Appeal number: FTC/31/2010
[2011] UKUT 78 (TCC)

NATIONAL INSURANCE CONTRIBUTIONS – contribution to FURBS – whether liable for Class I contributions – no – appeal allowed

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

FORDE AND McHUGH LIMITED **Appellant**

- and –

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

TRIBUNAL:
THE HON MR JUSTICE FLOYD
JUDGE AVERY JONES

Sitting in public in the Royal Courts of Justice on 3 February 2011

Richard Bramwell QC, Michael Sherry and Anne Redston (instructed by Charterhouse (Accountants) LLP) for the Appellant

Philip Jones QC and James Rivett (instructed by the General Counsel and Solicitor to HM Revenue and Customs) for the Respondents

DECISION

Introduction and background

1. This is an appeal against the decision of the Respondents, the Commissioners for Her Majesty's Revenue and Customs, that the Appellant company Forde and McHugh Limited was liable to pay Class 1 National Insurance contributions in the period 6 April 2002 to 5 April 2003 on sums paid into a funded unapproved retirement benefits scheme ("FURBS" – "the Scheme"). The sums paid were in respect of the sole member of the scheme, Mr W.A. McHugh, a director of the Appellant company. The appeal is being heard at first instance by the Upper Tribunal by direction of the Presidents of the First-tier and Upper Tribunals, as it is a lead case for a number of other appeals.

2. The Scheme was set up by deed dated April 11th 2002, between the Appellant as one party and Mr McHugh and Barnett Waddington Capital Trustees Ltd ("the Trustees") as the other. Any property vested in the Trustees for the purposes of the Scheme was to be applied towards the provision of Relevant Benefits in accordance with the Trust Deed and Rules contained in the Schedule to the Trust Deed.

3. By a letter dated April 9th 2002, the Appellant invited Mr McHugh to join the Scheme. On April 11th 2002, Mr McHugh accepted the invitation and agreed to be bound by the Rules. He also stated that in the event of his death he wished the Trustees to exercise their discretion in favour of his wife. At all material times Mr McHugh has been the only Member.

4. On April 11th 2002, the directors of the Appellant resolved that a contribution should be made to the Trustees of the Scheme. The contributions to the Scheme in respect of Mr McHugh were Treasury Stock with a nominal value of £162,000 and £1,000 by way of a cash contribution. Mr McHugh was entitled to benefits as described in Rules 5-8. These provided for Benefits on Retirement from Service; Death Benefits; Benefits on Change in the Nature of Service; and Benefits on Leaving Service Before Retirement Age.

The relevant statutory provisions

5. These are commendably short. We set out first the charging provision, section 6(1) of the Social Security Contributions and Benefits Act 1992 ("SSCBA"), italicising the most relevant part:

> "6(1) Where in any tax week *earnings are paid to or for the benefit of an earner* over the age of 16 in respect of any one employment of his which is employed earner's employment—
>
> > (a) a primary Class 1 contribution shall be payable in accordance with this section and section 8 below if the amount paid exceeds the current primary threshold (or the prescribed equivalent); and

> (b) a secondary Class 1 contribution shall be payable in accordance with this section and section 9 below if the amount paid exceeds the current secondary threshold (or the prescribed equivalent)."

6. Section 3 provides a definition of "earnings":

> "3(1) In this Part of this Act and Parts II to V below—
>
> (a) 'earnings' includes any remuneration or profit derived from an employment; and
>
> (b) 'earner' shall be construed accordingly."

7. We are concerned with the meaning of "earnings … paid to or for the benefit of an earner".

Secondary Legislation

8. The Social Security (Contributions) Regulations 2001 ("SSCR"), provide by regulation 25 that certain payments are to be disregarded in the calculation of earnings. By paragraph 1 of Part II of Schedule 3 "a payment in kind" is to be disregarded. However, paragraph 2 of the same Part provides that:

> "Payments falling within paragraph 1 of this regulation do not include any payment by way of -
>
> (a) the conferment of any beneficial interest in -
>
> (i) any asset mentioned in Part III or Part IV…"

9. Part IV includes as "assets" by paragraph 3:

> "Loan stock, bonds and other instruments creating or acknowledging indebtedness issued by or on behalf of a government, a local authority or public authority."

10. Finally, the SSCR provide by paragraph 13 of Schedule 2 that:

> " 13. - (1) If, pursuant to a retirement benefits scheme, a payment is made with a view to providing any benefits under such a scheme in relation to more than one person, the amount of earnings which is comprised in that payment shall be calculated or estimated on the basis set out in whichever of subparagraphs (2) or (3) applies.
>
> (2) If the separate benefits to be provided to each of the people referred to in sub-paragraph (1) are known at the time when the

> payment is made, the basis is that of the separate payments which would have had to have been paid to secure the benefits.
>
> (3) In any other case, the amount of the payment shall be apportioned equally between all the persons in respect of whose earnings the payment is to be taken into account."

The legislative history

11. Under the National Insurance Act 1965, graduated contributions were payable whenever there was made to a person over the age of 18 "a payment on account of his remuneration in any one employment" of above £9 a week. References to remuneration were to be taken to include only "emoluments assessable to income tax under Schedule E (other than pensions). There was accordingly a close link between remuneration (on which the graduated contributions had to be paid) and emoluments under the income tax legislation. That link was dropped in the Social Security Act 1973 and is no longer present in the 1992 Act which we have to construe here.

Income tax cases

12. In *Smyth v Stretton* (1904) 5 TC 36, the question at issue was whether sums paid into a fund for the benefit of the assistant masters at Dulwich College were to be treated as salary, given that they could not be taken out of the fund except in certain events such as retirement or death. Channell J held that the sums paid did, on the proper construction of that particular scheme, amount to salary paid to the masters, but which the masters were obliged, by agreement with the College, to pay into the fund.

13. *Edwards v Roberts* (1935) 19 TC 618 was an income tax case decided by the Court of Appeal (Hanworth MR, Romer and Maugham LJJ) in 1934. Mr Roberts was an employee of the W.T. Henley Telegraph Works Company. Under his service agreement, his employer paid sums of money at the end of each financial year into a "conditional fund" held by trustees to be invested in the shares of the company. The terms of the trust prevented Mr Roberts from receiving the capital in the fund until the end of the fifth financial year or termination of employment. He was to cease to have any further right to the fund in the event of his dismissal for misconduct. On his resignation from the company the fund was transferred to him. At that stage it had a value greater than the aggregate amount of the sums paid into the fund. He was assessed to income tax under Schedule E on the amount of the current market value of the shares at the date of transfer to him. Mr Roberts contended on his appeal, amongst other things, that he ought instead to have been assessed on the (smaller in aggregate) amounts paid into the fund during each year of assessment.

14. The provision of Schedule E to the Income Tax Act 1918 under which the assessment was raised required there to be

> "additional salary, fees or emoluments"

15. Hanworth MR distinguished *Smyth v Stretton* on the ground that in these particular circumstances:

> "there could not be said to have accrued to this employee a vested interest in these successive sums placed to his credit, but only that he had a chance of being paid a sum at the end of six years if all went well."

16. Romer LJ said that:

> "The Company agreed to pay to the employee during his service his salary at the rate of £425 per annum, but agreed 'as an additional inducement to the Employee more effectively to perform his duties and assist in promoting and advancing the interests of the Company' that the Company would in the year 1927 pay him the sum of £1,639. That being so, it seems to me clear that the £1,639, though in truth an emolument of the office held by Mr. Roberts, was an emolument for the year in respect of the year 1927, and cannot be treated as made up of a series of emoluments for the preceding years."

17. Maugham LJ said:

> "In the present case the sums in question, so far from being called increases of salary, are by the terms of the agreement distinguished from salary, since the salary is mentioned in Clause 5 of the agreement as being a salary at the rate of £425 per annum, and the sums to be set aside out of the net profits of the Company are not described as salary at all, and, therefore, distinguished from salary. In the second place it seems to me not immaterial to observe that the advantages which are being provided for Mr. Roberts are purely advantages to be derived out of the net profits of the Company and depend upon the gross amount of profit which shall be divided among the holders of Preference and Ordinary Shares of the Company as dividend or bonus upon their shares in respect of each financial year. So the sums in question are conditional upon the success from the profit-earning point of view of the Company. Next it is to be observed that Mr. Roberts had only a conditional right, that is to say, a right as given to him conditionally upon the events mentioned in Clause 8 of the agreement being complied with, to receive the investments which might be made on his behalf at times and in the manner therein mentioned. If all those circumstances are taken into consideration I think that it results in this, that the benefits which he might conditionally become entitled to under the agreement are not in a true sense part of the salary in the wide sense chargeable under Schedule E of the Income Tax Act."

18. Thus, on general principles, there are no "emoluments" for income tax purposes when the employer pays a sum into a conditional or contingent fund for the ultimate benefit of the employee. Statute has, however, intervened in the case of income tax so as to treat contributions paid to a retirement benefit scheme with a view to the provision of benefits for the employee, whether or not subject to any contingency, as income of the employee assessable to tax (Income and Corporation Taxes Act 1988 section 595).

National Insurance cases

19. In *Tullett & Tokyo Forex International Limited & others v Secretary of State for Social Security* [2000] EWHC Admin 350, the employers had set up a scheme for the payment of bonuses to highly paid employees through life insurance policies taken out by the employers on the lives of the employees. The scheme operated as follows. (1) The employer took out a life policy on the life of the employee paying in the first instance a very small premium; (2) The employer executed a declaration of trust so as to hold the policy on trust for the employee; (3) the employer bought a short-dated gilt which it transferred to the insurer as an additional premium, thereby enhancing the value of the policy; (4) the employer assigned the policy to the employee; (5) The policy of insurance could be surrendered for cash immediately on assignment to the employee. The Secretary of State contended that the transfer of the gilts to the insurers was a "payment of earnings to or for the benefit of the earner" (the words used in the SSCBA) and accordingly attracted Class 1 National Insurance contributions. The Appellants submitted that this was not the case: the transfer of gilts represented the cost to the insurer of providing what was properly to be regarded as earnings, namely the life policy whose value was enhanced.

20. The advantage to the employer of contending that the earnings were properly the life policy with enhanced value was that they could contend that it was a "payment in kind", and therefore excluded under the SSCR from inclusion in "earnings". However, although payments in kind were not to be taken into account, this exclusion was subject itself to a further exclusion. It did not apply to any payment "by way of the conferment of a beneficial interest in" certain types of asset including certain types of life insurance. Thus, in the case under consideration, the initial small premium paid on the policy would be taken into account for NIC purposes, but the transfer of the gilts would not. It did not confer a beneficial interest in the life policy.

21. Andrew Collins J considered that not every payment for the benefit of an employee could be within the wide words of section 6(1). He concluded that there had to be a limitation. He dealt with the limitation in this way at [22]:

> "The question I have to answer is what is the extent of that limitation. I think that [counsel for the employers] is correct to focus on the word "earnings" since that gives the clue. The limitation is that a payment for the benefit of an employee must provide something for that employee and it is the value of what the payment provides that constitutes his earnings. Thus if the payment discharges a debt due, it can properly be regarded as

> the equivalent of money paid to the employee. If it obtains a benefit in kind, it is the benefit which is the earnings not the payment to obtain it. ”

22. The payment of gilts to the insurer was therefore not “earnings paid … for the benefit of an earner” – a conclusion he reinforced at [27]. It was a conclusion that he reached with considerable reluctance when “many might think that the reality of the situation ought to produce a different result”.

23. Two other cases are worth mentioning. In the first, *Sempra Metals Ltd v Revenue and Customs Commissioners* [2008] STC (SCD) 1062, the Special Commissioners had to decide a number of issues concerned with the payment of bonuses to employees. Two of those issues were whether payments into family benefit trusts were earnings for income tax or National Insurance purposes. So far as income tax was concerned, the Special Commissioners asked themselves whether the “money or its equivalent in cash was placed unreservedly at the disposal of the employees”. Because the employees were not free to do whatever they liked with their allocated funds, they answered this question in the negative. The Special Commissioners did not hear any separate argument on the National Insurance contributions question, and therefore reached the conclusion that the payments were not earnings paid for the benefit of an earner.

24. In *Telent plc v Revenue and Customs Commissioners* [2008] STC (SCD) 202, the employer made money contributions into a FURBS and an unapproved life assurance scheme for the benefit of an employee, a Mr Beck. The Special Commissioner distinguished *Tullett & Tokyo* on the basis that the employer was contractually bound to make contributions for Mr Beck’s benefit. Mr Jones, who appeared on behalf of the Revenue in that case and in this, has told us that he did not advance such an argument in *Telent*. On the basis that *Tullett & Tokyo* did not apply directly to the case before him, the Special Commissioner was able to hold that what Mr Beck got was membership of the scheme and “continuing funding represented by the appellant’s ongoing contributions”. The amount of “earnings” was therefore the amount of the contributions into the scheme.

The arguments on this appeal

25. For the Appellant, Mr Bramwell QC and Mr Sherry submitted that, just as with income tax before the intervention of statute, payments by an employer into funds which were subject to a contingency before they vested in the employees were not “earnings paid to or for the benefit of an earner”. They relied on *Tullett & Tokyo*, and contended that *Telent* was wrongly decided. They contended that there was no basis for giving “earnings” any wider meaning for National Insurance purposes than “emoluments” has in the income tax sphere.

26. For the Respondents, Mr Jones QC submitted that *Tullett & Tokyo* was wrongly decided. “Remuneration” in section 3 of the SSCBA was wider than “emoluments”. The common sense view was to regard these payments as the earnings or remuneration of the employee even though subject to a contingency. As something of

an afterthought, he submitted in the alternative that it was appropriate to regard what Mr McHugh received as a contingent interest in a fund which could be valued by reference to the payments into the fund. Finally he contended that, if *Tullett & Tokyo* was correctly decided, it was distinguishable here, because a beneficial interest in the gilts transferred to the trustees was conferred on Mr McHugh (see the legislation quoted at [8] above). Hence it was not to be disregarded as a payment in kind. That interest could be valued by reference to the value of the gilts when they were transferred in.

Our decision

27. There is no dispute that the transfers of gilts into the Scheme in the present case were made for the benefit of Mr McHugh. The critical question is whether they amounted to "earnings paid" for his benefit

28. An important plank in the Respondents' argument is the notion that "earnings" in the field of National Insurance is a wider notion than "emoluments" in the field of tax. The Respondents point to five structural differences between tax and national insurance:

(1) NICs fund state benefits, whereas tax is not tied to any form of expenditure;

(2) NICs are payable by both employer and employee, whereas tax is only a liability of the employee;

(3) NICs are credited to that employee's National Insurance account, whereas tax does not confer any entitlement to benefit;

(4) NICs are non-cumulative and calculated on a pay-period basis, whereas income tax payments are provisional;

(5) There is no provision for end of year assessment of NICs, unlike tax.

29. Whilst these differences undoubtedly exist, they do not seem to us to throw much if any light on the question of statutory interpretation before us. Moreover, if the legislature was intending, by using the term "earnings" or "remuneration" to create a wider notion that that of "emoluments", it is unclear to us how much wider that notion is supposed to be.

30. In their skeleton argument the Respondents placed some considerable reliance on the decision of Blackburn J in *R v The Postmaster General* (1876) 1 QBD 658. That was a decision under the Telegraph Act 1868, an Act concerned with providing compensation to officers or clerks who lost their positions as a result of the purchase of a telegraph company by the Postmaster General. The case turned on the true construction of the word "annual emolument" in that Act. We did not find that case of any assistance. At least one of the two Judges in the Divisional Court, Quain J, thought that the term "emoluments" was wider than the term "remuneration". The Respondents fastened on the fact that Blackburn J observed that "remuneration" would include board and lodging, whereas other authorities such as *Tennant v Smith* (1892) AC 150, indicate that it is not included in "emoluments" for income tax purposes. But *The Postmaster General* case provides no support for the proposition

that "remuneration" is a wider notion than "emoluments" even in the context of that Act. Mr Jones very fairly recognised in oral argument that he could not get much out of *The Postmaster General.*

31. Another argument advanced in the Respondents' skeleton was to the effect that the construction of earnings advanced by the Appellant would render paragraph 13 of Schedule 2 to the SSCR *ultra vires*. That provision, although incorrectly captioned "Apportionment of payment **from** a retirement benefit scheme…" appears to treat payments **to** such a scheme as "earnings". Other provisions, such as the disregard of payments to an approved pension scheme in paragraph 3(a) of Part VI of Schedule 3 to the SSCR would also be unnecessary if the Appellant's construction was right. However, Mr Jones again very fairly indicated that he did not suggest to us that we could use secondary legislation to construe primary legislation. The most that those provisions indicate is that the person who drafted them thought that a payment into such a scheme could represent "earnings" – but he may have been wrong.

32. In the end therefore the Respondents' case, stripped to its essentials, became an appeal to our common sense. The ordinary person would, it was submitted, be surprised to find that payments made into a retirement fund for his benefit were not his "earnings", or that he had not "earned" his pension contributions.

33. The same "common sense" approach is not visible in the income tax cases, as demonstrated by the different results in *Smyth v Stretton* (the Dulwich masters' case) and *Edwards v Roberts* where the critical question was that the employee only received a contingent or conditional interest in the fund. The same approach was adopted into the National Insurance field by Collins J in *Tullett & Tokyo* when he held that it was the enhanced value of the life policy which was the "earnings" and not the transfer of gilts to the insurers.

34. Mr Jones fairly recognised that, subject to his two alternative arguments, *Tullett & Tokyo* was a substantial obstacle in his way, and that he had to invite us to say it was wrong. He submitted that we were free to do so. The Upper Tribunal is a superior court of record of co-ordinate jurisdiction to the High Court (see section 3(5) of the Tribunals, Courts and Enforcement Act 2007). That is correct, but we consider, for the same reason, that decisions of the High Court are entitled to the very greatest respect, and we should only depart from them if we are satisfied that they were clearly wrong or decided *per incuriam*. We do not consider that either is the case here.

35. Even viewed in the absence of authority, the point is a finely balanced one. National Insurance contributions are not the sole liability of the employer. Were it so, one could perhaps recognise an argument that the basis of the contribution should be what the employer pays out rather than what the employee gets in. But absent such a clear distinction, it would, as Collins J said in *Tullett & Tokyo,* be "surprising if, absent, special provisions to deal with it the approach should differ" between income tax and National Insurance. So we do not think it would be right to differ from *Tullett & Tokyo.* It is beguiling to look only at the words "for the benefit of". But the statute plainly does not extend to all payments made for the benefit of an employee. Only "earnings" are to be used as the basis for the contribution. We are simply unable to

find the distinction contended for by the Respondents in the difference between "earnings" or "remuneration" and "emoluments".

36. *Tullett & Tokyo* was, of course, a strong case, as the insurance policies could be surrendered for cash immediately on assignment to the employee. It may well be, in the light of the more recent "cash delivery system" cases, considered in *Aberdeen Asset Management plc v HMRC* [2010] UKFTT 524 (TC), that the Secretary of State would not have felt obliged to concede, as he did in *Tullett & Tokyo*, that the scheme was not equivalent to placing cash in the hands of the employee. Moreover, as the Respondents point out, the case proceeded on the basis of a concession that if the enhancement of the value of the policy was "earnings", then this was a "payment in kind". However, whatever doubts we may have about the outcome in *Tullett & Tokyo*, the fact remains that if the Respondents' primary argument in the present case is correct, *Tullett* should have been decided the other way.

37. Accordingly we hold that neither the transfer of the gilts nor the cash payment to the trustees fall within "earnings paid to or for the benefit of an earner."

38. That leaves the two alternative arguments advanced by the Respondents. The first of these was that we can treat as "earnings" the grant of a contingent interest in a fund which could be valued by reference to the payments into the fund as in *Telent*. We were not persuaded by this. If a contingent interest fails to meet the definition of "earnings", because it does not give the employee a vested interest in the fund, then it seems to us that it does not assist the Respondents that it might be possible to place a value on it. The argument conflates qualification for National Insurance contributions, and computation of amount.

39. As to the second argument, it depends, as we understand it, on showing that a beneficial interest in the gilts is conferred on the employee when they are transferred into the scheme. Only then can the transfer be treated as excepted from "payment in kind". We are not persuaded that the effect of the scheme in the present case was to confer a beneficial interest in the gilts on Mr McHugh. Mr McHugh had a right to ensure that the trustees administered the trust properly. That meant that the trust fund had to be applied to provide the benefits described in the events specified. He did not have a beneficial interest in any of the assets held in the trust.

40. It follows that the appeal will be allowed and the decision set aside.

THE HON MR JUSTICE FLOYD

JUDGE AVERY JONES

RELEASE DATE: 21 February 2011