



26 February 2014

PRESS SUMMARY

The Commissioners for H.M. Revenue & Customs (Respondents) v Forde and McHugh Limited (Appellant) [2014] UKSC 14

On appeal from the Court of Appeal [2012] EWCA (Civ) 692

JUSTICES: Lord Neuberger (President), Lord Sumption, Lord Reed, Lord Toulson, Lord Hodge

BACKGROUND TO THE APPEAL

This appeal is the lead case in a number of appeals concerned with liability to pay National Insurance Contributions (NICs) and, in particular, with the interpretation of the phrase in section 6(1) of the Social Security Contributions and Benefits Act 1992, “[w]here in any tax week earnings are paid to or for the benefit of an earner”. The case focuses on the meaning of the word “earnings” in that phrase, and whether it covers a payment by the appellant, FML, of an employer’s contribution to a Funded Unapproved Retirement Benefits Scheme [1].

The scheme was set up by FML by trust deed on 11 April 2002 to provide certain benefits to its employees and directors. The trust provided that upon a member’s retirement from service the trustees were to apply the accumulated fund in providing the member with a pension for life or such other relevant benefits as might be agreed. On the member’s death the trustees were to realise the accumulated fund and apply the net proceeds to or for the benefit of a defined discretionary class of beneficiary.

On the same day, Mr McHugh, a shareholder and director of FML, asked to become a member of the scheme. He informed the trustees that he wished them to exercise their discretion in favour of his wife in the event of his death. FML made an initial cash contribution to the scheme of £1,000 and transferred to it Treasury Stock with the nominal value of £162,000, both for Mr McHugh’s benefit. He has been the only member of the scheme and has received no relevant benefits from it, as defined in section 612 of the Income and Corporation Taxes Act 1988 [2]. He was 54 years old when the transfers were made, and FML specified his retirement age to be his 60th birthday. However as he controlled FML this date could be brought forward for the purposes of the scheme [3].

The question was whether the transfers were payments of earnings to or for the benefit of Mr McHugh within the meaning of section 6 of the 1992 Act. It was agreed that the payment was for his benefit, but was it “earnings”? HMRC decided that it was, and that FML was therefore liable to pay Class 1 NICs on the value of the transfer. FML’s appeal to the Upper Tribunal was successful, but the Court of Appeal reinstated HMRC’s decision [4-5]. FML appealed to the Supreme Court.

Departing from its position before the Court of Appeal, FML accepted that “earnings” had a wider meaning than “emoluments” in income tax legislation. It submitted that the payment of “earnings” under section 6 did not extend to the employer’s transfer to a trust of funds or assets in which the earner had at the time of the transfer only a contingent interest [6].

JUDGMENT

In a judgment delivered by Lord Hodge, the Supreme Court unanimously allows the appeal.

REASONS FOR THE JUDGMENT

Lord Hodge examines the legislative history behind the UK's system of national insurance, which shows that NICs have indeed been levied on a basis that is different from the "emoluments" on which income tax has been raised [7-13]. He considers it significant that Parliament, in the National Insurance Act 1946, chose to use the word "earnings" rather than "emoluments". The latter word has been interpreted by the courts as referring to actual money payments and benefits in kind capable of being turned into money by the recipient [10]. Lord Hodge refers to primary legislation in 1911 and 1946 and also subordinate legislation for the purpose of demonstrating that the scheme of NICs legislation by which "earnings" includes non-convertible benefits in kind (unless they are disregarded) has existed since 1946 [11-13].

As a result of the assumptions on which the subordinate legislation had been framed, HMRC had to argue that earnings are paid to an earner both when assets are transferred to a pension scheme to be held on a trust and also when payments are made from the trust fund. HMRC looked to the payment and not to what the earner received. The sum paid into the trust was part of Mr McHugh's remuneration, going into a trust fund for the sole benefit of Mr McHugh and his wife. Payments out to him from the trust would also, it was submitted, be earnings as they were also payments to him in respect of his employment. Double counting would be avoided only as a result of specific disregards in the subordinate legislation [15].

Lord Hodge considers that "remarkable" position to be wrong for three reasons:

- First, the ordinary man on the underground would consider it counter-intuitive that a person would earn remuneration both when his employer paid money into a trust to create a fund for his benefit and again when at a later date the trust fund was paid out to him. If one gives words their ordinary meaning, it is clear that a retired earner receives "earnings" in respect of his employment in the form of deferred remuneration when he receives his pension. The payment from the trust is deferred earnings; the payment into it is not earnings [16].
- Secondly, HMRC's view could only be sustained by looking exclusively at what was paid and ignoring what the earner received. Such an interpretation denudes the word "earnings" of any meaning, so the phrase "earnings are paid" would amount to "payments are made" [17].
- The third reason relates to the method of computation. By treating the payment into the trust as earnings, HMRC fail to take into account the existence of the contingency. The transfer gave Mr McHugh not cash and treasury stock, but only the entitlement to a future pension or "relevant benefits" once the condition of reaching retirement age had been purified. The hypothetical value to his entitlement would not be the value at the date of the transfer of the assets paid into the fund, but the value of Mr McHugh's contingent right to the trust fund such as it would be at his retirement age. That would not be a simple exercise, and HMRC's approach fails to address what it was that Mr McHugh received when the transfer was made [18].

Lord Hodge concludes that the transfer to the trust was not the payment of "earnings" for section 6(1) purposes [19]. The court allows FML's appeal and reinstates the judgment of the Upper Tribunal [22].

References in square brackets are to paragraphs in the judgment.

NOTE

This summary is provided to assist in understanding the Court's decision. It does not form part of the reasons for the decision. The full judgment of the Court is the only authoritative document. Judgments are public documents and are **available at:**

www.supremecourt.uk/decided-cases/index.shtml