide him with a P60 for 2007/2008. HMRC say that this is because the administrators found no record for the appellant on the payroll. There is no evidence that P60's were not provided to other employees.

(5) The appellant knew that throughout 2007/2008 he was drawing round sum amounts and extracting other amounts from the Company. His evidence was that he was drawing down against amounts to which he was entitled under the Service Contract. Given these were round sum amounts, he should have realised that no tax or NICs were being deducted.

(6) There is no evidence that the Company payroll department had any difficulties in operating the payroll and no reason to believe that they would have failed to include a payroll entry for the appellant had they been instructed to deduct PAYE and NICs. The appellant has provided no witness evidence from the payroll department to corroborate his statement or to explain why PAYE and NICs were not operated on his salary.

(7) As controlling mind of the Company it would have been a simple matter to request evidence from the payroll department that his salary entitlement had not been properly subject to PAYE deductions and payments of NICs. On the available evidence it appears the appellant did nothing to ensure that his salary was being processed correctly.

(8) The appellant's evidence that he told Mr Home that he was expecting to be able to draw down against his salary as and when he needed to means that Mr Home must have been in a very uncertain position. How did Mr Home know

what amount the appellant would need? The appellant's statement that he assumed that the necessary deductions would be made should have been checked, given that this was a considerable change as to how things had been happening before (i.e. taking money on account of past and prospective dividends rather than by reference to his entitlement under the Service Contract). Given this change it is reasonable to conclude that he would have expected there to be changes in the manner by which the funds from the Company were made available to him and recorded.

(9) The fact, however, that he continued to draw money from the Company, as he had always done, and has produced no evidence that lends support to his belief that he was receiving and drawing on net amounts, suggests that he knew that the Company has wilfully failed to deduct PAYE tax and pay NICs on the salary to which he was entitled under the Service Contract.

155. It is for HMRC to establish that the Company wilfully failed to deduct PAYE and pay NICs on the relevant payments. It seems to have been accepted that, as a question of fact, no such deductions or payments were made. To establish wilfulness, HMRC must show a mental element of intentional or deliberate behaviour. To establish knowledge they must establish actual knowledge.

156. We have no evidence as to why the deductions or payments were not made. But we accept, without reservation, the evidence of Mr Febrey in relation to his discussion with Mr Home set at [115]-[123] above. Mr Shea makes the point that Mr Home might have misunderstood what Mr Febrey had asked him to do. There was nothing in writing to follow up that discussion. We took the view that Mr Febrey did indeed ask Mr Home to process the amounts he drew from the Company from April 2007 on account of his annual salary of £300,000 per year (i.e. the draw downs of the ongoing £400 a week) through the payroll. We accept that there was, as far as Mr Febrey was concerned, no misunderstanding as to what he said to Mr Home. Mr Home was a competent professional accountant. There was no indication that he had ever failed to act on an instruction in the past. Mr Febrey had no first-hand knowledge of how to operate a payroll and so he inevitably asked Mr Home to ensure that his salary was processed through the payroll. Mr Home seems to have failed to do this. But we have no evidence as to why this was. We cannot say if it was intentional or deliberate on the one-hand (and therefore wilful) or careless or just a matter of simple mistake on the other. The inference that Mr Home (and therefore the Company) acted deliberately or intentionally are conclusions that we cannot draw from the available evidence.

157. Mr Shea submits, however, that it is not Mr Home’s mental statement that we should consider. It is that of Mr Febrey. This is because the appellant was the controlling mind of the Company and, as director and chief executive, was in the unique position of being able to dictate what the Company should and should not do. Indeed, more than that, Mr Febrey had a duty and responsibility to ensure that PAYE was deducted and NICs accounted for on the amounts he drew down on account of his salary under the Service Contract with effect from April 2007.

158. Mr Shea cites the case the *West* as authority for this proposition.

159. In the Upper Tribunal decision in *West* the Tribunal dealt with Mr West's company's (Astral) failure to deduct tax wilfully, and Mr West's knowledge of that, together.

160. At [61] "As Mr West was the sole director of Astral, it is his actions, intentions and awareness that fall to be ascribed to the company. We can accordingly consider both questions effectively from the perspective of Mr West alone."

161. And again at [66] "….. What matters is whether Mr West (as the guiding mind of Astral) intentionally failed to deduct tax, and whether he knew that that had happened. His knowledge of the factual matters we have mentioned above must be sufficient to satisfy both those conditions…..".

162. Mr Shea says that Mr Febrey was in an identical position to Mr West in that like Mr West, Mr Febrey was sole director (of the Company).

163. But we do not agree that Mr Febrey's position as director of the Company is the same as Mr West's position as regards Astral. We have read both the FTT Decision and the UT Decision in *West*. Although it is not entirely clear from either, it seems that Astral was a genuine "one man company". Mr West was sole director and shareholder. There were no employees. There was no accounts or payroll department (hence the reason why Mr West asked his accountants to draft the relevant accounts). This is in considerable and significant contrast to the position of the Company which, on the unchallenged evidence, was a very substantial enterprise in 2007, with a turnover of approximately £20m, approximately 400 employees and sub-contractors and, importantly, 10 employees who worked in the Company's office some of whom were involved in an accounts or payroll function headed by a qualified chartered accountant. Notwithstanding that he was not a shareholder Mr Febrey had overall responsibility for ensuring that the Company complied with its legal obligations since he was the sole director. This was set out in a letter written by Trenfield Williams to Susan Elston dated 17 July 2011 in which Trenfield Williams say:

> "Of course, Mr Febrey, as sole director and chief executive officer at the time is "ultimately responsible" in exactly the same way as, for example, whoever fills an equivalent role in HMRC is "ultimately responsible" for everything that all its expert staff do and fail to do. But this is not to say that every mistake, failing or inadequacy is the CEO's personal responsibility and that every mistake, failing or inadequacy is "wilful". "

164. Our view is that a director can discharge his responsibility to ensure that the Company complies with its legal obligations by giving instructions to competent individuals within the Company. Delegating to appropriately qualified staff discharges that duty and this is what the appellant did. There was no indication from any previous behaviour exhibited either by Mr Home or other members of the accounts department, that they were not competent to run the payroll. There had been no issues with their competence prior to the instructions given by Mr Febrey in April 2007. There was no reason why Mr Febrey should not have thought that his clear instructions to process his drawings through the payroll should not have been acted on.

165. In the case of *West* it was found (at [65]):

> ".... crucially it did not affect the accepted fact that Mr West knew all along that, notwithstanding the acknowledgement of the indebtedness of the Company to HMRC in respect of the tax and NICs purportedly deducted, no actual payment of tax could or would ever be made.

166. This in stark contrast to the position of Mr Febrey. Mr Febrey had given (in his view anyway – which we accept) clear instructions to Mr Home to process his salary through the payroll whilst in *West* it was found as a fact that Mr West knew that no tax would be paid on the deemed remuneration that he had awarded himself to clear his loan account, in Mr Febrey's case we find as a fact that the appellant did not know that the Company would not deduct PAYE or not pay NICs. To the contrary, we find as a fact that he thought that the Company, through the agency of Mr Home and the payroll department, would so deduct PAYE and pay NICs on the salary that he drew from the Company with effect from April 2007.

167. We accept that the appellant might have done more. Mr Shea's point about not getting payslips weighs against the appellant, but not dramatically. The test is whether the appellant actually knew that the Company had failed to deduct or pay. There is no suggestion that the appellant was concerned about whether tax had been deducted but turned a blind eye to it, one element of which was a failure to ask for payslips. The appellant might have been put on notice that no tax or NICs were being deducted had he received payslips. But in their absence he had no actual knowledge that PAYE was being under-deducted or NICs were being underpaid.

168. Finally, *West* can be distinguished in respect of some crucial factual differences. The Upper Tribunal identified Mr West's knowledge as being [65]:

> "(a) The mechanics of the creation of the remuneration in his favour, (b) its calculation as a gross amount which, after deduction of tax and NICs, would equal the amount he owed to the company on his Loan Account, (c) the crediting of the relevant amounts in the company's accounts to both his Loan Account and to a creditor's account in respect of tax and NICs and (d) the making of the various corporate and personal tax returns ……".

169. The purpose of Mr West's creation of the remuneration in his favour was to "soak up" amounts which were outstanding in his loan account. Secondly, this was a "deemed" payment rather than an actual payment.

170. In contrast, we have found as a fact that the salary of £300,000 under the Service Contract and indeed the amounts that the appellant drew down on a weekly basis (i.e. the £400 per week) were not affected or influenced by the state of the appellant's loan account with the Company and whereas in *West* the remuneration was never going to be paid, in Mr Febrey's case remuneration of £400 per week (plus other extractions) were clearly actually paid to him or for his benefit.

171. Mr Shea also points out that it would have been difficult for Mr Home to know precisely the amount that he should process through the payroll since Mr Febrey's

evidence is that he intended to draw amounts against his salary on a needs basis. But of course, as things turned out, Mr Febrey simply carried on drawing £400 per week. So as regards those payments, it would have been abundantly clear to Mr Home what amount he should operate PAYE on. Similarly, the fact that round sums were drawn out by Mr Febrey, although a point in Mr Shea's favour, was explained by Mr Febrey on the basis that he had simply assumed that Mr Home would operate PAYE on any amount that he withdrew, and if he was extracting a gross amount of £400, Mr Home would deduct the appropriate amount of PAYE tax and NICs, so that the net amount was £400. We accept this evidence.

172. Finally, we note that Grant Thornton were unable to give Mr Febrey a P60 which suggests that they had no record of him being on the payroll. But this is not significant. We have found as a fact that the payments to Mr Febrey for 2007/2008 were on account of his entitlement under the Service Contract and that he was (as he freely admits) an employee of the Company throughout the 2007/2008 tax year.

Conclusion

173. For all the reasons given above, it is our conclusion that although the Company failed to deduct the PAYE tax or make payments of the relevant NICs on the amounts drawn down by the appellant in the 2007/2008 tax year such failure was not wilful. Furthermore, Mr Febrey did not actually know of that failure.

DECISION

174. It is our decision therefore that:

(1) For the tax year 2005/2006, the appellant received no employment income to which either the Discovery Assessment for this tax year or the Directions can apply.

(2) For the tax year 2006/2007, the appellant received no employment income to which either the Discovery Assessment for this tax year or the Directions can apply.

(3) For the tax year 2007/2008, the appellant did receive employment income. His present right to present payment of that employment income, notwithstanding that the Service Contract was entered into before then, arose only at the beginning of the tax year 2007/2008 (in April 2007). The amount of this income is £56,276.29. The Directions do not apply to all or any part of this income since although there was a failure by the Company to deduct the PAYE tax or pay the NICs on that amount it was not a wilful failure, nor did Mr Febrey actually know that there had been any such failure.

175. And so we allow the appellant's appeals against the assessments for income tax and NICs for each of the three tax years under appeal.

APPEAL RIGHTS

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.

NIGEL POPPLEWELL
TRIBUNAL JUDGE

RELEASE DATE: 20 DECEMBER 2018

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APPENDIX

The Relevant Legislation

The legislation

Income tax

1. Under the PAYE system, the employer is liable to deduct tax in accordance with regulation 21(1) of the Income Tax (Pay As You Earn) Regulations 2003 (the "**PAYE Regulations**"):

> "On making a relevant payment to an employee during a tax year, an employer must deduct or repay tax in accordance with these Regulations by reference to the employee's code, if the employer has one for the employee."

2. The employer is then liable to account to HMRC for those deducted amounts (regulation 68 of the PAYE Regulations).

3. A "relevant payment" is defined, by regulation 4 of the PAYE Regulations, subject to certain exceptions which do not apply in this case, to mean a payment of, or on account of, net PAYE income. Net PAYE income is, in the circumstances of this appeal, the same as PAYE income (there are no relevant deductions as provided for by regulation 3). PAYE income is defined by section 683 of the Income Tax (Earnings and Pensions) Act 2003 ("**ITEPA**") relevantly to include PAYE employment income, namely any taxable earnings from an employment determined in accordance with section 10(2) of ITEPA. In the case of a UK resident employee, the full amount of any general earnings which are received in a tax year is an amount of taxable earnings from the employment in that year (section 15(2) of ITEPA).

4. The meaning of "payment" for the purposes of the PAYE Regulations is given by section 686 of ITEPA:

> "(1) For the purposes of PAYE regulations, a payment of, or on account of, PAYE income of a person is treated as made at the earliest of the following times—
>
> *Rule 1* 5
>
> The time when the payment is made.
>
> *Rule 2*
>
> The time when the person becomes entitled to the payment.
>
> *Rule 3*
>
> If the person is a director of a company and the income is income from employment with the company (whether or not as director), whichever is the earliest of—

(a) the time when sums on account of the income are credited in the company's accounts or records (whether or not there is any restriction on the right to draw the sums);

(b) if the amount of the income for a period is determined before the period ends, the time when the period ends;

(c) if the amount of the income for a period is not determined until after the period has ended, the time when the amount is determined.

…

(2) Rule 3 applies if the person is a director of the company at any time in the tax year in which the time mentioned falls.

(3) In this section "director" means—

(a) in relation to a company whose affairs are managed by a board of directors or similar body, a member of that board or body,

(b) in relation to a company whose affairs are managed by a single director or other person, that director or person, and

(c) in relation to a company whose affairs are managed by the members themselves, a member of the company,

and includes any person in accordance with whose directions or instructions the company's directors (as defined above) are accustomed to act.

(4) For the purposes of subsection (3) a person is not regarded as a person in accordance with whose directions or instructions the company's directors are accustomed to act merely because the directors act on advice given by that person in a professional capacity."

5. Section 686 effectively mirrors section 18 ITEPA, which provides Corresponding rules to establish when general earnings are treated as received so as to be taxable earnings for a particular tax year by virtue of section 15(2).

6. The personal tax return of an individual is required, by section 9 of the Taxes Management Act 1970 ("**TMA**"), to include a self-assessment, including an assessment of the amount the individual is chargeable to income tax for the year of assessment. Payments on account of income tax are credited by section 59B(1) TMA. As regards PAYE, provision for adjusting the total net tax deducted, and thus the amount of the credit, is made by regulation 185 of the PAYE Regulations, which includes an adjustment to the actual total net tax deducted in the case of tax treated as deducted, as follows:

"(1) This regulation applies for the purpose of determining—

…

> (b) the difference mentioned in section 59B(1) of TMA (payments of income tax and capital gains tax: difference between tax contained in self-assessment and aggregate of payments on account or deducted at source),

…

(2) For those purposes, the amount of income tax deducted at source under these Regulations is the total net tax deducted during the relevant tax year ("A") after making any additions or subtractions required by paragraphs (3) to (5).

…

(5) Add to A any tax treated as deducted, other than any direction tax, but—

> (a) only if there would be an amount payable by the taxpayer under section 59B(1) of TMA on the assumption that there are no payments on account and no addition to A under this paragraph, and then
>
> (b) only to a maximum of that amount.

(6) In this regulation—

> "direction tax" means any amount of tax which is the subject of a direction made under regulation 72(5), regulation 72F or regulation 81(4) in relation to the taxpayer in respect of one or more tax periods falling within the relevant tax year;
>
> "relevant tax year" means—
>
> …
>
> (b) in relation to section 59B(1) of TMA, the tax year for which
>
> the self-assessment referred to in that subsection is made;
>
> …
>
> "tax treated as deducted" means any tax which in relation to relevant payments made by an employer to the taxpayer in the relevant tax year—
>
> (a) the employer was liable to deduct from payments but failed to do so, or
>
> …
>
> "the taxpayer" means … the person whose self-assessment is referred to in section 59B(1) of TMA (as the case may be)."

7. It is thus the case that the creditable tax under section 59B(1) TMA generally includes PAYE tax which the employer was liable to deduct under the PAYE

Regulations whether or not the employer has in fact deducted that tax. But this is subject to a number of exceptions for certain amounts of PAYE, collectively referred to as "direction tax". One such exception is that which HMRC applied in this case, namely regulation 72 of the PAYE Regulations, which relevantly provides:

> "(1) This regulation applies if—
>
> > (a) it appears to the Inland Revenue that the deductible amount exceeds the amount actually deducted, and
> >
> > (b) condition A or B is met.
>
> (2) In this regulation …
>
> > "the deductible amount" is the amount which an employer was liable to deduct from relevant payments made to an employee in a tax period;
> >
> > "the amount actually deducted" is the amount actually deducted by the employer from relevant payments made to that employee during that tax period;
> >
> > "the excess" means the amount by which the deductible amount exceeds the amount actually deducted.
>
> …
>
> (4) Condition B is that the Inland Revenue are of the opinion that the employee has received relevant payments knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from those payments.
>
> (5) The Inland Revenue may direct that the employer is not liable to pay the excess to the Inland Revenue.
>
> (5A) Any direction under paragraph (5) must be made by notice ("the direction notice"), stating the date the notice was issued, to—
>
> > …
> >
> > (b) the employee if condition B is met.
> >
> > …
>
> (6) If a direction is made, the excess must not be added under regulation 185(5) or 188(3)(a) (adjustments to total net tax deducted for self-assessments and other assessments) in relation to the employee.
>
> …"

8. If a valid direction is given under regulation 72, under the self-assessment system the employee will not be entitled to credit for the amount which should have been, but

was not, deducted by the employer. The employee will accordingly be liable for income tax on the taxable earnings without the benefit of that tax credit.

9. The employee has two rights of appeal in this respect. The first, by regulation 72C of the PAYE Regulations, is an appeal against a direction notice under regulation 72(5A), namely when condition B in regulation 72(4) is met:

> "(1) An employee may appeal against a direction notice under regulation 72(5A)(b)—
>
> > (a) by notice to the Inland Revenue,
> >
> > (b) within 30 days of the issue of the direction notice,
> >
> > (c) specifying the grounds of the appeal.
>
> (2) For the purpose of paragraph (1) the grounds of appeal are that—
>
> > (a) the employee did not receive the payments knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from those payments, or
> >
> > (b) the excess is incorrect.
>
> (3) On an appeal under paragraph (1) that is notified to the tribunal, the tribunal may—
>
> > (a) if it appears that the direction notice should not have been made, set aside the direction notice; or
> >
> > (b) if it appears that the excess specified in the direction notice is incorrect, increase or reduce the excess specified in the notice accordingly."

10. The second, and corresponding, avenue of appeal is against an assessment or amendment to a self-assessment under section 31 TMA. The powers of the FTT on such an appeal are set out in section 50 TMA as follows:

> "(6) If, on an appeal notified to the tribunal, the tribunal decides—
>
> > (a) that the appellant is overcharged by a self-assessment;
> >
> > …
> >
> > (c) that the appellant is overcharged by an assessment other than a self-assessment,
>
> the assessment or amounts shall be reduced accordingly, but otherwise the assessment or statement shall stand good.
>
> (7) If, on an appeal notified to the tribunal, the tribunal decides

(a) that the appellant is undercharged to tax by a self-assessment

…

(c) that the appellant is undercharged by an assessment other than a self-assessment,

the assessment or amounts shall be increased accordingly."

National insurance contributions

11. Class 1 NICs are divided into primary Class 1 contributions and secondary Class 1 contributions (see section 1 of the Social Security Contributions and Benefits Act 1992 ("SSCBA")). In both cases such contributions are payable when, in any tax week, earnings are paid to or for the benefit of an earner in respect of an employment of his (section 6(1) SSCBA). The term "earnings" includes any remuneration or profit derived from an employment, and "earner" is construed accordingly (section 3(1) SSCBA). Earnings-related contributions are calculated by reference to the gross earnings from the employment in question (regulation 24 of the Social Security (Contributions) Regulations 2001 (the "**NIC Regulations**")).

12. Primary contributions are the liability of the earner (section 6(4)(a) SSCBA), but that is subject to paragraph 3 of Schedule 1 SSCBA, under which the secondary contributor, normally the employer, is liable in the first instance to pay the earner's primary contribution, and the liability of the earner is excluded.

13. Paragraph 3(1) of schedule 1 to the SSCBA provides:

"(1) Where earnings are paid to an employed earner and in respect of that payment liability arises for primary and secondary Class 1 contributions, the secondary contributor shall (except in prescribed circumstances), as well as being liable for any secondary contribution of his own, be liable in the first instance to pay also the earner's primary contribution or a prescribed part of the earner's primary contribution, on behalf of and to the exclusion of the earner; and for the purposes of this Act and the Administration Act contributions paid by the secondary contributor on behalf of the earner shall be taken to be contributions paid by the earner."

14. Paragraph 3(1) of Schedule 1 SSCBA does not, however, apply and the earner's liability for primary Class 1 contributions is consequently not excluded, if regulation 86 of the NIC Regulations applies. Regulation 86 relevantly provides:

"(1) As respects any employed earner's employment—

(a) where there has been a failure to pay any primary contribution which a secondary contributor is, or but for the provisions of this regulation would be, liable to pay on behalf of the earner and

…

(ii) it is shown to the satisfaction of an officer of the Board that the earner knows that the secondary contributor has wilfully failed to pay the primary contribution which the secondary contributor was liable to pay on behalf of the earner and has not recovered that primary contribution from the earner;

…

the provisions of paragraph 3(1) of Schedule 1 to the Act (method of paying Class 1 contributions) shall not apply in relation to that contribution.

…"

15. Regulation 86 can apply only in relation to a failure to pay a primary contribution where the secondary contributor "has not recovered that primary contribution". The only means whereby such a contribution may be so recovered is by a deduction from earnings (paragraph 6 of Schedule 4 to the NIC Regulations).

16. Where there has been no deduction from earnings, and the conditions in paragraph 86 of the NIC Regulations are met, the earner will be liable to pay the primary Class 1 contributions. The earner has a right of appeal against a decision of HMRC in that respect. The decision is one to which section 8(1)(c) SSC(TF)A applies, and the right of appeal arises by virtue of section 11 of that Act. The FTT's jurisdiction is set out in regulation 10 of the Social Security Contributions (Decisions and Appeals) Regulations 1999 ("the NIC Decisions and Appeals Regulations"):

> "If, on an appeal under Part II of the [SSC(TF)A] … that is notified to the tribunal, it appears to the tribunal that the decision should be varied in a particular manner, the decision shall be varied in that manner, but otherwise shall stand good."

Discovery assessment

17. Set out below are sections 29, 34 and 36 of the TMA:

29. Assessment where loss of tax discovered.

(1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment

(a) that any income unauthorised payments under section 208 of the Finance Act 2004 or surchargeable unauthorised payments under section 209 of that Act or relevant lump sum death benefit under section 217(2) of that Act which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax have not been assessed, or

(b) that an assessment to tax is or has become insufficient, or

(c) that any relief which has been given is or has become excessive,

the officer or, as the case maybe, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax.

(2) Where –

(a) the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, and

(b) the situation mentioned in subsection (1) above is attributable to an error or mistake in the return as to the basis on which his liability ought to have been computed,

the taxpayer shall not be assessed under that subsection in respect of the year of assessment there mentioned if the return was in fact made on the basis or in accordance with the practice generally prevailing at the time when it was made.

(3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above—

(a) in respect of the year of assessment mentioned in that subsection; and

(b) in the same capacity as that in which he made and delivered the return, unless one of the two conditions mentioned below is fulfilled.

(4) The first condition is that the situation mentioned in subsection (1) above was brought about carelessly or deliberately by the taxpayer or a person acting on his behalf.

(5) The second condition is that at the time when an officer of the Board—

(a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment ; or

(b) informed the taxpayer that he had completed his enquiries into that return,

the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above.

(6) For the purposes of subsection (5) above, information is made available to an officer of the Board if—

(a) it is contained in the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment (the return), or in any accounts, statements or documents accompanying the return;

(b) it is contained in any claim made as regards the relevant year of assessment by the taxpayer acting in the same capacity as that in which he made the return, or in any accounts, statements or documents accompanying any such claim;

(c) it is contained in any documents, accounts or particulars which, for the purposes of any enquires into the return or any such claim by an officer of the Board, are produced or furnished by the taxpayer to the officer; or

(d) it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection

(1) above—

(i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above; or

(ii) are notified in writing by the taxpayer to an officer of the Board.

(7) In subsection (6) above—

(a) any reference to the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment includes—

(i) a reference to any return of his under that section for either of the two immediately preceding year of assessments; and

(ii) where the return in under section 8 and the taxpayer carries on a trade, profession or business in partnership, a

reference to any partnership return with respect to the partnership for the relevant year of assessment or either of those periods; and

(b) any reference in paragraphs (b) to (d) to the taxpayer includes a reference to a person acting on his behalf.

(7A) The requirement to fulfil one of the two conditions mentioned above does not apply so far as regards any income or chargeable gains of the taxpayer in relation to which the taxpayer has been given, after any enquiries have been completed into the taxpayer's return, a notice under section 81(2) of TIOPA 2010 (notice to counteract scheme or arrangement designed to increase double taxation relief).

(8) An objection to the making of an assessment under this section on the ground that neither of the two conditions mentioned above is fulfilled shall not be made otherwise than on an appeal against the assessment.

(9) Any reference in this section to the relevant year of assessment is a reference to—

(a) in the case of the situation mentioned in paragraph (a) or (b) of subsection (1) above, the year of assessment mentioned in that subsection; and

(b) in the case of the situation mentioned in paragraph (c) of that subsection, the year of assessment in respect of which the claim was made.

34. Ordinary time limit of 4 years

(1) Subject to the following provisions of this Act, and to any other provisions of the Taxes Acts allowing a longer period in any particular class of case, an assessment to income tax, capital gains tax or to tax chargeable under section 394(2) of the Income Tax (Earnings and Pensions) Act 2003 5 may be made at any time [not more than 4 years after the end of the year of assessment to which it relates.

(2) An objection to the making of any assessment on the ground that the time limit for making it has expired shall only be made on an appeal against the assessment.

36. Loss of tax brought about carelessly or deliberately etc

(1) An assessment on a person in a case involving a loss of income tax or capital gains tax brought about carelessly by the person may be made at any time not more than 6 years after the end of the year of assessment to which it relates (subject to subsection (1A) and any other provision of the Taxes Acts allowing a longer period).

(1A) An assessment on a person in a case involving a loss of income tax or capital gains tax–

(a) brought about deliberately by the person,

(b) attributable to a failure by the person to comply with an obligation under section 7, or

(c) attributable to arrangements in respect of which the person has failed to comply with an obligation under section 309, 310 or 313 of the Finance Act 2004 (obligation of parties to tax avoidance schemes to provide information to Her Majesty's Revenue and Customs),

may be made at any time not more than 20 years after the end of the year of assessment to which it relates (subject to any provision of the Taxes Acts allowing a longer period).

(1B) In subsections (1) and (1A) references to a loss brought about by the person who is the subject of the assessment include a loss brought about by another person acting on behalf of that person.

(2) Where the person mentioned in subsection (1) or (1A) ("the person in default") carried on a trade, profession or business with one or more other persons at any time in the period for which the assessment is made, an assessment in respect of the profits or gains of the trade, profession or business in a case mentioned in subsection (1A) or (1B) may be made not only on the person in default but also on his partner or any of his partners.

(3) If the person on whom the assessment is made so requires, in determining the amount of the tax to be charged for any chargeable period in any assessment made in a case mentioned in subsection (1) or (1A) above, effect shall be given to any relief or allowance to which he would have been entitled for that chargeable period on a claim or application made within the time allowed by the Taxes Acts.

(3A) In subsection (3) above, *"claim or application"* does not include an election under any of sections 47 to 49 of ITA 2007 (tax reductions for married couples and civil partners: elections to transfer relief).

(4) Any act or omission such as is mentioned in section 98B below on the part of a grouping (as defined in that section) or member of a grouping shall be deemed for the purposes of subsections (1) and (1A) above to be the act or omission of each member of the grouping.