THE SPECIAL COMMISSIONERS

EXECUTORS OF DR HARVEY ERNEST POSTLETHWAITE
Appellants

- and –

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS
Respondents

Special Commissioners; **THEODORE WALLACE**
CHARLES HELLIER

Sitting in public in London on 29 and 30 November 2005 and 25 September 2006

Patrick Way and **Claire Simpson,** Counsel instructed by **Stevens & Bolton LLP** for the Appellant

Peter Twiddy, Assistant Director **HMRC Capital Taxes Office,** and **Anne Pissaridou,** (on 29 and 30 November 2005); **Colin Ryder,** of the **Capital Taxes Office** (on 25 September 2006) for the Respondents

DECISION

1. This appeal concerns the interaction of section 10 of the Inheritance Tax Act 1984 ("IHTA") excluding from inheritance tax dispositions not intended to confer gratuitous benefit with section 94 imposing a charge on participators when a close company makes a transfer of value.

2. In this case Pintacorze Ltd paid £700,000 to the trustees of a Funded Unapproved Retirement Benefit Scheme ("FURBS") to provide benefits for Dr Postlethwaite and his family, he being the sole beneficial shareholder and also the sole employee of Pintacorze Ltd.

3. On 20 December 1991 Pintacorze Ltd had contracted with an Italian company to provide the services of Dr Postlethwaite for a fee of £600,000 per year and on the same day entered into am employment contract with Dr Postlethwaite with a salary of £75,000 per year with bonus and pension arrangements to be agreed.

4. On 31 August 1993 Pintacorze Ltd paid £700,000 to the FURBS which had been established on that day. Under the scheme Dr Postlethwaite was entitled to benefit on termination of service subject to surviving to 50 or at normal pension age; Dr Postlethwaite was 50 on 4 March 1994. In the event of his death before receiving the benefits there were discretionary trusts for a class which included his widow and children of whom there were two. He died on 13 April 1999. There was no evidence as to the termination of his contract with Pintacorze. Pintacorze was wound up on 21 February 2001

5. On 18 April 2005 the Revenue determined that the payment by the company in 1993 was a transfer of value which was not a disposition not intended to confer gratuitous benefit In essence the case advanced initially was that Dr Postlethwaite wished to safeguard his and his family's future, that this involved conferring a gratuitous benefit on his family and that his intention was imputed to the company because the directors implemented his wishes; during the hearing Mr Twiddy widened his case to cover a benefit to Dr Postlethwaite himself although this was not in his skeleton argument.

6. Mr Way submitted that there was no transfer of value by the company because section 10 applied, there being no intention to confer a gratuitous benefit. He accepted that section 12(1) did not apply because the company was not liable to income tax or corporation tax being a non-resident company and that section 12(2) did not apply because the scheme was not approved and Dr Postlethwaite was connected with the company. Alternatively he said that the payment to the FURBS was relieved by section 13 because the property was to be held on trusts within section 86(1).

7. Mr Twiddy accepted that the trustees of the scheme and the Albany International Assurance Ltd ("Albany") which issued ten policies to the trustees on 1 September 1993 were not connected with the company and that the disposition to them was made in a transaction at arm's length so that paragraph (a) of section 10(1) was satisfied. He did not accept that the test in paragraph (b) was satisfied.

8. The issues are, therefore, whether the subjective test in the opening words of section 10 was satisfied or whether the payment was excluded by section 13 from being a transfer of value because the payment was to be held on trusts for the benefit of employees as described in section 86(1) and the other requirements of section 13 were satisfied. Logically the section 13 issue comes first, however the submissions at the initial hearings were concerned with section 10.

9. There was some debate as to whether, if section 10 did not apply, the transfer of value fell to be reduced under section 94(1) on the basis that Dr Postlethwaite acquired a future interest under the scheme so that his estate was increased and that the interest of Mrs Postlethwaite was also property and the part of the transfer attributable thereto was exempt under section 18. Mr Twiddy contended that the transfer of value under section 94 would be so reduced. Mr Way on the other hand said that the scheme of the inheritance tax is that an interest in a trust other than an interest in possession does not form part of a person's estate and that no reduction would therefore be available.

10. While Mr Twiddy's submission is at first sight surprising it has some force given the closing words of section 5(1) taken with sections 47 and 48. The issue was not however covered by the determination under appeal. This is unfortunate since the determination was nearly 13 years after the transfer, six years after the death of Dr Postlethwaite on 13 April 1999 and nearly four years after Pintacorze Ltd was wound up on 21 February 2001. If the Appellants fail in this appeal and thereafter there is a dispute on the quantum this will involve a further appeal. Mr Ryder told us that the Capital Taxes Office only learned of the payment to the FURBS in a letter of July 2001 and that the determination in April 2005 followed fairly detailed correspondence.

The evidence and the facts

11. There was an agreed statement of facts some of which we have already covered. There was a common bundle including minutes of the directors of Pintacorze Ltd, the contract between Pintacorze and Dr Postlethwaite, the trust deed for the FURBS, ten policy schedules of £70,000 issued by Albany with the policies, and letters from Gestions Sportives Automobiles SA ("GSA") and their lawyers to Pintacorze Ltd or Eric Axford, a director.

12. David Aspinall, managing director of Aspinall Financial Management Ltd, and George Koopman gave evidence to which there was no substantial challenge by Mr Twiddy. A witness statement by Mr Axford was read.

13. We find the following facts.

14. Dr Postlethwaite was born on 4 March 1944 and died on 13 April 1999. His wife was born on 22 April 1944. They had two children. At the time of the payment Dr Postlethwaite was domiciled in the UK but was neither resident nor ordinarily resident. At the time of his death he was resident in the UK.

15. Pintacorze Ltd was incorporated in Jersey on 23 January 1990. At the material time Dr Postlethwaite was the sole beneficial owner of the shares. The directors were Mr

Axford, J. B. Collins and P. R. Lewin. The company was controlled and managed in Jersey and was therefore not resident in the UK.

16. Between 1981 arid 1987 Dr Postlethwaite, who was a highly skilled designer and engineer in Formula One motor racing, worked for Ferrari, contributing to Ferrari winning the Constructor's World Championships in 1982 and 1983. From 1987 to 1991 he was engaged by the Tyrell Racing Organisation and Sauber in the UK.

17. In December 1991 Dr Postlethwaite returned to work for Ferrari in Italy, working through Pintacorze Ltd for GSA which was connected with Ferrari. Lawyers for GSA in Milan prepared draft agreements between GSA and Pintacorze and between Pintacorze and Dr Postlethwaite. On 19 December 1991 the directors of Pintacorze approved the agreements and gave a power of attorney to an Italian lawyer to sign them.

18. On 20 December 1991 a contract between Pintacorze and GSA was signed under which Pintacorze provided engineering services for a fee of £600,000 per annum. The contract provided for the services to be those of Dr Postlethwaite. The agreement provided for monthly payments of £50,000 starting on 31 January 1992. 25 The agreement was for an initial term of two years, but provided for renewal to be agreed by 30 June 1993.

19. Also on 20 December 1991 a contract was signed between Pintacorze and Dr Postlethwaite under which he was employed to provide his services in the business of designing, developing and manufacturing motor racing cars throughout the world.

20. Clause 3 provided for a salary of £75,000 per annum payable monthly and in addition "such bonus ... as may be determined from time to time by the Board and agreed in writing by the Company and the Employee." Pintacorze was to provide suitable motor cars with expenses and reimbursement of all reasonable travelling and other expenses.

21. Clause 4 provided that Pintacorze should maintain during the employment "the separate personal pension arrangements effected for the Employee as agreed by the Company and the Employee." No arrangements were agreed prior to August 1993.

22. Clause 7 provided that the employment should continue until 31 December 1993 with annual extensions thereafter unless either party served written notice before 16 December in any year.

23. Dr Postlethwaite was the sole employee of Pintacorze and his duties were performed wholly outside the UK. He was probably among the top three or four motor racing engineers in the world in 1991. The fee paid by GSA to Pintacorze was in line with the cost of the services of comparable motor racing engineers. The basic salary paid by Pintacorze to Dr Postlethwaite was very low for a person of his standing and it was clearly assumed by the parties that either consideration would be given to bonus payments under clause 3 or pension arrangements under clause 4, or that Dr Postlethwaite would otherwise benefit from funds accumulated by Pintacorze since he was its sole shareholder.

24. No bonus was paid. There was no evidence as to what expenses were paid nor as to whether any expenses were payable by GSA to Pintacorze. By the end of July 1993 fees of £950,000 had become payable by GSA to Pintacorze and salaries totalling £118,750 had become payable to Dr Postlethwaite.

25. On 4 June 1993 Pintacorze agreed with GSA to postpone the deadline for agreeing the renewal of the agreement from 30 June to 30 September 1993 because the person who would be responsible for Ferrari's Racing Team was only taking charge on 1 July.

26. On 10 August 1993 the directors of Pintacorze resolved to set up a retirement benefits scheme to provide relevant benefits for Dr Postlethwaite on reaching normal pension age, retirement or leaving service but not before his 50th birthday and for the benefit of his family, dependants or other nominees on his death before receiving benefits. It was resolved to make an initial contribution of £700,000 with the intention to make further contributions but no obligation to do so. Dr Postlethwaite was invited to apply for membership on the same day and he did so by a letter dated 27 August asking the trustees to pay the totality of title death benefits to his wife in the event of his death in service.

27. The deed establishing the scheme was executed by the trustees and Pintacorze on 31 August 1993, being a retirement benefits scheme within ICTA 1988, section 611.

Clause 1 contained definitions

> " 'Accumulated Fund' means the Trust Fund or part thereof allocated to a Member pursuant to Clause 4.2 hereof. Provided however that any allocation of assets to a particular Member's Accumulated Fund is for benefit calculation purposes only. It does not affect the fact that the assets are held as a common trust fund out of which all the benefits are to be provided. No beneficiary is entitled to any specific assets of the Scheme.
> 'Beneficiary' means any Member or other person to whom a Benefit is to be paid under the Rules.
> 'Benefits' means any lump sum, pension, annuity or other money (including any transfer of any property comprised in the Trust Fund) payable by the Trustees under the terms of the Trust.
> …
> 'Employee' means an employee or director (including a non-executive director) of the Employer.
> 'Member' means a person who has joined the Scheme in accordance with the procedure set out in Clause 2 hereof.
> 'Normal Pension Age' in respect of any Member shall be that notified to the Member in his formal announcement of benefits payable under the Scheme.
> …….
> 'Potential Beneficiaries' are those persons defined in Clause 6.3 hereof."

Clauses 2,4, 5 and 6 provide so far as relevant as follows:

> "2. Each Employee who has accepted an invitation by the Employer to join the Scheme will join on the date notified to him. He will complete an application to join in the form

required by the Trustees and a formal announcement of the benefits payable under the Scheme shall be made to him.
3. …..

"4.2 .,. each Member will be entitled to an Accumulated Fund ... contingent on his service with the Employer ... terminating by his retirement, death or withdrawal from service ('the Vesting Date') Provided however that if the Trustees shall decide (but not until they so decide) the Vesting Date .... may be the Members Normal Pension Age (if this precedes the Members termination of service on retirement or withdrawal from service), or any date subsequent to Normal Pension Age.

4.3 The Trustees will (after making an allowance for their reasonable expenses) allocate to a Member's Accumulated Fund the contributions paid ... in respect of him and a fair share ... of the income, gains and losses arising from the Trust Fund from time to time ...

4.4 A Member will not be entitled to the Accumulated Fund until the Vesting Date and until that time nor will a Member be entitled to any income or gains arising to the Trustees in respect of his Accumulated Fund. Until the Vesting Date all such income and gains must be a accumulated ...

5.1 No benefits shall be paid or applied to a Beneficiary from the Scheme until the Vesting Date**.** Provided always that in any event no Benefits shall be paid or applied to a Member before his 50th birthday.

5.2 ... the Benefits payable under this clause 5 during the Trust Period shall be such annuities, pensions, lump sums or assets ... paid, applied to or assigned to, for or in respect of a Member out of that Member's Accumulated Fund as announced to the Member from time to time by the Employer and the Trustees after consultation with the Member.

……

5.6 In the provision of Benefits the Scheme shall in all respects comply with the preservation laws and cash equivalent laws of the Social Security Acts and subordinate legislation.

…..

6.1 When ... a Member has died prior to receiving Benefits .., the Trustees shall realise such Member's Accumulated Fund. After doing so the Trustees shall pay the net proceeds (the 'Death Benefit') with any interest obtained thereon to or for the benefit of all or such one or exclusive of the other or others of the Potential Beneficiaries in such shares and proportions if more than one and generally in such manner as the Trustees may from time to time determine within two years of the death of such Member and in default ... to or for the benefit of the persons who would have been entitled to the Death Benefit... under the law relating to [intestacy] ... if such deceased Member had died wholly intestate and domiciled in England without leaving any spouse him surviving and possessed only of an absolute beneficial interest in the Death Benefit.

…

For the purposes of this Deed in respect of each Member the 'Potential Beneficiaries' are:-

> (a) any widow/widower of the Member;
> (b) any child, brother or sister of the Member or of his spouse;
> (c) any parent, ancestor descendant or collateral relative of the Member or of his spouse;
> (d) any person ... wholly or in part financially, dependent upon the Member;
> (e) any person who is the spouse or issue of any person referred to above;
> (f) any person nominated by the member in writing to the Trustees during his lifetime or in his will;
> …"

28. On 31 August 1993 Pintacorze paid a contribution of £700,000 to the Scheme and on 1 September Albany, a Manx company, received a transfer of £700,000 from the trustees being the premiums for ten assurance policies on the lives of Dr Postlethwaite and his wife. The application for the policies was sent by Mr Aspinall for the trustees.

29. On 1 September the trustees accepted Dr Postlethwaite's application for membership and notified him in a formal announcement that his Normal Pension Age under the scheme was 60. The notification was in accordance with clause 1 of the Scheme. It does not appear that any decision postponing Vesting Date was made under clause 4.2.

30. On 24 September 1993 GSA wrote to Pintacorze confirming termination of the agreement of 20 December 1991 with effect from 30 September 1993. GSA agreed to pay the amounts due as if the agreement had terminated on 20 December 1993. The letter referred to "our various meetings regarding the earlier termination of our December 20, 1991 agreement."

The evidence of Mr Aspinall

31. We now turn to the evidence of Mr Aspinall on whose advice the scheme was established, the payment made and the Albany policies were taken out. He is also one of the executors who are the Appellants. He amplified a six page witness statement and was cross-examined.

32. He first became involved in advising Dr Postlethwaite when recommended by Dr Postlethwaite's accountant in 1989. He was not involved in the negotiation of the contracts in December 1991 but his recollection was that the engagement with GSA was expected to last for three to five years. He did not have access to his notes at the time which under FSA rules were with the company for whom he was then working.

33. In his statement Mr Aspinall said that in 1991 the larger part of Dr Postlethwaite's wealth was tied up in his principal residence and in a collection of classic cars. His salary of £75,000 was sufficient to cover his general living costs, but Dr Postethwaite had only made limited provision for retirement and was keen to secure his long term financial security. He had advised Dr Postlethwaite not to enter into any substantive pension arrangements with Pintacorze in haste but to wait for matters to settle.

34. He said that after around 18 months he was asked by Dr Postlethwaite and later by Pintacorze to look at how Pintacorze might best use the funds accumulating. The contract made provision for a retirement benefits scheme and Dr Postlethwaite was underfunded and saw the chance to catch up. After discussing the options he had advised using the pension scheme. He said that the other alternatives would have been to remunerate Dr Postlethwaite by way of bonus or a dividend. He visited Jersey once before the resolution of 10 August 1993. He said that the options for a British expatriate working abroad were very limited. A FURBS under the Finance Act 1989 allowed uncapped benefits; if Dr Postlethwaite returned to the UK the scheme funds would not be liable to UK tax although any benefits would be taxable as income. He said the contribution of £700,000 would not have given an excessive benefit based on Dr Postlethwaite's salary and projected service to 60. He produced a calculation to show that if Dr Postlethwaite had contributed at the maximum allowable level to an approved UK scheme until he was 60 and his salary of £75,000 had increased with inflation, the pension which he would have obtained was about the same as that which the £700,000 would secure.

35. Mr Aspinall told Mr Twiddy that he had advised Dr Postlethwaite not to rush into making pension arrangements at the start. He said that Dr Postlethwaite saw the opportunity to safeguard his and his family's future. When setting up the scheme Mr Aspinall was dealing with Pintacorze to which he had sent his advice. He advised on the use of Albany but did not advise on the drafting of the trusts which were prepared by Albany. He said that under the scheme Dr Postlethwaite was the sole beneficiary while he was alive; there was no other employee. He said that the package was standard for such arrangements.

36. He told Mr Twiddy that he had been unaware of the agreement in June with 45 GSA to postpone the renewal deadline.

37. Mr Aspinall told the Tribunal that he recalled Dr Postlethwaite saying that it was not a happy ship at Ferrari second time. He knew that Dr Postlethwaite was finding it difficult but was not aware that it was that serious. He was not aware of the meetings referred to in GSA's letter of 24 September 1993 (see paragraph 30). In his statement he said that 'there was a clash of personalities at Ferrari and that after Dr Postlethwaite received an offer from Tyrell with a 10 per cent equity stake the GSA contract was ended prematurely.

38. We accept the above evidence.

Submissions on section 10

39. Mr Way submitted that IHTA section 10 applied to the transfer of £700,000 by Pintacorze which would otherwise have given rise to a charge on the deceased under section 94 as a participator. He said that the quantum would have been £700,000 because the value of Dr Postlethwaite's estate was not increased by the company's transfer: his benefits were not available until the age of 50 and depended on termination of service and the dependants' benefits were discretionary. He said that section 94(2)(a) would have applied if a bonus paid to a participator had been chargeable under Schedule E but did not

apply to the payment to trustees: section 94(2)(b) did not apply because Dr Postlethwaite was domiciled in the United Kingdom. If the Revenue were correct Dr Postlethwaite should have declared a transfer of value in 1993; it would have made no difference if benefits under the scheme had been paid to him before his death.

40. He said that the word "intended" in section 10 refers to the transferor, here the company. The requirements of subsection (a) were satisfied because the company and the trustees were not connected with each other nor was the insurance company connected with either. The company and the trustees were "parties with separate and distinct interests" who had agreed terms in their own respective interest, see *Mansworth vJelley* [2002] STC 1013 at 1018. The fact that trustees were involved did not mean that the disposition was not at arm's length, see *IRC v Stenhouse's Trustees* [1992] STC 103 at 109. In any event he submitted that the test under subsection (b) was satisfied. He referred to *IRC v Spencer-Nairn* [1991] STC 60.

41. Mr Way submitted that on the facts the subjective test, that the disposition was not intended to confer any gratuitous benefit on any person, was satisfied. The disposition was the payment by Pintacorze to the trustees and the 'transaction' was that disposition together with the associated payment to the insurance company,

42. He said that Pintacorze had no gratuitous intent when it made retirement arrangements for its employee. There was no intent to confer any gratuitous benefit on Dr Postlethwaite. The benefit to him was entirely in consideration of his employment and given his earning capacity with and for the company was not gratuitous.

43. Mr Way accepted that the company was Dr Postlethwaite's alter ego but said that the issue under section 10 was what the company did and what was its intention. The company had its own legal existence regardless of where its controlling mind was, see *Salomon v Salomon & Co* [1897] AC 22 at 31 and 41. It made no difference if the directors did what Dr Postlethwaite asked them to do. He said that section 10 applied whether the disposition was the transfer to the trustees or the transfer via the trustees to Albany. He said that the associated operations did not extend to Dr Postlethwaite's employment, which was too remote, but that in any event there was no gratuitous intent. The company had a valuable employee and the payment motivated his continuing employment. It was in reality part of his remuneration package and was in line with commercial reality.

44. In a Statement of Case served pursuant to a direction, Mr Twiddy pleaded that section 13 did not apply because the trusts permitted property to be applied to Dr Postlethwaite, a participator. The transfer depreciated the value of the company to the detriment of the sole participator. It had not been shown by the Appellants that the requirements of section 10(1) were satisfied.

45. In his very brief skeleton argument Mr Twiddy said that the company was Dr Postlethwaite's alter ego. It was his wealth which went into a form of discretionary trust for the benefit of a class of persons. That was a manifestation of gratuitous intent which

resulted in a considerable loss to his estate. The £700,000 payment was for the benefit of Dr Postlethwaite's family and in reality was by him.

46. Mr Twiddy accepted that the trustees were not connected with the company and that the test in subsection (a) of section 10(1) was satisfied.

47. He said that there was a broad class of beneficiaries under clause 6 in the event of Dr Postlethwaite's death before receiving benefits. These were persons on whom a gratuitous benefit might be conferred. Mr Aspinall had referred to Dr Postlewaite seeing an opportunity to safeguard his and his family's future. He said that this indicated an intention by Dr Postlethwaite to confer a gratuitous benefit on his family.

48. He said that the transactions should be viewed in their context. The same principles apply to the interpretation of tax statutes as to any other statutes, see *Barclays Mercantile Business Finance Ltd v Mawson* [2005] 1 AC 684.

49. Mr Twiddy said that the payments arose from discussions between Dr Postlethwaite and Mr Aspinall when Dr Postlethwaite had asked how to use the accumulating money. Mr Aspinall's package was implemented by the company. It was not enough to look at the transactions by the company in isolation. Section 94 was designed to negative the effect of gifts by a close company by attributing them to participators. It was not suggested that the company was a sham or that its separate existence should be ignored. The aim of the legislation was parity of treatment of transfers of value by a close company with transfers by an individual. If Dr Postlethwaite had made a discretionary trust this would have been a transfer of value. If Pintacorze had made a transfer to Dr Postlethwaite's wife, this would have been exempt under section 18.

50. He said that for the purposes of section 10 the intentions of Dr Postlethwaite should be attributed to Pintacorze. The reality was that the company received the money from the GSA contract, retaining most of it and that Dr Postlethwaite's intention triggered the creation of the retirement benefit scheme. The directors simply implemented his wishes adopting a standard package prepared by Mr Aspinall; he did not say that the directors did not consider it. The disposition was for the benefit of Dr Postlethwaite and his family. As it happened he drew nothing from the scheme although this was not predicted in 1993. Mr Twiddy said that the position would have been the same if the payment had been £70,000 rather than £700,000. He said that if the pension had been solely for Dr Postlethwaite, for example an annuity certain, there would have been no charge because the loss to the company's estate would have been matched by a gain to his estate; the position would have the same if a bonus had been paid to him.

51. Mr Twiddy said that sections 12 and 13 were enacted because the dispositions covered might involve gratuitous benefits not exempted under section 10. He said that section 12(1) does not cover a non-resident company. He said that it was a moot point whether the payment to the FURBS had any value to Dr Postlethwaite's estate. He said that the value to Dr Postlethwaite of his entitlement under the scheme fell to be deducted under section 94(1). This was a valuation issue. A person's estate under section 5(1) is the aggregate of all property to which the person is beneficially entitled, except that the

estate immediately before death does not include excluded property which included reversionary interests under section 48. The rights of Mrs Postlethwaite in the event of his death before drawing benefits were property within section 272; her interest was covered by section 18.

52. He said that whatever the difficulty it was for the Appellants to show that section 10 applied.

53. In reply Mr Way said that focus of section 10(1) is on the words "not intended". The relevant intention was that of the company. Inevitably consideration of this has an objective element which involves considering the surrounding circumstances including the high earning capacity of Dr Postlethwaite. The company's intention was wholly commercial because the money had been earned by Dr Postlethwaite's efforts. There was no difference in principle between the company paying a salary of £600,000 a year, a salary of £75,000 and a bonus of £525,000 and a salary of £75,000 and provision of £525,000 for retirement benefits. Viewed as a payment for past services it was reasonable and not gratuitous.

54. He said that a payment to provide a provision for Dr Postlethwaite alone would have been covered by section 10. The fact that perfectly normal provision was made for dependants in the event of his death did not negate the intention to give a retirement benefit to him. He was only 49 at the time of the payment.

Submissions as to section 13

55. Mr Way submitted that the payment to the FURBS was relieved by section 13. The trusts were of the description specified in section 86(1) and permitted the property to be applied for the benefit of employees. Although Dr Postlethwaite was a participator under section 13(2)(a), subsection (4)(a) applied because any payment to him would have been taxable under section 596A(2) of the Taxes Act 1988 if he had been resident in the United Kingdom. Similarly any payment of a lump sum to his widow would have been her income, although in practice covered by Extra-Statutory Concession A10.

56. He said that section 86(1) applied if the trusts did not permit the property to be applied otherwise than for persons within paragraphs (a) or (b). The final words of section 86(1) "during that period" meant that so long as there was a period during which the trusts did not so permit, section 86(1) did apply. At the time of the transfer in 1993 the trusts satisfied section 86(1), the fact that at some future date the trusts might permit an applicati on outside paragraph (a) and (b) was not relevant during the period when the trusts did not so permit. He referred to *Dymond's Capital Taxes* paragraph 21.412 and *McCutcheon on Inheritance Tax,* 4th ed (2005) at paragraph 16-48.

57. Mr Way said that at the time of the payment to the FURBS the trusts did not permit the property to be applied to anyone except Dr Postlethwaite, because clause 6.3 under which other persons might benefit only took effect on his death. He said that section 86(1) must be applied at the time of the disposition for the purposes of section 13. At the time of the transfer the only person for whose benefit the property could be applied was

Dr Postlethwaite. He said that section 86(3)(a) which required that the class include all or most of the employees or office holders was satisfied because the directors could be invited to join at any time.

58. He said that, if section 86(1) is interpreted as covering persons who might benefit after Dr Postlethwaite's death, relatives of a spouse who could benefit under clause 6.3(b)(c) or (e) were covered by section 86(1)(b) which referred to "marriage or relationship to" employees and was wide enough to encompass a collateral relative of a spouse; as to clause 6.3(f) he submitted that a person nominated by a Member was a person defined by their relationship to him in that they could only benefit if nominated by him.

59. Mr Ryder submitted that section 86, and therefore section 13, did not apply (1) because the trusts were not for the benefit of most or all employees or office holders as required by section 86(3)(a) because the directors were not members and because it was only open to those invited to join; (2) because the funds were ring-fenced by allocation to a member's accumulated fund under clause 4.3 and were not thus held for "all or most" of the employees and (3) because the potential beneficiaries under clause 6.3 were too wide for section 86(1).

60. He said that the reference in section 13(1) to "trusts of a description specified in section 86(1)" imported the provisions in section 86(2) to (5). He pointed to the similarity in wording between section 13(l)(a) and (b) and section 86(3)(a) and (b).

61. Mr Ryder said that at the time of the payment although Dr Postlethwaite had applied to join the Scheme under clause 2, the trustees had not notified the date of his joining or made a formal announcement.

62. He said that the words "during that period" in section 86(1) referred back to the word "period" earlier in the subsection although they did not encompass the word "indefinitely". He submitted that the relevant period in this case was the trust period which was defined as 79 years. He accepted that section 86(1) envisaged that there might be a trust which satisfied section 86(1) for a limited period but did not thereafter.

63. Mr Way in reply said that until the death of Dr Postlethwaite the trusts did not permit property to be applied for the benefit of persons outside section 86(l)(a) or (b). That period continued until his death.

64. He submitted thai: the word "or" before "holding office" in section 86(3)(a) and also in section 13(l)(a) is alternative and that it sufficed that the class comprised the only employee.

Conclusions

65. Since section 10 is not relevant if section 13 applies, we consider section 13 first. Section 13 provides as follows:

"(1) A disposition of property made to trustees by a close company whereby the property is to be held on trusts of the description specified in section 86(1) below is not a transfer of value if the persons for whose benefit the trusts permit the property to be applied include all or most of either -

(a) the persons employed by or holding office with the company, or

….

(2) Subsection (1) shall not apply if the trusts permit any of the property to be applied at any time (whether during any such period as is referred to in section 86(1) below or later) for the benefit of-

(a) a person who is a participator in the company making the disposition, or

….

(d) any person who is connected within any person within paragraph (a)

….

(4) In determining whether the trusts permit property to be applied as mentioned in subsection (2) above, no account shall be taken -

(a) of any power to make a payment which is the income of any person for any of the purposes of income tax, or would be the income for those purposes of a person not resident in the United Kingdom if he were so resident..."

66. Section 86 provides

"(1) Where settled property is held on trusts which, either indefinitely or until the end of a period (whether defined by a date or in some other way) do not permit any of the settled property to be applied otherwise than for the benefit of-

(a) persons of a class defined by reference to employment in a particular trade or profession, or employment by, or office with, a body carrying on a trade, profession or undertaking, or
(b) persons of a class defined by reference to marriage or relationship to, or dependence on, persons of a class defined as mentioned in paragraph (a) above,

then, subject to sub section (3) below, this section applies to that settled property or, as the case may be, applies to it during that period.

….

(3) Where any class mentioned in subsection (1) above is defined by reference to employment by or office with a particular body, this section applies to the settled property only if-

(a) the class comprises all or most of the persons employed by or holding office with the body concerned ..."

67. It appears that it was originally considered that section 13 could not apply because Dr Postlethwaite was a participator. It was however not in dispute that any payment to him or his widow would in law have been income within section 13(4)(a) and the fact that Extra-Statutory Concession A10 applied is immaterial.

68. For section 13(1) to apply the property must following the disposition "be held on trusts of the description specified in section 86(1)". The wording of section 86(1) is far from clear. We accept the submission of Mr Way that the wording contemplates the possibility that section 86 may apply for part only of a period during the property is subject to the trusts. If the requirement in section 86(1) had to be satisfied for the entire period of the trust the words "during that period" would be otiose. We also accept that under section 86(1) itself it is immaterial that other persons may benefit in the future, see *Diamond* at 21.413. We note that the wording is "do not permit" rather than "prohibit" or "prevent". Furthermore the words "at any time" which appear in section 13(2) do not appear in section 86(1). At the time of the disposition the trusts did not permit the property to be applied for anyone but Dr Postlethwaite while he was alive.

69. Although the application of section 86(1) to any settled property is subject to subsection (3), it does not seem the subsection (3) affects the description in subsection (1) as opposed to its application,

70. Mr Ryder pointed out that the directors who were office holders were not members of the Scheme and said that the requirements of section 13(l)(a) were therefore not satisfied.

71. Mr Way had two responses to this. First that it sufficed if all or most of the employees were members, the first "or" in section I3(l)(a) being alternative. We do not accept this because in our judgment both the alternatives are descriptive of "persons" and the persons in question cover both categories.

72. His other response was that the class within section 13(1)(a) did in fact include the directors because they could be admitted to the Scheme. The problem there is that they had not been admitted : indeed there was no intention that they would be. The time at which it must be determined whether section 13(l)(a) is satisfied must be the time of the disposition: "holding" refers to persons who hold office at that time and "include" is in the present tense. Section 13(2) by contrast refers to "any time". In our judgment it would be illogical to interpret section 13(l)(a) as satisfied because of the possible future admission of the directors while holding that the negative requirement in section 86(1)(a) was not being infringed because possible beneficiaries under clause 6.3 could not benefit in Dr Postlethwaite's life time.

73. Another difficulty for the Appellant is that the property transferred to the FURBS was allocated to the Accumulated Fund of Dr Postlethwaite when the premiums were paid on the policies. Although the deed referred to it being held as a common fund, it seems clear that even if other directors had been admitted to the scheme at that time they could not have benefited from the property transferred.

74. There was some debate as to the position at the time of the payment to the FURBS which preceded the admission of Dr Postlethwaite by one day. It seems to us that until his admission the trust was not complete so that there was technically a resulting trust and that the disposition only took effect on his admission.

75. We conclude therefore that section 13 did not apply to the transfer to the FURBS.

Section 10

76. This brings us to section 10. This is the first appeal in which the application of section 10 has arisen in relation to a transfer of value by a close company under section 94. Section 10(1) provides as follows:

> "(1) A disposition is not a transfer of value if it is shown that it was not intended, and was not made in a transaction intended, to confer any gratuitous benefit on any person and either:
>
> (a) that it was made in a transaction at arm's length between persons not connected with each other; or
>
> (b) that it was such as might be expected to be made in a transaction at arm's length between persons not connected with each other."

"Transaction" includes a series of transactions and any associated operations, see section 10(3).

77. The disposition in question was the payment by Pintacorze to the scheme trustees and the transactions included the making of the scheme, the admission of Dr Postlethwaite to membership and the purchase of the life policies.

78. It was common ground that the relevant intention under section 10(1) is that of the transferor, here the company. It would be irrelevant to the charge under section 94 if a participator could show that he himself had no gratuitous intent. The intentions of Dr Postlethwaite are relevant only to the extent that they can be imputed to the directors through whom the company acted. It is clear that in this case the directors did what Dr Postlethwaite, on the advice of Mr Aspinall, asked. That was not improper as the recent Court of Appeal decision of *Wood v Holden* [2006] EWCA Civ 26 makes clear. There was no suggestion that the powers of the board were usurped or that they did not consider the matter. However the fact that the company did what Dr Postlethwaite wanted does not mean that its intentions were necessarily the same as his.

79. In order to succeed the executors have to show a negative intention in relation to a disposition over twelve years ago by a company acting in accordance with the wishes of a person who died nearly seven years ago when the company was dissolved over four years ago. This must be shown on the balance of probabilities. In many cases the negative intention can be shown by direct evidence. However direct evidence is not essential. There is no time limit for a notice of determination under section 221. The transferor may

be long since deceased or the company defunct. It is clear therefore that it must be possible to infer the negative intention from the circumstances.

80. It is clear that when the £700,000 payment was made no thought was given to the possible application of section 94 and thus to the relevance of section 10. It follows that there is no evidence expressly directed to section 10. If any of the directors had attended to give oral evidence, their evidence might have been relevant if they could remember the matter after the lapse in time; however we think it unlikely that they could have assisted on this aspect quite apart from the lapse in time. It is necessary therefore for the: Appellants to rely on the contemporary documents and on the evidence of Mr Aspinall whose contact with Dr Postlethwaite was much greater than that of the directors and who advised the directors. Greater reliance can be placed on the documents than is sometimes the case since they clearly were not prepared with section 10 in mind.

81. Just as in *Inland Revenue Commissioners v Spencer-Nairn* [1991] STC 60 the fact that the sale of land was far less than the open market value was not conclusive for section 10, so also is the fact that the payment by Pintacorze reduced the value of its estate. Lord Hope pointed out at page 68a that transactions which are gratuitous may be taken out of the clause if they satisfy the tests laid down, otherwise the subsection would be deprived of its content; the gratuitous element is no more than a factor.

82. Although the employment contract provided for a bonus and for personal pension arrangements to be agreed, no agreement was reached before the transactions in issue. The transactions from the resolution of 10 August 1993 up to the admission of Dr Postlethwaite to the scheme constituted an agreement giving effect to clause 4. There was however no prior legal obligation for Pintacorze to pay £700,000.

83. It is necessary to consider the intention of the company in the context in which the disposition was made. The company in which Dr Postlethwaite was the sole beneficial shareholder had earned fees of £950,000 up to the end of July 2003 by providing the services of Dr Postlethwaite to GSA and had paid him a salary of one-eighth of that sum. It had therefore accumulated £831,250 less administrative costs and any expenses. Further monthly receipts were anticipated. There is no reason whatever to believe that GSA was paying the company an excessive amount to Pinatacorze for Dr Postlethwaite's services. The evidence was to the contrary.

84. In June 2003 the renewal of the GSA agreement had been put back to September 30, however Mr Aspinall was not aware of this. His evidence was that he was aware of difficulties but he did not consider them to be that serious. Although in closing Mr Twiddy referred to GSA's letter of 4 June 1993 postponing renewal as a cloud on the horizon, he did not challenge Mr Aspinall's evidence on this. The inference must be that in his discussions with Mr Aspinall which were presumably before 10 August 1993 Dr Postlethwaite had not informed Mr Aspinall that he expected to cease working at GSA, even if this was the case. If it was the case, there is no reason why he would not have told Mr Aspinall. The directors of course knew from the letter of 4 June that renewal had been put back. There is however nothing to indicate that they were aware of any real difficulties given that Mr Aspinall did not believe them to be serious.

85. It is clear that if Pintacorze had agreed at an early stage of Dr Postlethwaite's employment to pay £700,000 to a FURBS on 31 August 2003 provided he completed 20 months service that such payment would not have been intended to confer a gratuitous benefit. The fact is however that it did not so agree. The consequence is that when agreed and paid the payment was substantially if not entirely in consideration of past service. However in our judgment the fact that on legal analysis the payment was for past consideration does not mean that it was made with the intention of conferring a gratuitous benefit.

86. The interpretation of the words "not intended ... to confer any gratuitous benefit" in section 10 has not been the subject of any appeal either to the Special Commissioners or to the Court, As Lord Hope pointed out in *Spencer-Nairn,* section 10(1) can be satisfied in spite of the fact that a gratuitous benefit is conferred. The initial test under section 10(1) is one of intention as to which the existence of a gratuitous element is no more than a factor.

87. The word "gratuitous" is clearly crucial but is important that it is descriptive of "benefit". While reference to a gratuitous intention may be a useful shorthand, the actual test concerns an intention to confer "any gratuitous benefit".

88. The word "gratuitous" is not statutorily defined. When linked with benefit it clearly connotes bounty. It **is** used in the first sense given in the New Shorter Oxford English Dictionary,

> "1. Given or obtained for nothing; not earned or paid for; free."

The other sense involves something adverse to the recipient or object, such as a gratuitous insult.

89. Clearly if a payment is made under a binding legal obligation it will not be intended to confer a gratuitous benefit unless the creation of the obligation was in an associated operation which conferred a gratuitous benefit. If Dr Postlethwaite's contract with Pintacorze had provided for a FURBS payment of £700,000 after 20 months service, not only would the payment not have diminished Pintacorze's estate, but it could not have been with intent to confer a gratuitous benefit on him.

90. However the natural meaning of "gratuitous" is not limited to dispositions otherwise than for fall consideration under a legal obligation. In our judgment the fact of past consideration may be sufficient to negate an intention to confer a gratuitous benefit provided that the past consideration is commensurate with the benefit conferred.

91. In the present case the contract between Dr Postlethwaite and Pintacorze specifically contemplated a bonus in addition to a salary and pension arrangements to be agreed. A surplus in excess of £800,000 had accrued by the end of July 2003 generated entirely from income earned for the company by Dr Postlethwaite. In those circumstances we do not consider a payment of £700,000 to a pension arrangement for him can properly be described as "given ... for nothing" or "not earned" to use the meaning given in the New Shorter Oxford English Dictionary. The fact that the payment accorded with Dr

Postlethwaite's wishes did not have the effect that the company intended to confer a gratuitous benefit. It is to be noted that clause 4 of the service agreement provided for the pension arrangements to be agreed. If the sum had been paid as a bonus it would not have been apt to describe it as given for nothing. We do not see that the fad; that a large FURBS payment was made instead of a bonus affects the position. If the payment had been excessive in comparison with what Dr Postlethwaite had earned for the company, the position might well have been very different. That was not however the case.

92. Even if that were not the case, to the extent that the transaction was intended to confer a benefit on Dr Postlethwaite, we do not believe that the directors would have considered themselves to be bestowing a gratuitous benefit on him when they knew that he was the sole beneficial shareholder of the company. In paying out for his benefit monies to which he already had an effective economic entitlement they would not in our view have considered that they were conferring bounty upon him, giving him a benefit for nothing, giving him something to which he had no claim, or giving him something free: whatever they gave to the FURBS reduced the value of his shares in the company.

93. This approach it is noted does not render otiose the provisions in section 94(1) which reduce the transfer of value apportioned to a participator by the amount by which his estate is increased by the transfer, or the provision in section 94(2)(a) which exempts, inter alia, taxable dividend income received by a participator. In many cases when an apportionment under section 94(1) falls to be made, a participator receiving a benefit or a dividend will not be the sole beneficial shareholder and the transfer of value will benefit him alt the expense of the others. In such circumstances it might well be difficult for it to be show that the company had no gratuitous interest.

94. Implicit in Mr Twiddy's submission was that the provision of death benefits to the spouse or dependant of a member of a scheme involves an intention to confer a gratuitous benefit on the spouse or dependant and is only relieved if covered by section 12. We do not accept this proposition which seems to us to be more in keeping with Victorian times than with modem family law and pension legislation.

95. Mr Twiddy fastened on the evidence by Mr Aspinall that Dr Postlethwaite wished to safeguard his and his family's future and submitted that Dr Postlethwaite wished to confer a gratuitous benefit on those to whom death benefits would be payable. However Dr Postlethwaite's intention was that any death benefit would to his widow (see paragraph 26 above). It should be remembered however that in 1993 he was only 49 years old There is no evidence that he was in anything but good health. The normal life expectation of a man in England aged 50 given in Whitaker's Almanack (1993) was over 25 years. It was clearly unlikely that Dr Postlethwaite would die before receiving benefits even taking account of the preservation of benefits under clause 5.6 and it follows that it was unlikely that any death benefits would become payable under clause 6. While we accept that Dr Postlethwaite clearly did wish to protect his widow in the event of his early death, it seems clear that his primary intention was to be able to provide for her during his life. We do not consider such intention to be an intention to confer a gratuitous benefit on her because primarily it was to provide for himself. The element of benefit intended to be directly conferred upon her was de minimis.

96. It follows that even if Dr Postlethwaite's wish to provide for his wife is to be imputed to the company we do not consider that such intention was an intention to confer a gratuitous benefit on her.

97. We conclude that it has been shown that the payment of £700,000 was not intended to confer a gratuitous benefit on Dr Postlethwaite or anyone else. The appeal is allowed.

THEODORE WALLACE

CHARLES HELLIER

SPECIAL COMMISSIONERS

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