

A COURT OF SESSION (EXTRA DIVISION OF INNER HOUSE)—17 AND  
18 DECEMBER 1991 AND 14 FEBRUARY 1992

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B HOUSE OF LORDS—15 AND 16 FEBRUARY AND 17 JUNE 1993

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**Commissioners of Inland Revenue v. Herd<sup>(1)</sup>**

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*Income Tax—Schedule E—Employment—Gain on sale of shares—Whether taxable under Schedule E—Whether purchaser liable to deduct tax under the Income Tax (Employments) Regulations 1973 SI 1973 No. 334 Regulation 13—Finance Act 1972, s 79(1), Finance Act 1976, s 67(1).*

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The taxpayer, H, was managing director of a subsidiary company within a group. He was asked by CI Ltd., the parent company, to examine the state of affairs at another subsidiary, CBCE Ltd., which was experiencing difficulties. Subsequently he was asked by CI Ltd. to become a director of CBCE Ltd. He agreed to do so on certain conditions, one of which was that he should be entitled to purchase from CI Ltd. a holding of ordinary shares in CBCE Ltd. and that he should have rights in certain circumstances to require CI Ltd. to re-acquire his holding. CI Ltd. agreed to these terms and on 25 March 1980 sold to H 10,000 ordinary shares in CBCE Ltd. for £1, that being their then market value. On the same day H was appointed an executive director of CBCE Ltd. On 4 May 1983 H sold his shares in CBCE Ltd. back to CI Ltd. for £380,000. Their market value at that date was £211,300. H was assessed to income tax under Sch E in the sum of £379,999 in terms of s 79 of the Finance Act 1972 and s 67 of the Finance Act 1976.

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On appeal to the Special Commissioners H contended (i) that on the disposal of the shares he was assessable to capital gains tax and not to income tax, and (ii) that, in any event, if income tax was payable, the liability to account for such tax fell on CI Ltd. under the Income Tax (Employments) Regulations 1973. The Special Commissioner who heard the appeal held (i) that the initiative in the share purchase had come from H, that he had thus not acquired the shares in pursuance of any “opportunity offered to him” in terms of s 79(1) Finance Act 1972 or any “available” opportunity within s 67(1) Finance Act 1976, and that, accordingly, these sections did not apply; but (ii) that if the sections had applied, CI Ltd. would not have been liable to deduct tax under the Income Tax (Employments) Regulations 1973 from the amount they paid for the shares. The Special Commissioner therefore allowed the appeal.

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The Crown appealed.

An Extra Division of the Inner House of the Court of Session held, dismissing the Crown’s appeal, (1) that the circumstances in which the shares had been acquired did come within the terms of s 79(1) Finance Act 1972 and

<sup>(1)</sup> Reported (CS) [1992] STC 264; (HL) [1993] 3 All ER 56; [1993] STC 436.

s 67(1) Finance Act 1976, thus giving rise to a charge to income tax under Sch E; but (2) (Lord Sutherland dissenting) that CI Ltd. was obliged, when paying for the shares, to deduct PAYE tax under the Income Tax (Employments) Regulations 1973 and to account for it to the Commissioners of Inland Revenue and that H was therefore not liable to pay the tax which had been assessed. A

The Crown appealed. H did not pursue his contention that s 79 Finance Act 1972 and s 67 Finance Act 1976 did not apply to charge income tax. B

*Held*, in the House of Lords, allowing the Crown's appeal, that neither the empowering provisions of the Income and Corporation Taxes Act 1970 nor the Income Tax (Employments) Regulations 1973 included an obligation on the payer to deduct tax from a payment only part of which was assessable to income tax under Sch E; that was emphasised by the provision that the obligation to deduct arose on the making of any payment of, or *on account of*, any income assessable to income tax under Sch E; where a provision was as detailed as that, if the intention had been to impose an obligation to make a deduction from a payment which was in part to be treated as income under Sch E, that would have been expressly provided for and, even more important, some machinery would have been set up for distinguishing in the single payment between the amount to be subject to deduction and the balance. C D

*Per curiam*: [The *ratio* of the decision] would not prevent a payer being under an obligation to deduct tax where it was clear that there were two or more payments made together some of which were emoluments under Sch E while others were not. E

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CASE F

Stated for the opinion of the Court of Session as the Court of Exchequer in Scotland under the Taxes Management Act 1970, s 56 by a Commissioner for the Special Purposes of the Income Tax Acts. G

I. On 12 and 13 June 1990 I, one of the Special Commissioners, heard the appeal of Charles Anderson Peden Herd ("Mr. Herd") against an additional assessment to income tax for the year 1983-84 in the figure of £379,999. H

II. Two questions were raised by the appeal:

(i) whether, on the true construction of s 79(1), Finance Act 1972 and of s 67(1) Finance Act 1976, the circumstances in which Mr. Herd acquired certain shares in Cruden Building & Civil Engineering Ltd. ("CBCE") were such circumstances as are referred to in the said statutory provisions; and I

(ii) whether (since a charge to tax under the said statutory provisions falls to be made under Sch E) the liability to account for any such tax to the Commissioners of Inland Revenue fell on Mr. Herd's employer, under the Income Tax (Employments) Regulations 1973, to the exclusion of Mr. Herd.

A III. Mr. Herd and Mr. Malcolm Matthews (a director of Cruden Investments Ltd.) gave evidence before me.

IV. The following documents were proved or admitted before me:

a statement of agreed facts;

B a volume of agreed documents (the productions for the Commissioners of Inland Revenue numbered 1 to 12); and

a quantity of correspondence etc including, in particular, copies of two letters from Mr. Matthews to Mr. Herd dated 2 October 1979 and 11 January 1980.

C The documentary evidence is not annexed hereto but it is available for inspection by the Court if desired.

V. On the evidence, both oral and documentary, I find the following facts:

D (i) The Cruden group contains several companies operating within the construction industry. The parent company of the group is Cruden Investments Ltd. ("Investments") and it has a number of operating subsidiaries. The latter include Crudens Ltd., Hart Builders (Edinburgh) Ltd. ("Hart") and CBCE. Save as appears below, these subsidiaries have at all material times been wholly-owned by Investments.

E (ii) In October 1966 Mr. Herd joined the group as an employee of Crudens Ltd. Some time later he moved to Hart and in 1973 he was appointed managing director of Hart. That company proved successful under his management.

F (iii) Early in 1979 Crudens Ltd. was reorganised and its building operations in the West of Scotland passed to CBCE (previously thereto, a dormant company in the group). Within a few months it became apparent to the board of Investments (which received monthly management accounts from its subsidiaries) that CBCE had problems and that its first-year accounts were likely to show a large loss.

G (iv) In September 1979 Mr. Matthews discussed the situation at CBCE with Mr. Herd and outlined certain proposed arrangements. The nature of those arrangements was set out by Mr. Matthews in a letter to Mr. Herd dated 2 October 1979. The board of Investments wished Mr. Herd (in addition to his duties at Hart) to act on an *ad hoc* basis as "Group Construction Manager" to deal with specific problems. The new function would carry a salary supplement. The first allotted task would be to examine the state of affairs at CBCE and to make a report thereon, with recommendations.

(v) Paragraph 4 of the letter of 2 October 1979 reads:

I "It is understood between us that it is probable that after a period the operations of Hart and CBCE will be carried out under your direct management and that although remaining as Managing Director of Hart, it is probable that you will be required to assume an executive position, e.g. Executive Chairman, in CBCE. In that case your *ad hoc* responsibilities as Group Construction Manager would cease but the salary supplement would continue. It is also understood between us that in these circumstances the Group may

or may not continue to own CBCE but that for the period of ownership you will receive 10 per cent. of the pre-tax profits of the company and that in the event of the sale of the company, 10 per cent. of the sale proceeds.”

(vi) I infer from the terms of the said para 4, and find as a fact, that Mr. Matthews did not, on 2 October 1979 or earlier, envisage the transfer of any shares in CBCE to Mr. Herd in the event of Mr. Herd undertaking executive responsibility for CBCE.

(vii) Mr. Herd did not at once reply to the letter of 2 October 1979. However, he paid 8 two or three-day visit to the offices of CBCE in Glasgow and drew up a report. His recommendations were such that he anticipated (correctly, in the event) that the board of Investments would ask him to become involved in the management of CBCE, as suggested in the letter. He decided to negotiate terms through his solicitor. In addition to a share of profits (as indicated in the letter) he wished to have:

(a) a holding of ordinary shares in CBCE (amounting to at least 10 per cent. of the issued capital); and

(b) in the light of the risk of his being locked into CBCE with a minority shareholding in the event of Investments disposing of its holding to a third party—a possibility envisaged in Mr. Matthews’ letter—appropriate rights to require Investments to re-acquire his holding.

Those proposals were put to Investments (probably by Mr. Herd’s solicitor). The initiative in respect of them came exclusively from Mr. Herd and they constituted firm stipulations on his part.

(viii) The board of Investments accepted those propositions not later than 30 November 1979. The shareholding was agreed at 10 per cent. (Letter from Mr. Matthews to Mr. Herd dated 11 January 1980). Negotiations continued, largely in connection with the manner in which Mr. Herd’s share of the profits of CBCE (and the price payable by Investments for Mr. Herd’s shares therein, if re-acquired) should be calculated.

(ix) If Mr. Herd had not been prepared to accept executive responsibility for CBCE, the board of Investments would have acceded to a demand for the same terms made by any individual to whom the task was offered.

(x) On 25 March 1980, Investments sold to Mr. Herd 10,000 ordinary shares in CBCE, representing 10 per cent. of the issued capital of that company. The consideration paid by Mr. Herd was £1. That was the market value of those shares at that date. On the same day Mr. Herd was appointed an executive director of CBCE. It was solely because of his acceptance of that appointment that Investments agreed to sell the shares to him.

(xi) During the two following days agreements were executed relating to (i) the circumstances in, and the terms upon which, Mr. Herd’s shares in CBCE would be re-transferable to Investments; and (ii) Mr. Herd’s share of profits. In addition, CBCE’s obligations under the latter were guaranteed by Investments.

A (xii) Later in the year Mr. Herd was appointed a director of Investments. He retained that directorship, together with those in Hart and CBCE, until 1987.

B (xiii) On 4 May 1983 Mr. Herd sold his 10,000 shares in CBCE back to Investments for the sum of £380,000. The market value of the said shares at that date was £211,300. Investments paid Mr. Herd £250,000 at once and the balance on 30 November 1984. This sale did not occur in pursuance of any rights under the first of the agreements referred to in subpara (xi) above. None of the relevant circumstances had arisen.

C VI. Mr. Herd duly returned his gain of £379,999 (£380,000-£1) as a capital gain and has paid capital gains tax thereon. H.M. Inspector of Taxes, however, has taken the view that the gain was chargeable to income tax (with higher rate implications), as to £211,299 (£211,300-£1) under s 79 Finance Act 1972, and as to £168,700 (£380,000-£211,300) under s 67 Finance Act 1976. It was common ground that income tax is leviable in accordance with the provisions of those sections if the conditions set out in subs (1) of each of those sections (subject, as regards s 67, to the deletion by subs (7) of the condition in subs (1)(b) that the shares should have been acquired at an under-value) were satisfied.

D VII. A. Upon the first of the questions for my decision it was contended  
E on behalf of Mr. Herd:

F (i) that Mr. Herd did not acquire his shares in CBCE "... in pursuance of a [right conferred on him or] opportunity offered to him ..." (1972 Act) or "in pursuance of a [right or] opportunity available ..." (1976 Act). Nothing was "offered" or "available". Mr. Herd acquired his shares in consequence of his having, on his own initiative, made their acquisition a stipulation in his bargain with Investments; and

G (ii) that if, contrary to the foregoing, an opportunity was "offered", or was "available", it was not offered to Mr. Herd "as a director or employee" of CBCE or any other company (1972 Act) or available "by reason of" such employment (1976 Act). A true causal connection between the acquisition of the shares and Mr. Herd's employment was lacking.

B. Upon the same question it was contended for the Crown:

H (i) that the fact that Mr. Herd's acquisition of the shares in CBCE came about after an initiative had been taken by himself was not material; for the fact remained that an opportunity to acquire the shares was, in the event, made available to him; it was the existence or availability of the opportunity to acquire the shares which mattered rather than the manner in which the opportunity was initiated; and

I (ii) that it was clear on the facts that Mr. Herd had been given the opportunity to acquire the shares "as a director or employee" and "by reason of" his employment.

VIII. A. Upon the second of the questions for my decision (the PAYE question) it was contended on behalf of Mr. Herd:

(i) that the amounts made chargeable to tax under Sch E by the relevant provisions in the 1972 and 1976 Finance Acts were "emoluments",

and Investments (as the payer of the emoluments) was the “employer” as defined in the Income Tax (Employments) Regulations 1973 (“the PAYE Regulations”), regulation 2; A

(ii) that when it made payments to Mr. Herd (in connection with the re-acquisition of the CBCE shares) Investments, as employer, was bound to deduct tax (regulations 13 and 20) and to pay the tax deducted to the Collector (regulation 26); B

(iii) that the regulations do not provide for concurrent liability; and that none of the provisions thereof under which the employee (rather than the employer) may be required to pay the tax are applicable on the facts of the case. C

B. Upon the same question it was contended for the Crown:

(i) that although amounts chargeable under s 79 of the 1972 Act and s 67 of the 1976 Act are chargeable to tax under Sch E, the nature of any sums received by the employee is not thereby changed. The amounts remain capital in nature, and do not become income. Nor do they become income by being treated as earned income “(s 79(4)) or “treated as emoluments” (s 67(7)). D

(ii) that for the purposes of the application of the PAYE Regulations, “emoluments” means the full amount of any income to be taken into account in assessing liability under Sch E; and therefore E

(iii) that amounts chargeable under s 79 of the 1972 Act and s 67 of the 1976 Act are not “emoluments” within the meaning of the PAYE Regulations; that the payer thereof is not an “employer” within those regulations, and so forth. The regulations are concerned only with *income* assessable under Sch E (Income and Corporation Taxes Act 1970, s 204); F

(iv) that in any event s 79 of the 1972 Act and s 67 of the 1976 Act are concerned with how the amounts to which they apply are to be treated in the hands of the person who is made chargeable to tax under Sch E. They do not provide that a payment to which they apply is to be treated by *the payer* as a payment of emoluments to an employee. The payments by Investments to Mr. Herd were made in consideration for the transfer of shares and did not fall to be treated as payments by Investments of emoluments to Mr. Herd. There is therefore no basis for maintaining that Investments was obliged to deduct tax under the PAYE system from the amounts paid; G

(v) furthermore, that Parliament cannot have intended the PAYE Regulations to be applicable in the context of the two provisions in question in this case, because of their inappropriateness: H

(a) a charge to tax under s 79 of the 1972 Act may arise in circumstances not involving any payment. In such circumstances there could be no question of PAYE operating and the section clearly does not envisage that when a charge under it arises PAYE will operate in some cases but not in others; and I

(b) a charge to tax under s 67 of the 1976 Act may arise on the purchase by any person of shares previously acquired by an employee in the required circumstances, whether or not that person has any reason to know that the shares are shares relevant to such a

A charge, and so whether or not he would know that he was an “employer” under the Regulations, and liable to deduct tax accordingly.

IX. I gave my decision orally at the conclusion of the hearing.

B As to the first question, I was wholly satisfied that Mr. Herd had acquired his shares in CBCE by reason of his employment. The transfer of the 10,000 shares to Mr. Herd was an integral factor in the arrangements under which Mr. Herd became a director of CBCE on the same day, and it occurred for no other reason. However, as a matter of ordinary language, I could not accept that Mr. Herd had obtained the shares “in pursuance of”  
C any “opportunity offered to him” or any “available” opportunity. While it is not necessary in this case to decide that the provisions require there to be in existence an established share acquisition scheme of some kind—a proposition which I thought was clearly arguable—the acquisition must stem from an offer initiated by someone other than the acquiror. The Crown’s approach seemed to treat these words as adding nothing to the provisions. That could  
D not be right. I accordingly decided this question in Mr. Herd’s favour: and that sufficed to decide the appeal in his favour.

The second question I decided in the Crown’s favour, for the reasons indicated in the Crown’s contentions.

E X. At the request of the parties I did not immediately determine the appeal, but formally adjourned the hearing in case there were other matters which could conveniently be disposed of by agreement at the same time.

F XI. On 29 June 1990 I issued to the parties a revised transcript of my oral decision in the form of a note. A copy thereof is not attached hereto: so far as appropriate to a Stated Case its contents are set out herein. (Copies are however available for the Court if required.)

G XII. By a letter dated 3 July 1990 (which enclosed a copy of a letter dated 22 June 1990 from Mr. Herd’s accountants to the Solicitor of Inland Revenue) the Solicitor of Inland Revenue for Scotland informed me that the parties were agreed that the assessment should be reduced to “nil”: and on 9 July I formally determined the appeal accordingly. The parties were informed thereof by letters dated the same day.

H XIII. Immediately after receiving notice of such determination, the Commissioners of Inland Revenue declared to us their dissatisfaction therewith as being erroneous in point of law and on 24 July 1990 required us to state and sign a Case for the opinion of the Court of Session as the Court of Exchequer in Scotland, which Case we have stated and I, the Commissioner who heard the appeal, have signed accordingly.

I XIV. Before the determination was formally made, and again immediately after receiving notice of the determination, Mr. Herd’s agents purported to declare his dissatisfaction therewith, and to require us to state a Case. We declined to accept the first declaration and requirement on the ground that they were premature. We also declined to accept the second declaration and requirement, on the ground that they were incompetent. A party’s right to require a Case to be stated is, by s 56 of the Taxes Management Act 1970, dependent on his having duly expressed dissatisfac-

tion with the "determination"; and having succeeded on his appeal, Mr. Herd could not be dissatisfied with the determination. Dissatisfaction with a decision which (had it gone the other way) would have provided an alternative ground for arriving at the same determination is insufficient to initiate proceedings before the Court. It is sufficient that that party should be entitled to raise the alternative ground in any proceedings instituted at the behest of the other party. In order to enable that effectively to be done, the questions of law on which the opinion of the Court is sought include a question relating to the applicability of the PAYE Regulations. A  
B

XV. The questions of law for the opinion of the Court are whether on the facts found by me I was entitled to hold as a matter of law

(i) that on the true construction of s 79 Finance Act 1972 and s 67 Finance Act 1976 Mr. Herd did not acquire the shares in question in the circumstances referred to in subs (1) of each of those sections; and C

(ii) that on the true construction of the said sections, the Income and Corporation Taxes Act 1970 and the Income Tax (Employments) Regulations 1973, the liability to account for any tax payable on the assessment under appeal fell wholly on Mr. Herd. D

B. O'Brien

} Commissioner for the Special  
Purposes of the Income Tax  
Acts E

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98 High Holborn  
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14 January 1991 F

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The case came before the Extra Division of the Inner House of the Court of Session (Lords McCluskey, Coulsfield and Sutherland) on 17 and 18 December 1991 when judgment was reserved. On 14 February 1992 judgment was given against the Crown, (Lord Sutherland dissenting) with expenses. G

*W.A. Nimmo Smith Q.C.* and *R.S. Keen* for the Crown

*J.E. Drummond Young Q.C.* for the taxpayer H

No cases were cited in argument apart from those referred to in the judgments.

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**Lord McCluskey:**—This appeal to the Court of Session sitting as the Court of Exchequer is brought by Case Stated under s 56 of the Taxes Management Act 1970. The appeal is taken by the Commissioners of Inland Revenue (the Revenue) against a determination by the Special Commissioners of an appeal by the Respondent, Charles Anderson Peden Herd (the taxpayer), against an additional assessment to income tax for the year 1983–84 I



A in the figure of £379,999. Two questions were raised by the appeal to the Special Commissioners and they are narrated in the Stated Case as follows<sup>(1)</sup>:

B “(i) whether, on the true construction of s 79(1), Finance Act 1972 and of s 67(1), Finance Act 1976, the circumstances in which Mr. Herd acquired certain shares in Cruden Building & Civil Engineering Ltd. (‘CBCE’) were such circumstances as are referred to in the said statutory provisions; and

C (ii) whether (since a charge to tax under the said statutory provisions falls to be made under Sch E) the liability to account for any such tax to the Commissioners of Inland Revenue fell on Mr. Herd’s employer, under the Income Tax (Employments) Regulations 1973, to the exclusion of Mr. Herd.”

D From the oral and documentary evidence, including a statement of agreed facts, the Commissioner hearing that appeal made findings in fact which are set forth in para V of the Case. On that factual basis he decided the first question in the negative, that is to say in favour of the taxpayer; he also decided the second question in the negative, that is to say in favour of the Revenue. In the result, following sundry incidental procedure, the appeal was determined in the taxpayer’s favour. The Revenue having declared their dissatisfaction with the determination as erroneous in point of law required the Commissioners to state a Case for the opinion of this Court. The taxpayer wished to challenge the Special Commissioners’ ruling on the second question. The Commissioners, therefore, in accordance with the guidance given by the Lord President in *Gordon v. Inland Revenue Commissioners*<sup>(2)</sup> 1991 SLT 730 included a question in the Case so as to enable the issue lying behind the second question to be placed before this Court for its opinion.

F The factual background to this case is contained in the findings in fact and for the purposes of this opinion I shall simply summarise them, quoting verbatim from certain only of the findings. The Crudens Group contains several companies operating within the construction industry. The parent company of the group is Cruden Investments Ltd. (“Investments”) and it has a number of operating subsidiaries. The latter include Crudens Ltd., Hart Builders (Edinburgh) Ltd. (“Hart”) and CBCE. Save as appears below, these subsidiaries have at all material times been wholly owned by Investments. G In October 1966 Mr. Herd joined the group as an employee of Crudens Ltd. Some time later he moved to Hart and in 1973 he was appointed managing director of Hart. That company proved successful under his management. Early in 1979 Crudens Ltd. was reorganised and its building operations in the H West of Scotland passed to CBCE (previously thereto a dormant company in the group). Within a few months it became apparent to the board of Investments (which received monthly management accounts from its subsidiaries) that CBCE had problems and that its first-year accounts were likely to show a large loss. Following discussions with him, Mr. Matthews, a Crudens director negotiating for the group, proposed to Mr. Herd that he I should act as group construction manager and take certain steps to deal with the problems that had arisen; it was proposed that he would be rewarded for these additional responsibilities, but it was not then proposed that any shares in CBCE would be transferred to him as part of that reward. Mr. Herd, however, in responding, proposed that he should have (a) a holding of ordinary

<sup>(1)</sup> Page 30H/I ante.

<sup>(2)</sup> 64 TC 173.

shares in CBCE, and (b) rights in certain defined circumstances to require Investments to re-acquire that holding from him. The proposals advanced by Mr. Herd were accepted by the board of Investments and the holding was agreed at 10 per cent., but negotiations continued for some time on other details of the reward package. Findings-in-fact (ix) and (x) should be narrated in full

“(ix) If Mr. Herd had not been prepared to accept executive responsibility for CBCE, the board of Investments would have acceded to a demand for the same terms made by any individual to whom the task was offered.

(x) On 25 March 1980, Investments sold to Mr. Herd 10,000 ordinary shares in CBCE, representing 10 per cent. of the issued capital of that company. The consideration paid by Mr. Herd was £1. That was the market value of those shares at that date. On the same day Mr. Herd was appointed an executive director of CBCE. It was solely because of his acceptance of that appointment that Investments agreed to sell the shares to him.”

Mr. Herd retained directorships of Hart and CBCE until 1987. He became a director of investments later in 1980 and retained that directorship until 1987. On 4 May 1983 Mr. Herd sold his 10,000 shares in CBCE back to Investments for the sum of £380,000. The market value of the said shares at that date was £211,300. Investments paid Mr. Herd £250,000 at once and the balance on 30 November 1984. Paragraph VI of the Case reads as follows<sup>(1)</sup>

“Mr. Herd duly returned his gain of £379,999 (£380,000-£1) as a capital gain and has paid capital gains tax thereon. H.M. Inspector of Taxes, however, has taken the view that the gain was chargeable to income tax (with higher rate implications), as to £211,299 (£211,300-£1) under s 79 Finance Act 1972, and as to £168,700 (£380,000-£211,300) under s 67, Finance Act 1976. It was common ground that income tax is leviable in accordance with the provisions of those sections if the conditions set out in subs (1) of each of those sections (subject, as regards s 67, to the deletion by subs (7) of the condition in subs (1)(b) that the shares should have been acquired at an under-value) were satisfied.”

The principal statutory provisions with which this case is concerned are to be found in s 79 of the Finance Act 1972 and s 67 of the Finance Act 1976. I now set forth the relevant parts of those provisions, omitting those other parts that appear to have no material bearing upon the issues which this Court has to address.

#### Section 79

“(1) Where a person ... acquires shares or an interest in shares in a body corporate in pursuance of a right conferred on him or opportunity offered to him as a director or employee of that or any other body corporate, and not in pursuance of an offer to the public, subsections (4) and (7) of this section shall apply unless their application is excluded ... (4) Where this subsection applies and the market value of the shares at the end of the period mentioned in subsection (6) below exceeds their market value at the time of the acquisition the person making the acqui-

<sup>(1)</sup> Page 33C/D *ante*.

A sition shall be chargeable to tax under Schedule E for the year of assessment in which that period ends on an amount equal ...to the excess...and the amount so chargeable shall be treated as earned income, whether or not it would otherwise fall to be so treated.

B ...  
(6) The period referred to in subsection (4) above is a period ending at the earliest of the following times:—

- (a) the expiration of seven years from the acquisition of the shares or interest in the shares;
- C (b) the time when that person ceases to have any beneficial interest in the shares; and
- (c) in relation only to a person who acquires shares, the time when the shares cease to be subject to any restrictions other than restrictions attaching to all shares of the same class... .

D (12) Schedule 12 to this Act shall have effect for supplementing this section.”

Schedule 12, Part VII, para 6, provides *inter alia*, “ ‘director’ includes a person who is to be a director”; “ ‘employee’ includes a person who is to be an employee”.

E *Section 67*

“(1) Subsections (2) to (6) of this section apply where after 6th April 1976—

- (a) a person employed or about to be employed in director’s or higher-paid employment ‘(the employee)’ ... acquires shares in a company (whether the employing company or not); and
- F (b) the shares are acquired at an under-value in pursuance of a right or opportunity available by reason of the employment.

G ...  
(7) Where after 6th April 1976 shares are acquired, whether or not at an under-value but otherwise as mentioned in subsection (1) above, and—

- (a) the shares are subsequently disposed of by surrender or otherwise so that neither the employee nor any person connected with him any longer has a beneficial interest in them; and
- H (b) the disposal is for a consideration which exceeds the then market value of the shares,

I then for the year in which the disposal is effected the amount of the excess is treated as emoluments of the employee’s employment and accordingly chargeable to income tax under Schedule E.”

Against this background I turn to the first question raised by the taxpayer’s appeal to the Special Commissioners, narrated above, and to the corresponding question of law contained in the Stated Case, namely,<sup>(1)</sup>

(1) Page 30H/I *ante*.

“...whether on the facts found by me I was entitled to hold as a matter of law (i) that on the true construction of s 79 Finance Act 1972 and s 67 Finance Act 1976 Mr. Herd did not acquire the shares in question in the circumstances referred to in subs (1) of each of those sections.”

As the two sections quoted are not in identical terms it is appropriate to consider each section separately.

Section 79 of the 1976 Act sets out a number of conditions or circumstances; if they apply to the acquisition of shares in a body corporate by a person who is or is to be a director (whether of that or any other body corporate), and to their subsequent disposal, then that person is chargeable to tax under Sch E for the year of assessment during which he ceases to have any beneficial interest in the shares (for example, by selling them). The circumstances (so far as relevant to a case such as the present) are:—

*first*, that he acquired the shares in pursuance of a right conferred on him or opportunity offered to him;

*second*, that the right which he exercised or opportunity which he took derived causally from his being a director, actual or prospective, (whether of that or any other body corporate);

*third*, that he did not acquire the shares in pursuance of an offer to the public;

*fourth*, that the market value of the shares rose between the date of acquisition and the date of sale. It is not in dispute that the circumstances in which this taxpayer acquired the shares in question included the *third* and *fourth* narrated above. Before this Court it was conceded that the causal link between the taxpayer's directorships and the right or opportunity referred to in *second* above must be taken to be established in the light of the facts found. The only issue between the parties on the first question, therefore, related to the construction of the words in the section giving rise to the *first* condition or circumstance and the application of that condition to the facts found. The Revenue argued that the phrase “in pursuance of a right conferred on him or opportunity offered to him as a director or employee” was to be contrasted with the phrase “in pursuance of an offer to the public”, and was to be understood as laying down one condition only, not two as the Special Commissioner had thought. The section did not envisage two quite separate things, namely the right or opportunity on the one hand and the directorship or employment on the other. The wording was appropriate to cover any acquisition which a director or employee was enabled to make by virtue only of his status as director or employee and the fact that, by virtue only of enjoying that status, he was enabled to acquire shares which were not on offer to the public. If the section had included only part of the whole phrase, namely the latter part, that wording might have excluded acquisitions which did not derive from a contractual right contained in a pre-existing contract; yet some share incentive schemes were, or might be, discretionary, so that the director or employee had no pre-existing right to shares but merely an opportunity arising in the course of the employment to apply for shares. The addition of the words “or opportunity offered” widened the net. The construction that had appealed to the Special Commissioners gave these words a meaning they could not properly bear. The initiative for including

- A the term about the share acquisition in the contract between the taxpayer and Investments no doubt came from the taxpayer but it would be wholly contrary to the whole policy of the law of contract to seek to go behind the terms of a concluded contract to discover which contracting party had proposed each term. Furthermore, such an approach could give rise to the curious result that two directors with identical contracts would be treated wholly
- B differently for tax purposes simply because in the one case the director had been the first to propose a particular share acquisition scheme while in the second the identical proposal had emanated from the employer. No doubt the wording of the section might be improved, and could have been briefer, but there was no rule of construction to the effect that the draftsman must be assumed to have used the shortest form of wording available: *Commissioners of Inland Revenue v. Mobil North Sea Ltd.*<sup>(1)</sup> [1986] 1 WLR 296 at 303. The marginal note could not be used as an aid to construction: *David Watson Property v. Woolwich Building Society* 1990 SLT 764 at 766I. As it happened the marginal note was changed when the section was re-enacted in the consolidation statute of 1988. In any event, what was created for the taxpayer in this instance was a share investment scheme, even if it were unique, he alone
- C having insisted upon having this incentive. The words "opportunity offered" did not import a suggestion that the initiative must come from a particular party to negotiations. The ordinary dictionary meaning of opportunity was a chance or opening afforded by circumstances. Here, following upon a negotiation in which each party had an interest in insisting upon particular terms of the final contract, the taxpayer found that the opportunity to acquire the shares was available to him. The statute did not require that the opportunity had to be unsolicited or originate from the party other than the director. In *Cheatle v. Commissioners of Inland Revenue*<sup>(2)</sup> [1982] 1 WLR 834, Nourse J. had treated the words "in pursuance of a right conferred on him or opportunity offered to him as a director or employee of that or any other body corporate" as creating one single "requirement". Furthermore, finding in fact (x)
- D narrated, "it was solely because of his acceptance of that appointment that Investments agreed to sell the shares to him": this was a clear indication that Investments offered the shares as part of the price they were prepared to offer in return for his agreeing to accept the post or offer. Accordingly the taxpayer's acquisition of the shares took place in circumstances falling within the section.

- G In response, the taxpayer adopted the approach of the Special Commissioners. The words, "in pursuance of a right conferred on him or opportunity offered to him as a director..." incorporated two requirements, namely the causal link (which was conceded) and also the offering of an opportunity. Only Investments could have made such an offer and they had
- H not done so; the taxpayer had in effect demanded the shares and Investments had had to accept that demand. Words had to be given their ordinary meaning. Such wording was not apt to cover a situation such as the present, where the taxpayer had taken the initiative throughout. The word "offered" implied that there was someone who offered; clearly what was meant was that somebody other than the acquirer had to create and offer the opportunity. That
- I had not happened here. The Court should not be put off giving words their natural meaning just because it was suggested that there could be anomalous results flowing from a reading of the section according to its terms. The critical question was: "Who was it who put forward the term about the acquisition of shares?"

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(1) 60 TC 310.

(2) 56 TC 111.

Only if it was somebody other than the acquirer could it be said that the acquirer had been offered an opportunity to acquire shares. Nourse J. in *Cheatle* (*supra*) was addressing a quite different problem. A

In my opinion, the submissions of the Revenue are to be preferred. If the Special Commissioners' view were to be upheld it would mean that it would be necessary in any such case to go behind the contract and to study the preceding negotiations to discover who had offered what or who had taken which initiative. That would be a most unusual task to be required to undertake and I should be reluctant to hold that the statute required it to be undertaken unless the wording compelled such a result. Even more strange is the circumstance that, on that reading, two persons with identical contracts could find themselves treated wholly differently for tax purposes (one assessed under Sch E and the other paying capital gains tax) simply because in the one case the question of share acquisition had been put forward first by the employer whereas in the other the employee had been bold enough to ask for it. That appears to me to make no policy sense. The mischief at which the section is aimed is preventing particular emoluments given to employees by reason of their employment from being omitted from the assessment of their employment income. To construe the section as proposed by the taxpayer here would be to create an arbitrary method of enabling some such emoluments to be left out of the reckoning of employment income. Again, I should have to be persuaded that the wording of the section pointed clearly to such a result. I do not think it does. Although I accept that Nourse J. was addressing a different problem in *Cheatle* (*supra*) I consider he was right to accept the agreement of parties before him that the words in the section effectively contained two requirements only. The second was that the acquisition must not have been in pursuance of an offer to the public. The first envisaged that the opportunity or right flowed from the employment. The words "right conferred on him...as a director" would no doubt be apt to cover a right flowing from a pre-existing scheme which was in place when the director/employee took up his post; they might not be apt to cover an opportunity which became available only after he was in post, particularly an opportunity which was at the discretion of the employer. The words "opportunity offered" would be apt to bring within the section such an opportunity. If the employer first offered the opportunity to some directors/employees but not to others and those others then demanded the same opportunity, and obtained it, I cannot see why the tax consequences should be different for them. In any event, in this case, the findings in fact show that, although it was Mr. Herd who first raised the issue of a share acquisition, Investments, by accepting his demand, were prepared to offer something which they were entitled to refuse to offer, namely a share acquisition as originally proposed by Mr. Herd. Indeed if Mr. Herd had decided not to sign up for the post the same opportunity would have been afforded to anyone else who fitted the bill if he had wanted it (finding (xi)). In my opinion, both the underlying purpose of the section and the wording point to the same conclusion, namely that if by reason of being a director or employee (actual or prospective) a person is enabled to acquire shares, whether the enabling derives from a pre-existing contract or from a casual opportunity arising later, and regardless of who first proposes the kind of acquisition which is ultimately agreed, the acquisition fits this requirement of s 79(1). B  
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Section 67(1) of the 1976 Act is couched in different terms. Why that should be so is not clear because one would have thought that it was designed to cover the same situation. However, neither party argued before us that in

A the circumstances of this case the different wordings should yield different results. If anything, however, the wording of s 67(1)(b) is probably clearer: "right or opportunity *available* by reason of the employment". Similar reasoning applies to the construction of this subsection as applies to subs (1) of s 79 and, in my opinion, leads to the same result.

B In the light of the foregoing, and recognising that the matter is a pure matter of law, I consider that the first question in the case must be answered in the negative.

C The second question in the appeal to the Special Commissioners has been narrated in the first paragraph of this opinion. Paragraph VIII of the Case narrates the contentions of the taxpayer and of the Revenue in relation to this matter (there described as "the PAYE question"). That question is stated in the Case as a question of law for the opinion of the Court in these terms<sup>(1)</sup>:

D "...whether on the facts found by me I was entitled to hold as a matter of law... (ii) that on the true construction of the said sections, the Income and Corporation Taxes Act 1970 and the Income Tax (Employments) Regulations 1973, the liability to account for any tax payable on the assessment under appeal fell wholly on Mr. Herd."

E This question was decided in favour of the Revenue for the reasons advanced in the contentions, summarised as follows<sup>(2)</sup>:—

F "(i) that although amounts chargeable under s 79 of the 1972 Act and s 67 of the 1976 Act are chargeable to tax under Sch E, the nature of any sums received by the employee is not thereby changed. The amounts remain capital in nature, and do not become income. Nor do they become income by being 'treated as earned income' (s 79(4)) or 'treated as emoluments' (s 67(7));

G "(ii) that for the purposes of the application of the PAYE Regulations, 'emoluments' means the full amount of any income to be taken into account in assessing liability under Sch E; and therefore

H "(iii) that amounts chargeable under s 79 of the 1972 Act and s 67 of the 1976 Act are not 'emoluments' within the meaning of the PAYE Regulations; that the payer thereof is not an 'employer' within those Regulations, and so forth. The Regulations are concerned only with *income* assessable under Sch E (Income and Corporation Taxes Act 1970, s 204);

I "(iv) that in any event s 79 of the 1972 Act and s 67 of the 1976 Act are concerned with how the amounts to which they apply are to be treated in the hands of the person who is made chargeable to tax under Sch E. They do not provide that a payment to which they apply is to be treated by *the payer* as a payment of emoluments to an employee. The payments by Investments to Mr. Herd were made in consideration for the transfer of shares and did not fall to be treated as payments by Investments of emoluments to Mr. Herd. There is therefore no basis for maintaining that Investments was obliged to deduct tax under the PAYE system from the amounts paid.

(1) Page 30I *ante*.

(2) Page 34C/G *ante*.

(v) furthermore, that Parliament cannot have intended the PAYE Regulations to be applicable in the context of the two provisions in question in this case, because of their inappropriateness: A

- (a) a charge to tax under s 79 of the 1972 Act may arise in circumstances not involving any payment. In such circumstances there could be no question of PAYE operating and the section clearly does not envisage that when a charge under it arises PAYE will operate in some cases but not in others; and B
- (b) a charge to tax under s 67 of the 1976 Act may arise on the purchase by any person of shares previously acquired by an employee in the required circumstances, whether or not that person has any reason to know that the shares are shares relevant to such a charge, and so whether or not he would know that he was an 'employer' under the Regulations, and liable to deduct tax accordingly." C

The debate before us centred on these contentions. D

Counsel for the taxpayer, in challenging the decision of the Special Commissioners, drew our attention to the 1973 Regulations and in particular to the definitions contained in regulation 2. There the following definitions appear:— E

“ ‘emoluments’ means the full amount of any income to be taken into account in assessing liability under Schedule E after the deduction of allowable superannuation contributions and references to payments of emoluments include references to payments on account of emoluments; ‘employee’ means any person in receipt of emoluments; ‘employer’ means any person paying emoluments.” F

Regulation 2 also provides that other expressions have the same meaning as in the Income Tax Acts. There was, it was submitted, no statutory definition of “income”: all that the Income Tax Acts contained were particular charges to tax. Reference was made to *Lord Chetwode v. Commissioners of Inland Revenue* 51 TC 647 and to the speech of Lord Wilberforce at page 685<sup>(1)</sup>, G

“It is notorious that there is not and never has been any definition of income in the U.K. tax code. What, as income, is chargeable with income tax is left to be determined according to particular heads of charge under the Schedules.” H

It followed that one had to look at the particular provisions of the Acts in order to determine what was “income”. Regulation 13(1) of the 1973 Regulations provided as follows,

“On the occasion of any payment of emoluments to the employee, the employer, except where these Regulations otherwise provide, shall ascertain the cumulative emoluments of the employee at the date of the payment, the cumulative free emoluments, the cumulative taxable emoluments and the corresponding cumulative tax.” I

<sup>(1)</sup> [1977] 1 WLR 248, at page 251G.



- A Regulation 20(1) imposed upon the employer a duty to render a return to the Inspector and regulation 20(2) and (3) imposed upon the employer the duty to deduct tax by reference to the appropriate code in accordance with regulation 13. Thus, in every case, when paying emoluments (as defined) to employees (as defined) the employer (as defined) had a duty to calculate the amount of tax and to deduct it. Regulation 26(3) provided that in a case
- B where the amount deducted was less than the amount which the employer was liable to pay,

- C "...the Collector, on being satisfied by the employer that he took reasonable care to comply with the provisions of these Regulations and that the under-deduction was due to an error made in good faith, may direct that the amount of the excess shall be recovered from the employee, and where the Collector so directs the employer shall not be liable to pay the amount of the said excess to the Collector."

- D In any case where the employer was liable to pay there was no liability on the employee, unless regulation 26(3) was invoked by the Collector. It was clear from the terms of s 79(4) of the 1972 Act that the person making the share acquisition was to be chargeable to tax under Sch E and that subsection concluded with the words, "and the amount so chargeable shall be treated as earned income, whether or not it would otherwise fall to be so treated". The charge was created by s 1 of the Income and Corporation Taxes Act 1970 and fell under Sch E (s 181). The present circumstances fell
- E under case 1. It did not matter whether or not for other purposes the amount would fall to be treated as income; it did not matter if the emolument was of a capital nature for other, eg accounting, purposes; it was still taxable under Sch E as income. This was plain not only from s 79(4) but also from *Brumby v. Milner* 51 TC 583. At page 598 Walton J. stated, "In truth, under Schedule E there is no such thing as an emolument in the form of a capital receipt".
- F Russell L. J. delivering the judgment of the Court, stated at page 607(1),

- G "The question in any case whether a receipt by an employee is to be regarded for present purposes as 'emoluments or profits from' the employment has given rise to a number of judicial attempts to analyse or define or elaborate upon those words. Both sides, however, are at one in accepting the language of Upjohn J. approved by the House of Lords in *Hochstrasser v. Mayes* [1960] AC 376, at page 388.

- H "In my judgment", Upjohn J. said, "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'."

If the 1973 Regulations applied they covered everything that fell within their terms.

- I In *Weight v. Salmon*(2) 19 TC 174 the Court held that a company director's right to apply for certain unissued shares at a price considerably less than their current market value enabled him to make a profit assessable to income tax, so the capital nature of the item received did not take it out of Sch E. In the present instance the employer, within the meaning of the definition in the regulations, was Investments and regulation 13 would apply.

(1) [1976] 1 WLR 29, at page 34G/H.

(2) 51 TLR 333.

Precisely the same arguments applied to s 67 of the 1976 Act, subs (7) of which concludes with the words, A

“...for the year in which the disposal is effected the amount of the excess is treated as emoluments of the employee’s employment and accordingly chargeable to income tax under Schedule E.”

Reference should be made to the provisions of that Act relating to benefits in kind, starting with s 60. Section 60(1) referred to certain sums, paid in respect of expenses, and provided that B

“...those sums are to be treated as emoluments of the employment and accordingly chargeable to income tax under Schedule E.” C

The same wording was to be found in s 61(1), which related to the provision of housing etc. benefits. A similar provision was contained in s 187 of the Income and Corporation Taxes Act 1970 relating to payments on retirement or removal from office or employment. It was submitted that if the submissions of the Revenue which succeeded before the Special Commissioners were correct then the 1973 Employment regulations would not apply to such payments and the tax would have to be collected from the employee; (it was recognised and accepted that the regulations only affect payment, not benefits in kind, the latter being taxed in the hands of the taxpayer/employee). There was no provision in the regulations for “parallel liability”: *prima facie* the employer was liable and the Collector had to take a positive decision to shift liability from him to the employee and opt for direct collection. D E

Turning to the contentions for the Crown as narrated above, it was submitted for the taxpayer that the principal fallacy lay in the first. These payments fell to be “treated as income” (s 79(4)) or “treated as emolument” (s 67(7)). The third of the Revenue’s contentions simply repeated the same error. If the payments were to be treated as “emoluments” (as defined) then Investments were the employers within the meaning of regulation 2. So far as contention (iv) was concerned Investments were “the payer”, and regulation 13 applied. So far as the alleged inappropriateness referred to in contention (v) was concerned it was acknowledged that (a) was possibly anomalous, but PAYE operated when it could and there could always be some anomalies and difficulties, as with the payment of benefits in kind. So far as (b) was concerned, it was conceivable, but rather unlikely, that the situation envisaged there would arise. In that situation, Regulation 26(3) could apply to allow recovery direct from the employee if the person defined as “employer” in the Regulations failed to make the necessary deduction as a result of an error made in good faith. The present, however, was the typical and far more likely case. Although we were concerned here only with an assessment, an assessment was a determination as to who was liable to pay and what amount. The effect of this assessment was that the person assessed had to pay. The logical sequel to an assessment was a notice to pay. PAYE, however, could be collected without an assessment. F G H

In reply, the Revenue submitted that counsel for the taxpayer was conflating two separate stages, the stage of assessment and the stage of collection. The upholding of the assessment was not necessarily determinative of liability to pay. The Revenue were content to repeat the submissions made to the Special Commissioners and referred to the terms of the last three paragraphs of the note of the oral decision where the Special Commissioner gave fuller reasoning. Counsel drew attention to the anomalies arising if one I

- A looked at para (a) of s 79(6) and pointed out that even in a case where the shares were purchased from the acquirer there might be several purchasers and it would be odd if they became employers for the purposes of the PAYE Regulations. Regulation 26(3) covered errors only, so it was not a complete answer to the anomalies. This case was concerned with the tax consequences of a sale of shares. The normal consequence would be that the seller had to pay capital gains tax because the amount received was capital. That normal position would be altered only to the extent specifically provided by statute.
- B Both s 79 and s 67 contained deeming provisions requiring one thing to be "treated as" a different thing. The fact that something fell to be treated "as" income simply meant that it was not income. Our attention was drawn to *Wigan Coal and Iron Co. Ltd. v. Inland Revenue Commissioners* [1945] 1 All ER 392, per Wrottesley J., at page 396,
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"Where a statute says that A is to be deemed to be B it deals purposely with things which are not B; and it would not be necessary to say that A was to be deemed to be B if A and B were the same thing."

- D Other cases dealing with income were therefore of no relevance in the present circumstances. When looking at a deeming provision it was essential to discover for what purposes and between what persons the statutory fiction effected by deeming was to be resorted to. Sometimes it might be difficult to determine what the purposes of provisions in a Finance Act were and accordingly the principle to be applied was that found in the Opinion of Nourse J. in *Commissioners of Inland Revenue v. Metrolands (Property Finance) Ltd.* [1981] STC 193 at 208<sup>(1)</sup>, quoted in *Marshall (Inspector of Taxes) v. Kerr* [1991] STC 686 at 696<sup>(2)</sup>,
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- F "If the application of the provision would lead to an unjust, anomalous or absurd result then, unless the application would clearly be within the purposes of the fiction, it should not be applied. If, on the other hand, its application would not lead to any such result then, unless that would clearly be outside the purposes of the fiction, it should be applied."

- G An exception had to be made for unjust, anomalous or absurd results, whatever the apparent purpose may be; reference was made to the opinion of Harman J. in *Marshall v. Kerr* at pages 696 and 697. Thus it was of importance to notice the anomalous results that would flow in the present case. These provisions related only to assessment of Sch E tax and did not relate to the method of collection. The excess was not to be treated as an emolument:
- H it was only "the amount of" the excess that was to be treated as an emolument or as earned income. Accordingly, for any purposes other than determining the assessment, the receipt, if it was capital, remained capital. The effect of the word "accordingly" in s 67(7) was to limit the deeming provision; and the words "the amount of" in both sections were critical as limiting the ambit of the fiction. In the circumstances, Investments simply purchased shares in CBCE; they were not paying emoluments. It was only a matter of chance that the purchaser was the employee's employer: one could imagine many circumstances in which the purchaser would not be the employer and would have no means of knowing how much was to be deducted, simply because he had no access to the payee's code. (To this argument counsel for
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(1) 54 TC 679, at page 697E.

(2) TC Leaflet 3288, at page 5.

the taxpayer replied that it would be up to the purchaser to find out before he made a payment which might be treated as an emolument.) A

In reply, counsel for the taxpayer argued that it was not permissible to adopt a wide construction in construing a taxing statute. The assessment was the critical step. Once an assessment was made and not appealed it was confirmation that the tax was due by the person assessed. It could only be altered by the appeal procedure contained in the Taxes Management Act 1970, e.g. s 29(6). Once the assessment was final it was followed by the notice to pay. The only defence to a demand for payment at that stage would be to show that the sum had been paid. The approach taken by the Revenue in this case would have very far-reaching consequences on other cases such as the "golden handshake" cases. No doubt statutory fictions had to be looked at with some care but such fictions were widely used in tax legislation; several examples were to be found in s 187 of the 1970 Act, the section dealing with "golden handshakes". The fiction extended to the Employment Regulations; there was no reason not to regard it as extending to those Regulations; it could not be excluded. The alleged anomalies were distinctly exaggerated. Shares were commonly not sold to an ordinary person; they were sold to a market maker. A person who was not the employer but who became an employer for the purposes of the definition contained in the regulations should simply refuse to pay over until the necessary PAYE details were made known to him. These anomalous cases were unlikely to be common. In the case of a market maker the Inspector would be likely to be able to use regulation 26(3) to go against the taxpayer. B C D E

I will not attempt to conceal the fact that I find this question to be one of real difficulty; but I have come to be of the view that the taxpayer's contention is sound, for the reasons given by Lord Cocksfield. Initially I was impressed by the submission (v). Both paras (a) and (b) disclose possible anomalies resulting from treating the amounts in question as income for the purposes of the PAYE Regulations. I also accept that when Parliament employs a fiction in a statute in the form of a deeming provision the Court has to be very careful not to apply that fiction for any purpose not intended by Parliament. If the application of the fiction leads to an absurd, nonsensical or even anomalous result it certainly becomes necessary to go back and to ask whether it is necessary and was intended to extend the fiction so far. On the other hand, one must recognise that, in relation to these particular provisions, the normal case would not be one in which the anomalies would arise. Where an employee made a profit of the kind envisaged by s 79 or s 67 resulting from his employment one would expect that the employer would be the purchaser of the shares or at least would know of the purchase. Anomaly (a) is not so remarkable, in any event, because the PAYE Regulations only apply to payments, and if there is no payment by the employer then there is no reason why the employer should be liable to account for the tax: see s 204(1) of the Income and Corporation Taxes Act, 1970. Anomaly (b) is likely to be one rarely encountered, and, when it is, is likely to be in circumstances in which the Collector would have an option under the regulations to recover the tax from the employee. So far as the first of the Crown's contentions is concerned, I have come to be of the view that, for the purposes of both sections (ss 79 and 67), income is what the provisions of the statute say it is. Whatever their nature for ordinary accounting purposes the types of payment with which we are concerned here are to be treated as income or treated as emoluments respectively. There is nothing in either section to provide that the amounts should be so treated "for the purposes of assessment to tax only". F G H I

A “Income” and “emoluments” have only the meanings ascribed to them by the Taxes Acts in this context. If the Acts say that something is to be treated as income then, for the purposes of the Acts, it must be treated as income. Similarly with “emoluments”. Furthermore one should not divorce subs (4) and (7) from subs (1) respectively: the employee who is receiving the payment in respect of the disposal of the shares is a person who has acquired them in pursuance of a right or opportunity deriving directly from his employment and in the vast majority of cases that circumstance would be known to the person, the deemed employer under the PAYE Regulations, who later acquired the shares from him. I do not consider that in the normal case the application of the PAYE Regulations would give rise to difficulties. In those cases where it might, it appears to me likely that under regulation 26 there would be likely to be an escape from the potential anomaly. I do not propose to consider what the consequences of upholding the taxpayer’s submission would be in relation to other cases, such as under s 187 of the 1970 Act; that issue does not arise here and it would be better left until it did and the Court heard full submissions on it. I am not persuaded after reflection by the submission in relation to the importance of the words “the amount”; this argument, developed by Lord Sutherland, has less force in relation to s 67 than in relation to s 79. I do not find it easy to see what other wording would have been used, and this wording appears to me to be perfectly natural in the context of each of the sections. Furthermore it appears to me that if the purpose had been to enact only that the amount (i.e. the *quantum*) of the excess was to be added in with the other income or emoluments in order to enable the whole tax under Sch E to be assessed then that could have been worded simply by saying something like, “the amount of the excess will be added to the amounts of all other emoluments of the employee’s employment for the purposes of assessing the charge to income tax under Schedule E” (s 67(7)). A similar wording could have been adopted for s 79. On the whole matter, it is the language of each section that appears to me to lead to the conclusion that the PAYE Regulations apply, that, for the purposes of those regulations, the payments in question were emoluments as defined in regulation 2 and that Investments were the employer as also there defined. In these circumstances I conclude that the taxpayer’s submission is sound and that the second question falls to be answered in the negative. I would so move your Lordships.

G **Lord Coolsfield:**—This is an appeal by the Commissioners of Inland Revenue against a determination of the Special Commissioners dated 9 July 1990 reducing to nil the amount of an additional assessment to income tax made on the Respondent for the year 1983–84 in the figure of £379,999.00. The assessment was made under s 79(1) of the Finance Act 1972 (the 1972 Act) and s 67(1) of the Finance Act 1976 (the 1976 Act) and arose from the disposal by the Respondent of certain shares in Cruden Building & Civil Engineering Ltd. (“CBCE”) which he had acquired in 1980. CBCE is one of the companies within the Cruden Group, the parent company of which is Cruden Investments Ltd. (“Investments”) and the shares in question were sold by Investments to the Respondent on the same day on which the Respondent was appointed an executive director of CBCE. The consideration paid by the Respondent was £1 and it is found as a fact that that was the market value of the shares in question on that date. Subsequently, the Respondent was appointed a director of Investments and he remained a director of that company as well as of CBCE and another company in the Cruden group, Hart Builders (Edinburgh) Ltd., until some time after the sale of the shares about to be mentioned. On 4 May 1983, the Respondent sold the shares back to Investments for the sum of £380,000. The market value of

the shares at that date was £211,300. The Respondent returned the gain of £379,999 as a capital gain and has paid capital gains tax on it, but the Inspector took the view that the gain was chargeable to income tax under the sections of the 1972 and 1976 Acts above mentioned and the assessment was made upon that basis. A

Section 79 of the 1972 Act, so far as material, provides:— B

“(1) Where a person, on or after 6th April 1972, acquires shares or an interest in shares in a body corporate in pursuance of a right conferred on him or opportunity offered to him as a director or employee of that or any other body corporate, and not in pursuance of an offer to the public, subsections (4) and (7) of this section shall apply unless their application is excluded by subsections (2) and (3) of this section respectively.” C

Neither subs (2) nor subs (3) applies in the present case. Section 79 continues:—

“(4) Where this subsection applies and the market value of the shares at the end of the period mentioned in subsection (6) below exceeds their market value at the time of the acquisition the person making the acquisition shall be chargeable to tax under Schedule E for the year of assessment in which that period ends on an amount equal, except as provided by subsection (5) below, to the excess (or, if his interest is less than the full beneficial ownership, such part of that amount as corresponds to his interest); and the amount so chargeable shall be treated as earned income, whether or not it would otherwise fall to be so treated.” D

Subsection (5) is not material for the present purpose. Subsection (6) provides that the period referred to in subs (4) is to terminate at the earliest of the expiration of 7 years from the acquisition of the shares, or the time when the person ceases to have a beneficial interest in the shares or, in certain cases, the time when shares cease to be liable to certain restrictions. E

In the present case, the assessment was made under s 79 upon an amount equal to the difference between the price paid by the Respondent to acquire the shares and their market-value at the date of their sale to Investments, being the date on which the Respondent ceased to have an interest in them. F

Section 67 of the 1976 Act provides, so far as material:— G

“(1) Subsections (2) to (6) of this section apply where after 6th April 1976— H

- (a) a person employed or about to be employed in director's or higher-paid employment ('the employee'), or a person connected with him, acquires shares in a company (whether the employing company or not); and
- (b) the shares are acquired at an under-value in pursuance of a right or opportunity available by reason of the employment.” I

Subsection (7) provides:—

“Where after 6th April 1976 shares are acquired, whether or not at an under-value but otherwise as mentioned in subsection (1) above, and—

- A (a) the shares are subsequently disposed of by surrender or otherwise so that neither the employee nor any person connected with him any longer has a beneficial interest in them; and
- (b) the disposal is for a consideration which exceeds the then market value of the shares,
- B then for the year in which the disposal is effected the amount of the excess is treated as emoluments of the employee's employment and accordingly chargeable to income tax under Schedule E."

C In the present case, the assessment was made under s 67 upon the amount of the excess of the price paid by Investments over the then market value of the shares.

D It is common ground that one condition for the application of both s 79 and s 67 is that there should be a causal connection between the employment of the taxpayer and the acquisition of the shares. The question whether there was such a connection was debated before the Commissioner who found that such a causal connection existed. The relevant findings in fact are set out in detail in the Stated Case but it is not necessary to rehearse them because the Respondent did not seek to challenge the Commissioner's finding on this point.

E The first issue in the present appeal is whether, in the circumstances of the case, the Respondent acquired the shares "in pursuance of a right conferred on him or opportunity offered to him" in terms of s 79 or "in pursuance of a right or opportunity available" to him in terms of s 67. The Respondent's contention is, broadly, that the provisions do not apply

F because the shares were acquired in consequence of a stipulation put forward by him and insisted on by him, and not as the result of any opportunity offered to him by his employers or any associated company. The Commissioner found in favour of the Respondent on this point, and for that reason reduced the assessment to nil. The Commissioner found in fact that,

G when discussions were going on between representatives of the Cruden Group and the Respondent and those acting for him, the offer of employment initially made to the Respondent did not envisage any transfer of shares to the Respondent and that the proposal for a holding of shares was put forward by or on behalf of Mr. Herd. The Commissioner finds<sup>(1)</sup>:

H "The initiative in respect of [these terms] came exclusively from Mr. Herd and they constituted firm stipulations on his part."

I It is further found that if the Respondent had not been prepared to accept the employment in question, the Board of Investments would have acceded to a demand for the same terms made by any individual to whom the task for which the Respondent was employed was offered. It was contended on behalf of the Respondent, therefore, that he had acquired the shares in consequence of his having on his own initiative made their acquisition a stipulation in his bargain with Investments. In the Stated Case, the Commissioner gives his reasons for finding in favour of the Respondent as follows<sup>(2)</sup>:

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<sup>(1)</sup> Page 32E *ante*.

<sup>(2)</sup> Page 35B/D *ante*.

“However, as a matter of ordinary language, I could not accept that Mr. Herd had obtained the shares ‘in pursuance of’ any ‘opportunity offered to him’ or any ‘available’ opportunity. While it is not necessary in this case to decide that the provisions require there to be in existence an established share acquisition scheme of some kind—a proposition which I thought was clearly arguable—the acquisition must stem from an offer initiated by someone other than the acquirer. The Crown’s approach seemed to treat these words as adding nothing to the provisions. That could not be right. I accordingly decided this question in Mr. Herd’s favour: and that sufficed to decide the appeal in his favour.”

The Commissioner’s reasons are also set out in a note of the oral decision which he gave at the conclusion of the hearing of the appeal before him, but I do not think that there is any difference in substance between the reasons there appearing and those set out in the case.

The terms of s 79 are, I think, more favourable to the Respondent’s argument than those of s 67 and the argument should therefore first be tested against s 79. On the view which the Commissioner took, the question whether a gain on the sale of shares acquired by a director or employee, in circumstances otherwise falling within s 79, should bear capital gains tax only or income tax would depend upon whether it was the employer or the employee who first mentioned the possibility of the acquisition of the shares. Counsel for the Respondent could not suggest any reason why the tax treatment of such a gain should depend on such a consideration; and, in my view, a difference in the impact of tax depending on such a factor would be illogical and unfair. Further, in order to determine the proper tax treatment, it might be necessary to discover not only who said what, at each stage of the negotiations leading to the contract, but how and with what implication each statement was made. Would the Respondent’s arguments succeed only where the employee came into the negotiation with a fixed predetermined demand, or would it be enough if the demand emerged in response to something said by the employer? Would it be necessary to decide whether anything said by the employer amounted to, or was intended as, a hint of the availability of a share scheme or merely gave rise to the idea in the mind of the employee? Any such enquiry would be fraught with uncertainty. In any event, it is not normal to give weight, in the interpretation or application of a contract, to the fact that a term was originally suggested by one party or the other, except in the special case of contracts which fall to be interpreted *contra proferentem*. The force of the Respondent’s argument lies in the suggestion that it is necessary to give content to the words “in pursuance of an opportunity offered to him” and that the construction proposed by the Revenue fails to do so. In my view, however, the terminology of s 79 is explained by looking to its context in the Act. Section 78 deals with approved share option schemes and with the case where a person acquires rights to shares under such a scheme in the exercise of a right which he already has. It seems to me that when the draftsman came to s 79, he was anxious to emphasise that it was to apply both in the case in which shares were acquired in the exercise of a right and in the case in which they were acquired otherwise than in the exercise of a right and that the purpose of the whole phrase beginning “in pursuance of an opportunity...” is to distinguish between an opportunity open to the director or employee as such and one open to the public at large. The object might perhaps have been achieved with greater economy of language, but I do not think that it is correct to say that the Revenue’s construction leaves any words in the section without meaning. The Commissioner may be correct in



- A thinking that the draftsman had primarily in view established share schemes, but, again, I cannot see any logical reason for distinguishing between established schemes and the arrangement in the present case. In my view, therefore, the wording of s 79 does not bear the meaning which the Commissioner gave to it. The position is, in my view, even more clear in relation to s 67. The word "available" is entirely neutral, in my view, and cannot be said to contain any implication such as was contended for by the Respondent. In these circumstances, in my opinion, the decision of the Special Commissioner on the question of construction was wrong and he should have held in favour of the Crown on that point.

- C The second issue in this appeal concerns the application of the Income Tax (Employment) Regulations 1973, the PAYE Regulations. It was contended for the Respondent that the sum paid to him when the shares were sold constituted "emoluments" within the terms of those regulations and accordingly that any assessment in respect of that sum should have been made upon the employer and not upon him. It was contended for the Crown that, notwithstanding the terms of the statutory provisions and the regulations, the sum in question was and remained a capital payment in the hands of the Respondent and was not income for the purposes of the regulations. On this point the Commissioner accepted the contentions of the Revenue and would have found against the Respondent, had it been necessary for him to deal with the issue.

- E The question turns, ultimately, in my view, on the proper interpretation of the definition of the word "emoluments" in the 1973 Regulations but it is helpful to bear in mind the framework of taxation under the PAYE system in approaching that question.

- F The charge to tax under Sch E is found in Part VIII of the Income and Corporation Taxes Act 1970, commencing with s 181, under which tax is to be charged "in respect of any office or employment on emoluments therefrom" which fall under any of three cases, Case I being that where the holder of the office or employment is resident and ordinarily resident in the United Kingdom. Assessment and collection of tax under Sch E are dealt with in Chapter III of Part VIII, commencing with s 204 which provides:

- G "(1) On the making of any payment of, or on account of, any income assessable to income tax under Schedule E, income tax shall, subject to and in accordance with regulations made by the Board under this section, be deducted or repaid by the person making the payment... ."

- H Subsection 2 of s 204 permits regulations to be made governing, *inter alia*, the assessment and charge of income tax in respect of income to which the section applies. Section 205 provides, in short, that no assessment need be made on a person in respect of Sch E if the net tax deducted is the same as it would have been if all relevant circumstances had been known; but s 205(2) provides that nothing in the section prevents an assessment to Sch E being made and that such an assessment shall be made if the assessable person requests it, within certain time-limits. The 1973 Regulations made detailed provision for the deduction of tax, in accordance with s 204. Regulation 6 and following provide for deduction in cases in which the Inspector has issued a deduction card and regulation 20 provides for cases in which a deduction card has not been issued. Regulation 13 requires the employer, on the occasion of any payment of emoluments to the employee, *inter alia* to

ascertain whether any tax falls to be deducted and, if it does, to deduct it from the payment, and regulation 26 requires the employer to pay the tax deducted to the Collector within a defined period. Regulation 29 provides for a determination of the tax payable by the employer, and such a determination is subject to the same rules as regards appeals and finality as are assessments. It is clear, therefore, and it was not disputed in this case, that, in a case which falls under the regulations, the liability to deduct tax and pay it to the Collector in respect of every payment in cash or its equivalent, falls on the employer and not on the employee. Tax in respect of payments falling within the regulations is in terms of the regulations, recoverable from the employee only in certain limited circumstances. Regulation 26(3) provides that if the Collector is satisfied that the employer took reasonable care to comply with the provisions of the regulations but made an under-deduction in good faith, the Commissioners may direct that the amount of the excess shall be recovered from the employee, and in that case the employer ceases to be liable for it. There is also provision in regulations 50 and 51 for cases of casual employment and other cases in which the Inspector is of opinion that deduction of tax by reference to the tax tables is impracticable. Under both regulation 26(3) and regulation 50, some initiative requires to be taken by the Revenue and there is no question of any such initiative having been taken in the present case. Apart from the provisions of regulations 26 and 50, there is no room for the exercise of an option to charge tax in respect of a payment falling within the regulations either on the employer or on the employee or, indeed on both. Accordingly, if the payment in the present case is a payment falling within the regulations, the person accountable for tax on it is the employer. The issue in the present case is whether the payment in question falls to be considered to be a payment of emoluments within the meaning of the regulations.

Regulation 2(1) of the regulations includes the following definitions:

“ ‘Emoluments’ means the full amount of any income to be taken into account in assessing liability under Schedule E after the deduction of allowable superannuation contributions and references to payments of emoluments include references to payments on account of emoluments;

‘Employee’ means any person in receipt of emoluments; ‘Employer’ means any person paying emoluments.”

The argument for the Revenue was based on the proposition that the payment in the present case was not, in its own nature, an income payment and therefore that it did not fall within the terms of the regulations. It was accepted that the consequence of this argument would be that any particular payment could be scrutinised to see whether it was, in a true sense, income or not, and, if it was not, it would not fall within the definition of emoluments above quoted. It was further argued that ss 79 and 67 required certain payments to be treated as income but that such a requirement did not change the nature of the payments. Indeed, the terminology indicated that the payments were not income. Reference was made to certain authorities for the proposition that a deeming provision should not be extended beyond the purpose for which it was enacted. In particular, reference was made to *Wigan Coal and Iron Company v. Inland Revenue Commissioners* [1945] 1 All ER 392 at 396 and *Marshall v. Kerr*<sup>(1)</sup> [1991] STC 686 at 696. The basic proposition was supported by arguments to the effect that to require the payer of the price of

(<sup>1</sup>) TC Leaflet 3288.

A shares, who might well be a third party and ignorant of the circumstances in which the shares had been acquired, to deduct tax would have awkward or possibly unfair consequences. I recognise that there is force in the argument that, in a case such as this, the consideration paid to the taxpayer in respect of the shares is, in an ordinary sense, not an income payment. I am less impressed by the suggestion that there is an analogy between the payments

B with which this case is concerned and benefits in kind, in which no money payment passes. I do however also recognise that there may well be cases in which shares acquired in circumstances which fall within s 79 are sold to a third party, who may have no reason to think that he should deduct tax from the price, and that to deem such a person to be an employer appears anomalous. It is, I suspect, much less likely that such an anomaly would arise in

C practice in relation to s 67, because it is less likely that an independent third party would purchase the shares at a price greater than the market price. It is, however, not possible for the Court to judge how often transactions in shares falling under either section are likely to involve third parties. It may well be that in many cases the position would be adequately covered by regulation 26(3), but I think that it is necessary, for the purposes of the decision

D of this case, to assume that there may be a material number of cases in which the anomaly of treating a third party purchaser of shares as if he were the employer of the vendor may arise. Even on that basis, however, I have come to the conclusion that the terms of the legislation require that the Revenue's argument be rejected.

E Tax under Sch E is charged on emoluments from an office or employment. There is no definition of the word "emoluments" other than that contained in the regulations and no statutory definition anywhere of the word "income" (*Lord Chetwode v. Commissioners of Inland Revenue*(<sup>1</sup>) 51 TC 647 per Lord Wilberforce at 685-6). Sections 79 and 67 deal with payments which are derived from employment in the sense that the opportunity which leads

F to the payment is one which arises from the employment. The purpose of the statutory provisions is to bring these payments within the charge which falls on emoluments from an employment. Section 67 provides that the amount of the excess with which that section is concerned is to be treated as emoluments of the employment. It is not said that the amount is to be treated as emoluments for one purpose only, and in the absence of some such provision, I do

G not see how a distinction can be made so as to treat the amount as emoluments for some of the purposes of the Taxes Acts but not for others. In my view, s 67 directly requires that the amount in question should fall under the regulations. The wording of s 79 is different in that it provides that an amount *equal* to the excess rather than the amount of the excess should be chargeable, but, having regard to the purpose of the provisions as I have outlined them, I do not think that the difference is material or that the terms of

H s 79 bear the weight which the Revenue argument requires of them. In the absence of some other definition of what constitutes income for the purposes of the legislation, it seems to me that the statutory provisions which subject these amounts to tax under Sch E thereby also define them as income for the present purposes. The approach which I prefer is also, in my view, consistent

I with an observation made by Walton J. in *Brumby v. Milner* 51 TC 583 at 598: his Lordship said

"In truth, under Schedule E there is no such thing as an emolument in the form of a capital receipt."

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(<sup>1</sup>) [1977] 1 WLR 248.

I have, therefore, come to the view that the taxpayer's argument on this point should have prevailed. It follows that the decision of the Commissioner to reduce the assessment to nil was, in substance, correct. In all the circumstances, both the questions in the case should be answered in the negative.

**Lord Sutherland:**—Your Lordship in the Chair has set out the factual background to this case, the statutory provisions relevant to it, the two questions which are raised in this appeal and the arguments of the parties relative to these questions. I do not therefore propose to rehearse these matters further.

The first question relates to the true construction of s 79(1) of the Finance Act 1972 and s 67(1) of the Finance Act 1976. Dealing first with s 79(1), the critical words are

“...in pursuance of a right conferred on him or opportunity offered to him as a director or employee of that or any other body corporate, and not in pursuance of an offer to the public.”

The Special Commissioner has held that these words incorporated two requirements, namely a causal link between the acquisition of the shares and the employment of the taxpayer and also as a separate issue that there should be an offering of an opportunity. He has held as a fact that the initiative for the acquisition of the shares came from the taxpayer whose suggestion it was and therefore no opportunity was offered by the employers. This is the argument which was adopted by the taxpayer before this Court. In my opinion this argument cannot succeed. I consider that it is not appropriate to divide the relevant words into separate requirements as in my view these words are used in distinction to an offer to the public. This view would be in accordance with what was said in *Cheatle v. Inland Revenue Commissioners* [1982] 1 WLR 834 by Nourse J., albeit in a different context. Even taking the words “opportunity offered” as a separate entity I am still of the view that the Special Commissioners’ approach was the wrong one. This section is concerned with the acquisition of shares and no opportunity for the acquisition of shares can arise unless the existing shareholder is prepared to make them available. Once the existing shareholder indicates that he is prepared to do so, then an opportunity to acquire the shares is offered. In my opinion it is quite irrelevant to enquire into whose initiative brought about the availability of the shares for acquisition by the employee. It was said in argument on behalf of the taxpayer that the mischief aimed at in this section was the acquisition of shares under share incentive schemes other than those which were approved and that the wording of the section was apt to cover that mischief but not to cover the different situation where the acquisition of the shares came about because the employee had initiated the discussions. In my opinion, however, the mischief aimed at is the granting of indirect remuneration to an employee by means of the granting of shares which might otherwise be regarded as a capital transaction and I am quite unable to see what difference it makes whether the initiative came from the employer or from the employee. For these reasons I am satisfied that s 79(1) does apply to the shares in question. Section 67(1) of the 1976 Act has different wording in that the opportunity is not said to be offered but only available. Parties were agreed that despite the different wording of these sections the result should be the same. It is in my opinion clear that when all that is required is that an opportunity should be available there is no room at all for an enquiry into whose initiative brought about the availability of that opportunity. It is therefore even clearer that s 67(1) applies to

A these shares. Accordingly I consider that the first question in the case should be answered in the negative.

B Turning to the second question, my initial reaction was that the PAYE  
C Regulations were never designed to cover a situation such as the present and  
D that if the taxpayer's argument was well-founded this could lead to bizarre  
E results in many cases. It is passing strange that a person chargeable to tax  
F which the taxpayer in this case undoubtedly is should be exempt from assess-  
G ment of that tax because the regulations make provision for the collection of  
H the tax in the first place from his employer. The oddity is compounded by the  
I fact that other perquisites which are not payments but are nevertheless  
deemed to be earned income are chargeable under Sch E and can be assessed  
directly against the taxpayer and it is further compounded by the wide defini-  
tion of the word "employer" which can include someone who is by no stretch  
of the imagination in any way connected with the employment of the tax-  
payer. There is however a formidable argument based on the terms of the leg-  
islation and regulations made thereunder to the effect that the regulations do  
apply to this transaction. The relevant legislation starts with Part VIII of the  
Income and Corporation Taxes Act 1970 which creates Sch E and provides  
for tax under that Schedule to be charged in respect of any office or employ-  
ment on emoluments therefrom. Under s 204 of that Act, on the making of  
any payment of any income assessable to income tax under Sch E tax shall be  
deducted by the person making the payment and it is further provided that  
the Board shall make regulations with respect to the assessment, charge, col-  
lection and recovery of income tax in respect of all income assessable thereto  
under Sch E and that these regulations shall have effect, notwithstanding  
anything in the Income Tax Acts. The relevant regulations for the purposes  
of the present case are the 1973 Regulations made in accordance with s 204.  
Under regulation 2 it is provided that "emoluments" means the full amount  
of any income to be taken into account in assessing liability under Sch E and  
that "employer" means any person paying emoluments. Regulation 13  
requires an employer, when making any payment of emoluments to an  
employee, to ascertain whether any tax falls to be deducted and, if so, to  
deduct the tax from the payment and then under regulation 26 pay the tax  
deducted to the Collector of Taxes. Regulation 29 provides for a determina-  
tion of tax payable by an employer and this is for practical purposes taken to  
be equivalent to an assessment upon a taxpayer for the purposes of appeals  
and finality. Accordingly, under these regulations, if any payment of emolu-  
ments is made it is for the employer to deduct the appropriate tax and it is  
the employer who is answerable to the Collector of Taxes. Apart from certain  
minor matters dealt with in regulations 50 and 51 the only provision for col-  
lection of tax from the taxpayer is under regulation 26(3) which provides that  
if the Collector is satisfied that the employer took reasonable care to comply  
with the provisions of the regulations but made an under-deduction in good  
faith, the Commissioners may direct that the amount of the excess shall be  
recovered from the employee and the employer ceases to be liable. It was not  
argued that any such direction had been made in this case. Section 79(4)  
of the 1972 Act provides that where the market value of shares at the end of the  
period mentioned in subs (6) exceeds their market value at the time of acqui-  
sition the person making the acquisition shall be chargeable to tax under Sch  
E on an amount equal to the excess and the amount so chargeable shall be  
treated as earned income whether or not it would otherwise fall to be so  
treated. Subsection (6) indicates that the period referred to in subs (4) is a  
period ending at the earliest of certain times two of which are the time when  
the person ceases to have any beneficial interest in the shares and the expira-

tion of seven years from the acquisition of the shares. It is therefore possible under the latter provision that a charge to tax can arise at the end of seven years even though the shares have not been sold and no payment has been received in consideration of any such sale. Section 67(7) of the 1976 Act provides that where relevant shares are acquired and subsequently disposed of and the disposal is for a consideration which exceeds the then market value of the shares then the amount of the excess is treated as emoluments of the employee's employment and accordingly chargeable to income tax under Sch E. As was pointed out by Lord Wilberforce in *Lord Chetwode v. Commissioners of Inland Revenue* 51 TC 647<sup>(1)</sup>

"It is notorious that there is not and never has been any definition of income in the UK Tax Code. What, as income, is chargeable with income tax is left to be determined according to particular heads of charge under the Schedules."

Under regulation 2 the definition of emoluments refers to the income to be taken into account in assessing liability under Sch E. In *Brumby v. Milner* 51 TC 598 Walton J. pointed out that under Sch E there is no such thing as an emolument in the form of a capital receipt. The argument, accordingly, is that even though the payment made for the shares may have been capital in the hands of the payer, nevertheless it falls to be treated as income in the hands of the taxpayer and under ss 79 and 67 is chargeable to tax under Sch E. Because it is deemed to be income under Sch E it therefore inevitably constitutes emoluments within the meaning of regulation 2 and therefore the primary liability for payment falls upon the employer. I appreciate that this is a formidable argument but in my opinion it contains one fatal flaw. It fails, in my view, to take into account the precise terms of ss 79 and 67. Under s 79 it is not the consideration for the shares that is taxable nor even the excess of market value at date of sale against market value at date of acquisition, but it is said to be an amount equal to such an excess. The payment which was made by Cruden Investments to the taxpayer was a payment in consideration of the sale of the shares to them by the taxpayer. That payment did not of itself constitute emoluments. Under ss 79 and 67 the sum received by the taxpayer had to be analysed to see if it fell within either or both of these sections. When so analysed it became apparent that there was an excess in market value at the date of sale over market value at the date of acquisition and accordingly s 79 would apply and further it was apparent that the consideration given for sale of the shares exceeded the then market value and accordingly s 67 applies. The next stage is to calculate the amount of these excesses and in the case of s 79 to make chargeable to tax an amount equal to the excess relevant to that section and in the case of s 67 to make chargeable to tax the amount of the excess relevant to that section. These calculations however do not in any way affect the nature of the payment which was actually made by Cruden Investments to the taxpayer, namely the consideration for the shares which were sold. That was plainly a capital transaction. The fact that after the capital transaction has been completed a proportion of the amount received by the taxpayer has to be regarded as being received by him as income cannot affect the nature of the completed capital transaction. In the case of s 79 it is not even the relevant part of the consideration which is to be treated as income but is an amount equal to the excess. That accordingly envisages the completion of the capital transaction and thereafter a chargeability to tax on an amount not part of the consideration but a sum

<sup>(1)</sup> 51 TC 647, at page 685I.

- A equal to part of the consideration. Under s 67(7) it is true that there is no reference to an amount equal to the excess but the way in which that section is set out indicates that the first matter that has to be considered is whether the disposal is for a consideration which exceeds the market value of the shares. If the consideration which is given does in fact exceed the then market value, the amount of the excess is treated as emoluments and chargeable to tax.
- B Again, however, the section envisages that the sale of the shares for a particular consideration is a transaction on its own and that thereafter anything which is to be regarded as an excess for the purposes of that section is chargeable to tax. Accordingly in my opinion when Cruden Investments paid the sum of £380,000 for the shares they were doing precisely that, namely, making a capital payment in consideration of the purchase of the shares. It was only after that transaction was completed that certain liability to chargeability for tax arose. The actual payment received by the taxpayer was accordingly, in my view, a capital payment and not an income payment. Under ss 79 and 67 the excess over certain market values was to be treated for tax purposes as income in the hands of the taxpayer but by that stage the capital transaction had been completed. At the time when the payment was made Cruden Investments were paying for the shares and were not making any payments by way of emoluments to the taxpayer. It would follow that the PAYE Regulations would not apply. This view has at least the merit of avoiding certain anomalies. In the first place it means that in the case of the s 79 assessment it avoids the view that if shares are sold before the expiry of seven years the assessment has to be made upon the purchaser whereas if the seven years expire then the assessment falls to be made on the taxpayer. It avoids the anomaly that a purchaser who may have no connection whatever with the taxpayer's employment may be deemed to be an employer for the purposes of the regulations. It is also in conformity with the fact that the PAYE Regulations only relate to payments and do not relate to benefits in kind. Benefits in kind such as loans at low rate of interest, free or cheap accommodation or the provision of a car are all taxable under Sch E but because they do not involve direct payments the assessment is made not on the employer but on the taxpayer. Where there is a direct payment such as payment by way of expenses then no doubt tax is deductible at source. The present case is much more analogous to a benefit in kind than it is to a direct payment of emoluments. For these reasons I consider that the payment made by Cruden Investments to the taxpayer was a payment of a capital nature namely the consideration for the sale of the shares and that accordingly it could not constitute emoluments within the meaning of regulation 2. It follows that the assessment to charge under Sch E on the taxpayer under both ss 79 and 67 was correctly made and for these reasons I would answer the second question in the affirmative.
- H *Appeal refused, with expenses.*

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- I The Crown's appeal was heard in the House of Lords (The Lord Chancellor (Lord Mackay of Clashfern), Lords Keith of Kinkel, Jauncey of Tullichettle, Browne-Wilkinson and Slynn of Hadley) on 15 and 16 of February 1993 when judgment was reserved. On 17 June 1993 judgment was given unanimously in favour of the Crown, with costs.

*W.A. Nimmo Smith Q.C., R.S. Keen and Launcelot Henderson for the Crown.*

*J.E. Drummond Young Q.C.* and *C. Tyre* for the taxpayer. A

The following cases were cited in argument in addition to the cases referred to in the judgment:—*Wicks v. Firth*, 56 TC 318; [1982] Ch 355; *Inland Revenue Commissioners v. Metrolands (Property Finance) Ltd.* [1981] 1 WLR 637; *Brumby v. Milner* 51 TC 583; [1976] 1 WLR 1096; *Weight v. Salmon* 19 TC 174. B

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**Lord Mackay of Clashfern L.C.**:—My Lords, this is an appeal by the Commissioners of Inland Revenue from a decision of an Extra Division of the Court of Session (Lord McCluskey, Lord Coulsfield and Lord Sutherland), which by a majority, Lord Sutherland dissenting, found against the Revenue on a question of law stated by the Special Commissioner in an appeal by the taxpayer against an additional assessment to income tax under Sch E on the taxpayer for the year to April 1984 in respect of the sale of shares. The question is whether on a true construction of s 79 of the Finance Act 1972 and s 67 of the Finance Act 1976, the Income and Corporation Taxes Act 1970 and the Income Tax (Employments) Regulations 1973, the liability to account for any tax payable on the assessment under appeal fell wholly on the taxpayer. C D

The facts on which this question arises may be summarised as follows, and I am grateful to the parties for their agreement on the statement of facts, which I have largely followed. The taxpayer was appointed an executive director of Cruden Building & Civil Engineering Ltd. (hereinafter referred to as “CBCE”) on 25 March 1980. At that date, CBCE was a wholly-owned subsidiary of Cruden Investments Ltd. (hereinafter referred to as “Investments”). Later in 1980 the taxpayer was appointed a director of Investments and he retained that directorship and his directorship of CBCE until 1987. Apart from the taxpayer’s share-holding referred to below, CBCE remained a wholly-owned subsidiary of Investments at all material times. On 25 March 1980 Investments sold to the taxpayer 10,000 ordinary shares in CBCE which represented 10 per cent. of the issued capital of that company. The consideration paid by the taxpayer for those shares was £1.00. That was the market value of the shares as at 25 March 1980. Investments agreed to the sale of the shares solely because of the taxpayer’s acceptance of appointment as an executive director of CBCE. The 10,000 ordinary shares in CBCE were acquired by the taxpayer in such circumstances as are set out in s 79(1) of the Finance Act 1972. The shares were not acquired as an undervalue but otherwise were acquired by the taxpayer in such circumstances as are set out in s 67(1) of the Finance Act 1976. E F G H

On 4 May 1983 the taxpayer sold his 10,000 ordinary shares in CBCE back to Investments for the sum of £380,000. The market value of the shares at that date is agreed to have been £211,300. Investments paid the taxpayer £250,000 at once and the balance on 30 November 1984. In terms of s 79 of the Finance Act 1972 and s 67 of the Finance Act 1976 a charge to income tax under Sch E fell to be made since as a result of the sale of shares on 4 May 1983 the taxpayer ceased to have any beneficial interest in them. I

The Inspector of Taxes made an additional assessment under Sch E on the taxpayer for the year to April 1984 in the figure of £379,999 that is to say



A £380,000 minus £1.00 in respect of the sale of the shares. The assessment was made under s 79 of the Finance Act 1972 and under s 67 of the Finance Act 1976, as to £211,299 under s 79 of the 1972 Act and as to £168,700 under s 67 of the 1976 Act.

B The taxpayer appealed against the additional assessment to the Special Commissioner who reduced the assessment to nil. The Commissioners of Inland Revenue appealed to the Inner House of the Court of Session. There a number of matters were discussed but the only issue which arises before your Lordships is that which I have stated at the beginning of this speech.

C The Income and Corporation Taxes Act 1970, s 181(1) imposes a charge to tax under Sch E and provides that:

“1. Tax under this Schedule shall be charged in respect of any office or employment on emoluments therefrom which fall under one, or more than one, of the following Cases—”

D Section 183(1) of the Act of 1970 provides that the expression “emoluments” shall include all salaries, fees, wages, perquisites and profits whatsoever.

Section 204 of the Act of 1970 makes provision for the assessment and recovery of income tax under Sch E and provides as follows:

E “(1) On the making of any payment of, or on account of, any income assessable to income tax under Schedule E, income tax shall, subject to and in accordance with regulations made by the Board under this section, be deducted or repaid by the person making the payment, notwithstanding that when the payment is made no assessment has been made in respect of the income and notwithstanding that the income is in whole or in part income for some year of assessment other than the year during which the payment is made.

F (2) The Board shall make regulations with respect to the assessment, charge, collection and recovery of income tax in respect of all income assessable thereto under Schedule E, and those regulations may, in particular, include provision—

G (a) for requiring any person making any payment of, or on account of, any such income, when he makes the payment, to make a deduction or repayment of income tax calculated by reference to tax tables prepared by the Board, and for rendering persons who are required to make any such deduction or repayment accountable to, or, as the case may be, entitled to repayment from, the Board,

H (b) for the production to and inspection by persons authorised by the Board of wages sheets and other documents or records for the purpose of satisfying themselves that income tax has been and is being deducted, repaid and accounted for in accordance with the regulations,

I (c) for the collection and recovery, whether by deduction from any such income paid in any later year or otherwise, of income tax in respect of any such income which has not been deducted or otherwise recovered during the year,

(d) for the assessment and charge of income tax by the inspector in respect of income to which this section applies,

(e) for appeals with respect to matters arising under the regulations which would not otherwise be the subject of an appeal, and any such regulations shall have effect notwithstanding anything in the Income Tax Acts. . .

(3) The said tax tables shall be constructed with a view to securing that, so far as possible—

(a) the total income tax payable in respect of any income assessable under Schedule E for any year of assessment is deducted from such income paid during that year, and

(b) the income tax deductible or repayable on the occasion of any payment of, or on account of, any such income is such that the total net income tax deducted since the beginning of the year of assessment bears to the total income tax payable for the year the same proportion that the part of the year which ends with the date of the payment bears to the whole year.

In this subsection references to the total income tax payable for the year shall be construed as references to the total income tax estimated to be payable for the year in respect of the income in question, subject to a provisional deduction for allowances and reliefs, and subject also, if necessary, to an adjustment for amounts overpaid or remaining unpaid on account of income tax in respect of income assessable under Schedule E for any previous year.

For the purpose of estimating the total income tax payable as aforesaid, it may be assumed in relation to any payment of, or on account of, income assessable under Schedule E that the income paid in the part of the year of assessment which ends with the making of the payment will bear to the income for the whole of that year the same proportion as that part of the year bears to the whole year."

The regulations made under that power in force at the material time for the purposes of this appeal are the Income Tax (Employments) Regulations 1973 as amended up to 1983. Regulation 2(1) of these regulations includes the provision:

"In these Regulations, unless the context otherwise requires—

...

'Emoluments' means the full amount of any income to be taken into account in assessing liability under Schedule E after the deduction of allowable superannuation contributions and references to payments of emoluments include references to payments on account of emoluments; . . .

'employee' means any person in receipt of emoluments;

'employer' means any person paying emoluments; . . ."

The critical regulation is regulation 6(1) which provides:

"Every employer, on making any payment of emoluments during any year to any employee in respect of whom a code authorisation has been issued to him for that year by the Inspector, shall—

(a) if he has not already done so, prepare a deductions working sheet for that employee: and

- A (b) deduct or repay tax in accordance with these regulations by reference to the appropriate code, which shall be specified on the code authorisation.”

B The details of these arrangements are contained in later provisions of the regulations to many of which it is not necessary to refer. Some, however, must be referred to as they have a bearing on the argument addressed to your Lordships on the appeal.

Regulation 26 provides:

- C “(3) If the amount which the employer is liable to pay to the collector under paragraph (1) of this regulation exceeds the amount actually deducted by him from emoluments paid during the relevant income tax month, the collector, on being satisfied by the employer that he took reasonable care to comply with the provisions of these regulations and that the under-deduction was due to an error made in good faith, may direct that the amount of the excess shall be recovered from the employee, and where the collector so directs the employer shall not be liable to pay the amount of the said excess to the collector.

- D (4) If the amount which the employer is liable to pay to the collector under paragraph (1) of this regulation exceeds the amount actually deducted by him from emoluments paid during the relevant income tax month, and the Commissioners of Inland Revenue are of the opinion that an employee has received his emoluments knowing that the employer has wilfully failed to deduct therefrom the amount of tax which he was liable to deduct under these regulations, the said Commissioners may direct that the amount of the excess shall be recovered from the employee, and where they so direct the employer shall not be liable to pay the amount of the said excess to the collector.”

F No direction was made under either of these powers in the present case.

- G Regulation 48 provides for assessment and appeals. Regulation 49 makes provision with regard to a situation where the amount deducted is less or more than the total due under an assessment under Sch E for the year in question.

Regulation 49 provides:

- H “(2) If the tax payable under the assessment exceeds the total net tax deducted from the employee’s emoluments during the year, the Inspector may require the person assessed to pay the excess to the Collector instead of taking it into account in determining the appropriate code for a subsequent year, and where the Inspector so requires the person assessed shall pay the excess accordingly.

- I (3) For the purpose of determining the amount of any difference or excess as aforesaid, any necessary adjustment shall be made to the aforesaid total net tax in respect of—

(a) any tax which the employer was liable to deduct from the employee’s emoluments but failed so to deduct, having regard to whether the Commissioners of Inland Revenue or the collector have or have not directed that tax shall be recovered from the employee;

(b) any tax overpaid or remaining unpaid for any year; ... but any such difference resulting from an adjustment under sub-paragraph (a) of this paragraph shall be disregarded for the purpose of paragraph 1 above and of computing any tax overpaid under sub-paragraph (b) of this paragraph.” A

It follows from the provision I have just quoted that unless the Commissioners or the Collector have exercised powers which would enable a charge to be made against the employee in respect of sums which the employer should have deducted, the employee cannot be held liable for amounts which the employer ought to have deducted whether or not he has actually done so—in other words, apart from the powers to which I have referred, the Commissioners of Inland Revenue do not have power to claim from the employee tax which the employer was liable to deduct and pay to the Commissioners whether or not he has done so. B C

The scope of the general scheme in respect of Sch E and the regulations to which I have referred is illustrated by the decision of Hobhouse J. in *Booth v. Mirror Group Newspapers plc* [1992] STC 615 which was cited in argument but has no particular bearing on the problem arising in the present appeal. D

It is common ground between the parties to this appeal that wide as the provisions are for deduction of tax from payments they can apply only in respect of *payments* by the employer to the employee and therefore where benefits in kind not involving payments by an employer are in question they are not directly applicable. On the other hand in considering the coding the Inland Revenue are entitled to take into account benefits in kind which are taxable under Sch E although not the subject of specific deduction of tax under the Regulations. See *Regina v. Walton General Commissioners ex parte Wilson* [1983] STC 464. E F

It is to be noted, however, at this stage, that the provisions for deduction apply only to a payment of emoluments or a payment on account of emoluments.

I turn now to examine the specific provisions under which tax under Sch E is agreed to be chargeable either on the taxpayer or on Investments in this appeal. G

First of all s 79 of the Finance Act 1972, subs (4):

“Where this subsection applies and the market value of the shares at the end of the period mentioned in subsection (6) below exceeds their market value at the time of the acquisition the person making the acquisition shall be chargeable to tax under Schedule E for the year of assessment in which that period ends on an amount equal, except as provided by subsection (5) below, to the excess (or, if his interest is less than the full beneficial ownership, such part of that amount as corresponds to his interest); and the amount so chargeable shall be treated as earned income, whether or not it would otherwise fall to be so treated.” H I

The period referred to in subs (6) below is a period which may well come to an end without any payment. In this case, however, it came to an end when the taxpayer ceased to have any beneficial interest in the shares in question and following on that payments were made to him by Investments. If these

A payments were payments of emoluments or a payment on account of emoluments, I would conclude that the requirement to deduct tax applied even if in other situations subs (4) might be triggered where no such payment occurred.

The other provision founded on to create liability under Sch E is s 67 of the Finance Act 1976 which in subs (7) provides

B “Where after 6th April 1976 shares are acquired, whether or not at an under-value but otherwise as mentioned in subsection (1) above, and—

C “(a) the shares are subsequently disposed of by surrender or otherwise so that neither the employee nor any person connected with him any longer has a beneficial interest in them; and

(b) the disposal is for a consideration which exceeds the then market value of the shares,

D then for the year in which the disposal is effected the amount of the excess is treated as emoluments of the employee’s employment and accordingly chargeable to income tax under Schedule E.”

E It was pointed out by the Commissioners of Inland Revenue that in relation to both of these provisions the taxpayer’s argument might involve a person who was an “employer” only for the purposes of the income tax regulations because he made the payment in question, but that he might have no knowledge of the circumstances which gave rise to tax liability. On the other hand counsel for the taxpayer argued strongly that such circumstances were likely to be extremely limited and pointed to the exception to which I have referred for payments in good faith by an employer in the deduction regulations. I am of opinion that your Lordships have not material on which to form a very accurate view of the number of different circumstances in which these provisions apply and in particular the extent to which any third party acquirer of the shares might be ignorant of the circumstances which give rise to liability. I therefore prefer to rest my view on a narrower ground.

G In both of the statutory provisions relied upon as creating liability, the liability to tax under Sch E is not attracted by the amount paid but as in this case to part only of the amount paid. The charging mechanism is not one which treats the whole payment made in this case as an emolument and then preserves a right to claim a deduction by way of allowance. Indeed in this case each payment is subject to two different sections which provide the basis for two different charges under Sch E on sums which in total are less than the total of the payments. It is true that the deduction in this case is small but the ascertainment of its amount involving as it does questions of the market value of shares which are not publicly quoted could involve considerable calculation and perhaps even more important substantial judgments on matters of opinion. Neither the empowering provisions of the Act of 1970 nor the deduction regulations themselves include an obligation on the payer to deduct tax from a payment only part of which is assessable to income tax under Sch E. Indeed, this is emphasised by the provision that the obligation to deduct arises on the making of any payment of, or *on account of*, any income assessable to income tax under Sch E. Where the provision is as detailed as that, if the intention had been to impose an obligation to make a deduction from a payment which was in part to be treated as income under Sch E, I would have expected this to have been expressly provided for and,

even more important, some machinery set up for distinguishing in the single payment between the amount to be subject to deduction and the balance. A

This does not mean that by making one payment of two separate amounts each of which can be determined precisely at the time the payment is made one could avoid the obligation to make a deduction but I think it is significant, and in support of the view which I have taken, that s 60 of the Finance Act 1976 treats the expenses there in question as emoluments of the employment and accordingly chargeable to income tax under Sch E, preserving in subs (2) a claim for deductions under the appropriate sections of the Taxes Act. So, for example, where remuneration and expenses are paid together the total payment is a payment of emoluments within the provision requiring the payer to make the appropriate deduction of income tax on making the payment. B  
C

Although it is true that there is no finding of fact in this case that any difficulty was found in arriving at the appropriate market values it is obvious that the determination of these values could give rise to substantial disputes. D

Although I found the argument for the taxpayer attractive and cogently argued, I have reached the conclusion ultimately that to give effect to it would be to extend the scope of the provisions for deduction of tax under Sch E to situations for which they were not intended and in respect of which there is no machinery for determining in respect of a single payment at the time the payment is made the amount of it which is to be subject to the deduction arrangements. E

The taxpayer points to the provisions of regulation 26(3) of the 1973 Regulations. I think it is noteworthy and supportive of the view which I have formed that the regulation speaks about under-deduction due to an error made in good faith and does not appear to me to deal with the situation where the amount of emoluments paid is in question. There is no provision that I have been able to find which contemplates a question about the amounts of emoluments involved in any particular payment: rather the whole scheme appears to me to proceed on the assumption that all the payments in question are payments of emoluments and that any deductions are in respect of allowances to be made in computing the tax liability consequent upon the payments. I conclude therefore that when the Commissioners of Inland Revenue submit that the decision of the Court of Session should be reversed "because the consideration paid by Investments for the shares was not a payment of income assessable to income tax under Schedule E" they are correct. F  
G

The contention advanced by the taxpayer in this case was said by the Commissioners of Inland Revenue to be novel and, in my view, on a proper reading of the statutory provisions in question it falls to be rejected, but it is right that I should emphasise that my view applies only where a particular payment is treated only in part as assessable to income tax under Sch E. It would not prevent a payer being under an obligation to deduct tax where it was clear that there were two or more payments made together some of which were emoluments under Sch E while others were not. H

The reasons which I have given differ considerably from the reasons given by Lord Sutherland in the Court of Session for reaching the same view and I would not be prepared to affirm his analysis of the transaction into a capital transaction completed at the time of payment followed by a statutory I

- A treatment of certain parts of the payment as income for tax purposes. The reasoning of the majority only takes one the distance of saying that part of the payment was to be treated as emoluments of the taxpayer's employment under Sch E but for the reasons I have given this does not appear to me to be sufficient to sustain the taxpayer's argument and to have obliged the employers to deduct income tax under the 1973 regulations on making the payment
- B which even on the majority's view was in part only so assessable.

For the reasons I have given I would allow the appeal and hold that the second question of law posed by the Special Commissioner should be answered in the affirmative.

- C **Lord Keith of Kinkel:**—My Lords, I agree that this appeal should be allowed for the reasons set out in the speech of my noble and learned friend the Lord Chancellor.

- D **Lord Jauncey of Tullichettle:**—My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend the Lord Chancellor. For the reasons which he gives I agree that the appeal should be allowed.

- E **Lord Browne-Wilkinson:**—My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend the Lord Chancellor. For the reasons which he gives I agree that the appeal should be allowed.

**Lord Slynn of Hadley:**—My Lords, I have had the advantage of reading in draft the speech prepared by my noble and learned friend the Lord Chancellor. For the reasons he gives I too would allow the appeal.

- F *Appeal allowed, with costs.*

[Solicitors:—Solicitor of Inland Revenue (Scotland);  
Messrs. Dyson Bell Martin.]

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