



*CORPORATION TAX – computation of deductions - payments by Appellant before 2001 to employee benefit trust and after 2002 to family benefit trust - whether wholly and exclusively expended for the purposes of the Appellant's trade - yes - whether Appellant's profits computed in accordance with generally accepted accountancy practice - yes - whether payments to employee benefit trust were potential emoluments and so precluded from deduction for corporation tax purposes when paid - yes - whether payments to family benefit trust were made to an employee benefit scheme and so precluded from deduction for corporation tax purposes when paid - yes - ICTA 1988 ss 42 and 74; FA 1989 s 43(1); FA 2003 s143 and Sch 24*

*EMPLOYMENT INCOME – whether payments by Appellant to trusts were payments of emoluments or earnings giving rise to an obligation to deduct income tax and pay it to the Revenue – no – before 2003 ICTA 1988 ss 19(1), 131 and 203(1) and Income Tax (Employments) Regulations 1993 SI 1993 No. 744; after 2003 ITEPA 2003 ss 1, 6, and 684 and Income Tax (PAYE) Regulations 2003 SI 2003 No. 2682 Reg 80*

*NATIONAL INSURANCE CONTRIBUTIONS – whether payments by Appellant to trusts were earnings paid for the benefit of earners – no – Social Security Contributions and Benefits Act 1992 s6(1); Social Security Contributions (Transfer of Functions, etc) Act 1999 s8(1)(c)*

**THE SPECIAL COMMISSIONERS**

**SEMPRA METALS LIMITED**

**Appellant**

**- and -**

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

**Respondents**

**Special Commissioners: DR A N BRICE  
EDWARD SADLER**

**Sitting in London on 14 – 18 April 2008**

**Andrew Thornhill QC with Jonathan Bremner, Counsel, for the Appellant**

**Timothy Brennan QC with Diya Sen Gupta, Counsel instructed by the Solicitor of HM Revenue and Customs for the Respondents**

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## DECISION

### The appeal

- 5 1. Sempra Metals Limited (the Appellant) appeals against:
- (1) a number of estimated assessments to corporation tax for years before  
30 September 1998 and amendments to corporation tax self-assessments for  
periods after that date;
- 10 (2) a number of notices of determination dated 30 March 2007 and 2  
November 2007 determining tax payable by the Appellant under regulation 80  
of the Income Tax (Pay as You Earn) Regulations 2003 SI 2003 No. 2682 (the  
PAYE regulations); and
- 15 (3) a number of decisions dated 30 March 2007 and 2 November 2007  
made under section 8 of the Social Security Contributions (Transfer of  
Functions, etc) Act 1999 that the Appellant was liable to pay primary and  
secondary Class I national insurance contributions.
- 20 2. The appeal related to accounting periods ending from 30 September 1995 to  
31 December 2000 and from 31 December 2002 to 31 December 2005.

### The issues

- 25 3. The assessments and the amendments to self-assessment were made because  
the Commissioners for Her Majesty's Revenue and Customs (the Revenue) were of  
the view that certain payments made by the Appellant to an employee benefit trust,  
and later to a family benefit trust, were not deductible from the profits of the  
Appellant for corporation tax purposes. The notices of determination and decisions  
30 were made because the Revenue were of the view that the payments made by the  
Appellant to the trusts were emoluments or earnings of its employees. The Appellant  
appealed because it was of the view that the payments were deductible from its profits  
for corporation tax purposes and were not emoluments or earnings of its employees.
- 35 4. The issues arising out of the arguments of the parties were:
- (1) whether the payments made by the Appellant were wholly and  
exclusively expended for the purposes of the Appellant's trade within the  
meaning of section 74(1)(a) of the Income and Corporation Taxes Act 1988  
40 (the 1988 Act);
- (2) whether the profits of the trade of the Appellant were computed in  
accordance with generally accepted accountancy practice within the meaning  
of section 42(1) of the Finance Act 1998 (the 1998 Act);
- 45 (3) whether the payments made by the Appellant to the employee benefit  
trust were deductible for the purposes of corporation tax when they were paid

having regard to the provisions of section 43 of the Finance Act 1989 (the 1989 Act);

5 (4) whether the payments made by the Appellant to the family benefit trust were deductible for the purposes of corporation tax when they were paid having regard to section 143 and Schedule 24 of the Finance Act 2003 (the 2003 Act);

10 (5) whether the payments made by the Appellant to both trusts constituted the payment of emoluments or earnings to its employees giving rise to an obligation to deduct income tax and pay it to the Revenue; and

15 (6) whether the payments made by the Appellant to both trusts constituted earnings paid for the benefit of earners giving rise to a liability on the Appellant to pay national insurance contribution.

20 5. At the request of the parties we agreed, under Regulation 18(5)(b), to give a written decision in principle on these issues and to adjourn the making of the final determination until after the decision in principle had been issued.

#### **The evidence**

25 6. Six bundles of documents were produced (Files 1 to 6); very few of these documents were referred to at the hearing. Five other bundles (A to E) were produced some of which were referred to at the hearing. In addition a core bundle was produced to which constant reference was made at the hearing. We were grateful for the production of the core bundle.

7. Oral evidence was given on behalf of the Appellant by

30 *Mr George Edward Daniel*; Mr Daniel is a senior employee of the Appellant;

*Mrs Karon Ann Daniel*; Mrs Daniel is the wife of Mr Daniel and is also a nominated beneficiary of the Appellant's family benefit trust;

35 *Mr Edward Watkin Gittins* FCA of the Isle of Man; Mr Gittins was a director and the sole shareholder of Mt Management Limited (the trustee of the Appellant's employee benefit trust) and is a director and shareholder of MTM (Isle of Man) Limited (the successor of Mt Management Limited and the trustee of the Appellant's family benefit trust); MTM (Isle of Man) Limited is now known as Montpelier (Trust and Corporate) Services Limited;

40 *Mr Michael John Hutchinson*; Mr Hutchinson was the Managing Director, and later the Chief Executive Officer, of the Appellant until 2005 when he became the non-executive Chairman;

45 *Mr Timothy Robert Jones*, Mr Jones is a director and senior employee of the Appellant;

*Mr Andrew David Leyton*; Mr Leyton is a senior employee of the Appellant;

*Mr Gavin Rankine*; Mr Rankine is a senior employee of the Appellant;

*Mrs Victoria Rankine*; Mrs Rankine is the wife of Mr Rankine and a nominated beneficiary under the Appellant's family benefit trust;

*Ms Phyllis Rock*; Ms Rock is the wife of Mr Sellars and a nominated beneficiary under the Appellant's family benefit trust;

*Mr Geoffrey Stephen Sambrook*; Mr Sambrook was an associate director of the Appellant until he left in 1997;

*Mr Peter Glenn Sellars*; since 2006 Mr Sellars has been the Chief Executive Officer of the Appellant; and

*Mr David Paul Tregar*, Mr Tregar is the Finance Director, and later the Chief Financial Officer, of the Appellant.

8. Oral expert evidence on behalf of the Appellant was given by Mr Peter Alan Holgate the senior UK accounting technical partner with PricewaterhouseCoopers LLP. Mr Holgate had been the Secretary of the UK Accounting Standards Committee. He was also a member of the ASB's Urgent Issues Task Force, the ICAEW Financial Reporting Committee and Research Board and the CCAB International Accounting Committee. Written expert evidence on behalf of the Revenue was given by Mr Charles Roger Bath FCA, an Associate of the Chartered Institute of Taxation. Mr Bath is employed by the Revenue.

9. The first report of each expert witness considered payments to the employee benefit trust. Mr Holgate's first report was dated 7 July 2003 and Mr Bath's first report was dated 7 August 2003. Both expert witnesses met on 16 September 2003 and produced an agreed note of their meeting. Each expert witness submitted a further report about payments to the family benefit trust. Mr Holgate's supplementary report was dated 6 March 2008 and Mr Bath's updated report was dated 6 March 2008.

10. We consider the expert evidence within the context of the second issue in the appeal which concerns generally accepted accountancy practice.

#### **The facts**

11. From the evidence before us we find the following facts.

##### *The Appellant and its business*

12. The Appellant has at all material times carried on business in the City of London dealing in non-ferrous and precious metals either as principal or on behalf of clients. The Appellant was originally known as Metallgesellschaft Limited. In 1999 the parent of Metallgesellschaft Limited floated on the London Stock Exchange. In

2000 the parent of Metallgesellschaft Limited was taken over by Enron. Enron became insolvent in November 2001 and in February 2002 the Appellant was acquired by Semptra Energy of San Diego in the United States of America.

- 5 13. Until 30 September 1999 the Appellant's accounting period ended on 30 September in each year. Thereafter it ended on 31 December in each year.

*The Appellant's bonus arrangements*

- 10 14. The Appellant employs about one hundred employees and is a competitive and profitable company. Its profitability depends upon the success of its employees, some of whom deal on the relevant exchanges and others of whom look after the clients who give instructions for transactions. Maintaining employees of high quality is critical to the success of the Appellant's business. In the market in which the Appellant operates it is normal to remunerate senior employees partly by way of  
15 bonus. An individual employee's bonus could, in a good year, significantly exceed his salary. We formed the view that the Appellant was a benevolent and generous employer who was well trusted by its employees. It had a reputation in the market for retaining the services and loyalty of its employees.

- 20 15. Before 1995 the employees of the Appellant were paid a fixed salary and, in addition, the Appellant had a discretion whether to award any employee a bonus. After 1993 the total bonus pool was calculated as a percentage of the Appellant's pre-tax profits. The Appellant's directors decided which employees should benefit and the amount of the bonus to be paid to each. Before 1995 bonuses were paid to the  
25 employees with their salary and were treated as PAYE income. In some years up to 1994 the Appellant paid the bonuses in ways that saved liability to national insurance contributions, such as by way of gold bullion or platinum sponge.

*1995 – The discussions about the employee benefit trust*

- 30 16. In the summer of 1995 Mr Hutchinson and Mr Tregar of the Appellant met Mr Gittins of the Isle of Man. Mr Gittins outlined the ways in which an employee benefit trust could provide tax efficient benefits to employees. Mr Gittins explained that each year the Appellant could make payments to an employee benefit trust which payments would be allocated to the employees who had materially contributed to the  
35 Appellant's profits and used to benefit those employees thus assisting in the retention, recruitment and motivation of the employees. Mr Gittins said that the benefits could take many forms but Mr Tregar was attracted by the idea that loans could be made to the employees. Mr Tregar understood that there would be no charge to income tax, and no liability for national insurance contributions, if a market rate of interest were paid on the loans. As normally the Appellant had to pay £10 in national insurance  
40 contributions for every £100 of bonus paid to an employee, Mr Tregar formed the view that the scheme would enable the Appellant to provide employees with benefits equal to £110 for every bonus payment of £100.

- 45 17. After the meeting with Mr Gittins the Appellant took independent advice and held a meeting at which it consulted with its employees. No minutes were made of that meeting but Mr Tregar told us that it was made clear that an employee who

participated in the employee benefit trust would receive loans when he needed to draw on the payments which the Appellant had made to the trust and which had been "ring-fenced" for him. The loans would take the place of bonuses and there would be no tax or national insurance contributions. Alternatively, the trustee could invest an employee's allocation in a tax efficient manner (in property, shares or deposits in the Isle of Man) until it was taken as a loan. It was stated that the loans would be repayable but new loans could be taken out and loans could be written off at the discretion of the trustee. It was made clear that, if an employee left the Appellant, there would be no arbitrary calling-in of the loans. It was also stated that loans had advantages for inheritance tax purposes because the amount of the loan would reduce the value of a deceased employee's estate and the repayment of the loan would go back into the trust for the benefit of the employee's family. Finally it was stated that the loans would be interest bearing.

18. After the consultation meeting each employee was given the choice of either taking a bonus in cash (as before) or having the amount of his bonus paid to the employee benefit trust. All employees chose to use the new scheme. Mr Sambrook was told that he would not have to repay his loans if he left the employment of the Appellant.

*1995 - The establishment of the employee benefit trust*

19. On 26 September 1995 there was a meeting of the board of directors of the Appellant. Mr Hutchinson was in the chair and also present were Mr Tregar and Mr Jones. The meeting resolved "that the company should establish an employee trust for the purpose of providing benefits and the payment of bonuses to employees".

20. On the same date (26 September 1995) the Appellant as settlor executed a deed of settlement which established an employee trust. The trustee was Mt Management Limited of the Isle of Man, of which company Mr Gittins was the director and sole shareholder. The initial trust fund was £1,000. The trust period was eighty years or any earlier date specified by the trustee. The beneficiaries were the present, future and retired directors, officers or employees of the settlor and their spouses, children and remoter issue and any charitable body.

21. The deed of settlement gave the trustee power to hold the initial trust fund, and any added property, upon trust for sale with very wide powers of investment. In addition, the trustee was given power to lend all or any part of the trust fund to any beneficiary (whether or not including provision for the payment of interest) as the trustee thought fit. The trustee was also given power to appoint, by deed, capital and income for the benefit of all or one or more of the beneficiaries and, failing such appointment, to apply the income for the benefit of any beneficiary in its absolute discretion. We were informed that the power to appoint had never been exercised. Any capital or income not wholly disposed of by the trustee was to be held for the Red Cross Society of Geneva.

*The payments by the Appellant to the employee benefit trust*

22. On 14 November 1995 there was another meeting of the board of directors of the Appellant. Mr Hutchinson was in the chair and Mr Tregar was also present. The purpose of the meeting was stated to be "to consider a payment to the Employee Trust". The accounts for the year ending on 30 September 1995 were tabled and it was resolved that a payment of £3,650,000 be made to the trustee forthwith. The total amount to be paid was calculated in the same way as the total bonus pool had been calculated prior to 1995.

23. The meeting of 14 November 1995 then considered the performance of the individual employees for the year ending on 30 September 1995 and resolved to advise the trustee in writing "of their view as to recommendations on any payment which the trustees might consider making to employees". It was also recorded that any recommendations could not be binding on the trustee who would exercise its discretion. The minutes of the meeting then recorded the names of thirteen employees, including Mr Hutchinson, Mr Jones, Mr Tregar, Mr Sambrook and Mr Hussey and, against each name was recorded an amount.

24. In addition, the meeting of 14 November 1995 resolved that the board recommended that within twelve months the trustee might consider further benefits for the same thirteen employees and separate smaller further amounts were stated for each. The smaller amounts were in the nature of retention bonuses and each was dependent upon the employee remaining employed for the following twelve months. We were told that the amount of all the recommendations, including the further benefits, totalled £3,650,000.

25. The amounts recommended for Mr Hutchinson, Mr Tregar and Mr Jones were reviewed and approved by the Appellant's parent company before any final allocation was made.

26. Thereafter in each year until 2000 similar meetings were held and resolutions passed that amounts be paid to the trustee. Each time the minutes recorded the recommendations of the board and the amounts which the board recommended should be paid to identified employees. Exceptionally on 1 September 1997 the directors resolved to make a payment to the trustee of £2,250,000 and recommended that named employees be considered for benefit in stated amounts but on or after 30 September 1998. Each year each employee was given the choice of taking a bonus with his salary or having a payment made to the trust.

27. Details of the annual payments to the trustee were:

	<i>Accounting period</i>	<i>Amount of payments</i>
	30 September 1995	£3.651 M
	30 September 1996	£2.200 M
45	30 September 1997	£5.664 M *
	30 September 1998	£0.375 M
	30 September 1999	£2.943 M

31 December 2000	£0.305 M
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Total	£15.138M

5 \* the amount of £5.664M includes the payment of £2.25M made in September 1997.

28. For each year that the Appellant made payments to the employee benefit trust the total amount paid was calculated as 110% of the bonus pool to reflect the fact that  
10 the Appellant did not have to pay national insurance contributions on the amounts of the payments.

29. The Appellant also paid to the trustee an annual fee equal to 3% of the amount of the payments made to the trust.

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*The administration of the employee benefit trust*

30. Once the board of directors had resolved on the amounts applicable to each named employee, the trustee was sent a copy of the minutes of the board meeting. Members of the board verbally informed the employees of their recommendations.  
20

31. All the recommendations of the board of directors of the Appellant were followed by the trustee. Mr Gittins gave oral evidence, which we accept, that allocations were made in the records of the trustee and that, in effect, each employee had his own fund; the funds remained trust property but were allocated or  
25 "earmarked" to the individual employees, but were not formally constituted as a sub-trust for the individual employees. Each employee knew the amount which the directors had recommended should be allocated to him and regarded the amount of his allocation as "his" fund. In evidence Mr Hutchinson referred to the cumulative amount of all the sums allocated to him as "my pot".  
30

32. All the amounts recommended by the board of directors were made available by the trustee to the named employees. Although the class of beneficiaries stated in the deed of settlement included the present, future and retired directors, officers or  
35 employees of the Appellant and their spouses, children and remoter issue and any charitable body, no application for a loan was received from any beneficiary other than the employees named in the minutes of the meetings of the directors of the Appellant. Mr Gittins told us that if an application had been received from a beneficiary who was not a named employee then it would have been considered but only in relation to unallocated funds because all the allocated funds were regarded as  
40 "earmarked" for the named employees.

33. In November 1995 representatives of the trustee met individually some (but not all) of the employees named in the minutes of the meeting on 14 November 1995. We saw a transcript of the meeting with Mr Sambrook. The purpose of the meeting  
45 was stated to be "to try and get to know a little bit about" the employee in order to help the trustee to exercise its discretion under the deed of settlement. Mr Sambrook was asked about his wife and children, his home, its value and its mortgage, and his

5 other investments. He was told about the recommendations of the Appellant concerning the amounts which were allocated to him and were available to him from the trust. He was told that he could take these amounts in the form of a loan or, alternatively, his allocated amounts could remain invested in the trust. Bearing in  
10 mind the size of some of the loans which were made, and the nature of the interviews, it could not be said that the interviews enabled the trustee to establish fully the financial circumstances of each employee, but Mr Gittins stated that the principal factor which the trustees took into account in considering the ability of the employee to service and repay the loan was his actual and potential earning capacity.

10 34. Only two employees decided they did not want a loan and their allocated funds were invested at interest; the interest was accumulated and added to that employee's allocated fund. Mr Hutchinson took some loans but also suggested other investments to the trustee and he told us that "the trustee invested my pot in the things  
15 I suggested". However, not all the investment suggestions he made were accepted by the trustee, as the trustee was not prepared to make a loan to a third party to the extent of the amounts requested by Mr Hutchinson.

20 35. The Appellant asked the trustee to retain 40% of the funds for future income tax but this was not done on the basis that all the loans made to the employees were repayable.

*The loans to employees*

25 36. No application by a named employee for a loan to be made to him was refused by the trustee although some loans were made in stages. If an employee chose to take his allocated amounts by way of loan he signed a loan agreement. We saw a copy of a loan agreement signed by Mr Sambrook on 1 December 1995. The loans were unsecured. Mr Sambrook's agreement stated that interest was payable annually in arrears at the rate of 8% per annum but later agreements stated that the rate of interest  
30 was 2% over LIBOR. The arrangements for the payment of interest on the loans was described by a representative of the trustee to a named employee at an interview held on 30 November 1995 in the following way:

35 "The reason for a rate of interest at 8% is that the loan has to be seen to be commercial and 8% is the Inland Revenue's official rate at present. If there was no rate of interest the Revenue would deem it as a benefit in kind and you would be taxed accordingly. However, the interest you will pay annually in arrears in essence is paid to yourself, back to the trust and you can take a new loan for the full amount and the capital continues to grow."

40 37. In fact until 2004 no demands for interest were made by the trustee and no interest was paid by the employees.

45 38. Initially no term was stated for repayment of loans but in later years loans were granted for a period of one year. Mr Tregar told us that the loans were intended to be repayable and that if an employee behaved, say, fraudulently, he could be "deprived of his allocation". On the other hand it was never intended that an

