[2018] UKFTT 017 (TC)

TC06297

Appeal number: TC/2016/02445

CAPITAL GAINS TAX – whether Appellant entitled to Business Assets Taper Relief - whether Appellant employed - whether payments made to Appellant were made under Sale and Purchase Agreement or were payments of salary

FIRST-TIER TRIBUNAL
TAX CHAMBER

JOHN SHANNON **Appellant**

- and -

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

TRIBUNAL: JUDGE MARILYN MCKEEVER

MR NIGEL COLLARD

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1R 4QU on 6 November 2017

Mr Michael Sherry, Counsel for the Appellant

Mr Simon Bracegirdle, presenting officer for the Respondents

DECISION

Introduction

1. The issue in this case is whether the Appellant, Mr Shannon, was employed by Regis Corporation ("Regis") between 6 April 2000 and 11 July 2003 so that he was eligible for Business Assets Taper Relief ("BATR") for Capital Gains Tax purposes.

2. We had before us a bundle of correspondence and documents and we heard oral evidence from Mr Shannon himself and Mr David Convisser of Gerald Edelman who was Mr Shannon's accountant throughout the relevant period and remains his accountant.

3. Mr Shannon was director and shareholder of Supercuts UK Ltd. ("Supercuts"). On 31 October 1999 Mr Shannon sold his entire shareholding. A small part was sold for cash, but the majority was sold to Regis, a US company listed on the New York stock exchange, in exchange for shares in Regis.

4. Mr Shannon sold some of his shares in Regis in the 2002-3 tax year and the balance in 2003-4, on 11 July 2003. The present appeal relates to the tax year 2003-4, but the issue in this appeal will also determine his liability for the previous tax year.

5. It is common ground that the shares which were sold were "business assets" for taper relief purposes from 6 April 1998 to 31 October 1999 and "non-business assets" for the period 1 November 1999 to 5 April 2000. An announcement was made in the Autumn Statement in November 1999 that changes were to be made to the taper relief regime and it appeared that this would be favourable to taxpayers. The changes were introduced with effect from 6 April 2000 and broadly, meant that (subject to other conditions) a shareholder would be eligible for enhanced taper relief if he was an employee of the company whose shares he held. The dispute between the parties relates to Mr Shannon's status in the period from the introduction of the new rules to the dates of the sales of the shares.

6. HMRC opened an enquiry into Mr Shannon's 2003-4 tax return on 9 January 2006. Mr Shannon was involved with a number of companies and businesses and his financial affairs were complex. HMRC already had open enquiries into Mr Shannon's tax returns for the years from 1999-00 to 2002-3 and the information provided in the course of some of those enquiries proved to be relevant to the current matter.

7. On 12 August 2011 HMRC amended the 2003-4 return under section 9C(2) Taxes Management Act 1970; a "jeopardy assessment". This was appealed on 9 September 2011. A closure notice was issued on 14 July 2015 indicating an additional tax liability of £119,007.60 and this was appealed on 29 July 2015. Following a statutory review, Mr Shannon appealed to this Tribunal on 25 April 2016.

The law

8. The law is not in dispute. Taper relief was introduced in 1998 by Schedule A1Taxation of Chargeable Gains Act 1992 ("TCGA"). Paragraph 4 set out the conditions for shares to be business assets. Broadly, they had to be shares in the individual's "qualifying company".

> ***"Conditions for shares to qualify as business assets***
> ***4***
> *(1) This paragraph applies, in the case of the disposal of any asset, for determining (subject to the following provisions of this Schedule) whether the asset was a business asset at a time before its disposal when it consisted of, or of an interest in, any shares in a company ("the relevant company").*
> *(2) Where the disposal is made by an individual, the asset was a business asset at that time if at that time the relevant company was a qualifying company by reference to that individual….*

9. Initially, the conditions for a company to be a qualifying company required the individual to be an employee of the company and/or to have voting rights in respect of the shares of the company in question.

> ***"Companies which are qualifying companies***
> ***6***
> *(1)…*
> *(2) A company was a qualifying company by reference to an individual,… at any time when both the following conditions were satisfied, that is to say—*
> *(a) the company was a trading company or the holding company of a trading group; and*
> *(b) the voting rights in that company were exercisable, as to not less than 25 per cent, by that individual …*
> *(3) A company was also a qualifying company by reference to an individual at any time when all of the following conditions were satisfied, that is to say—*
> *(a) the company was a trading company or the holding company of a trading group;*
> *(b) the voting rights in that company were exercisable, as to not less than 5 per cent, by that individual; and*
> *(c) that individual was a full-time working officer or employee of that company or of a company which at the time had a relevant connection* [a group company] *with that company."*

10. The conditions were changed with effect from 6 April 2000 so that employment on its own was sufficient for the company to be a qualifying company. The revised paragraph 6 read:

> ***"Companies which are qualifying companies***
> ***[6***
> *(1) A company shall be taken to have been a qualifying company by reference to an individual at any time when—*

(a) the company was a trading company or the holding company of a trading group, and
(b) one or more of the following conditions was met—
(i) the company was unlisted,
(ii) the individual was an officer or employee of the company, or of a company having a relevant connection with it, or
(iii) the voting rights in the company were exercisable, as to not less than 5%, by the individual."

11. Following the sale to Regis, Mr Shannon did not have sufficient votes for Regis to be a qualifying company by reference to him. Following the changes in 2000, the company would be a qualifying company if he had an office or employment with Regis.

12. This would make a significant difference to his tax liability. Under the taper relief rules as they applied during the years in question, if the Regis shares were business assets, the actual gain would be reduced by 75% after two year's ownership, giving an effective Capital Gains Tax rate of only 10% at a time when the normal rate was 40%. If the assets were non-business assets, the percentage reduction in the gain tapered over a ten year period and the maximum reduction after this time was only 60%.

The facts and evidence

13. The burden of proof is on the Appellant to show, to the normal civil standard, on the balance of probabilities that he was employed by Regis in the relevant period.

14. Mr Shannon was the Chairman of and a shareholder in Supercuts until its sale to Regis on 31 October 1999. The deal took two or three months to conclude and was embodied in a Sale and Purchase Agreement ("SPA"). We did not have a full copy of the SPA. In the course of the enquiry, Mr Shannon sought information from a number of people who had been involved with the transaction, including Mr Spencer Leslie, who had been the Chief Executive of Supercuts. Mr Leslie sent Mr Shannon an extract from the SPA dealing with something called the "Change of Control Obligation".

15. Clause 12.1 of the SPA referred to an agreement made between "the Company", presumably Supercuts, and Mr Shannon and Mr Leslie under which the Company was to pay to each of Mr Shannon and Mr Leslie a "Change of Control Payment" being the sum of £100,000 a year for five years from Completion.

16. Clause 12.2 provided that in consideration of the release of the Company from its obligation to pay the Change of Control Payment, the Purchaser (presumably Regis) would pay to each of Mr Shannon and Mr Leslie, the sum of £100,000 a year for five years from Completion payable monthly. The Clause went on to say *"In the event that the Inland Revenue shall treat the payments…as income, the Purchaser shall indemnify each of John Shannon and Spencer Leslie against any National Insurance or income tax that they are found to be liable to pay in respect of the payments…to the extent…that such liability exceeds the capital gains tax*

which John Shannon or Spencer Leslie… would otherwise have been liable to pay had such payments been treated as a capital receipt." We infer that it was hoped that the payments would be treated as capital for capital gains tax purposes and we note that Regis promised to indemnify both men in respect of the excess tax, if the payments were treated as income.

17. Gerald Edelman prepared the tax returns for both Mr Leslie and Mr Shannon. Mr Convisser's witness statement explains that Mr Leslie declared the payments in his return under "other income". We do not know whether this was following a dispute with HMRC over the treatment and we do not know whether Mr Leslie claimed under the indemnity.

18. In November 1999, shortly after the completion of the sale, the government announced prospective changes to the taper relief regime. It seems that the proposed changes meant that it would be to Mr Shannon's advantage if he became an employee of Regis. At the time, the details of the changes were not known, but as set out above, the provisions enabled an employee without any votes in his employing company to claim the more favourable business assets rate of taper relief.

19. Mr Convisser recalled that when he became aware of the proposed changes, he spoke to Mr Shannon and suggested that he should ask if Regis would give him employment after the sale.

20. Mr Shannon's evidence referred to this phone call and said that he discussed it with Supercuts' lawyer, a Mr Fellerman. Mr Fellerman suggested that he should agree with Regis that the Change of Control Payment should be changed to employment income and that he, Mr Shannon, should become an employee of Regis. Mr Fellerman said it was a simple matter and something Mr Shannon could easily agree by way of an exchange of letters directly with Regis.

21. Mr Shannon stated, in his Witness Statement, that he distinctly remembers exchanging letters with Regis confirming that the Change of Control Payment would be cancelled and the payments of £100,000 a year would be employment income. He further stated that the form of letters exchanged left him in no doubt whatsoever that he was under an obligation to provide services if asked and had then become an employee. Mr Shannon also said that Regis wanted his help at the time by voting his shares in favour of a Special Resolution and, effectively, he agreed to vote with them in return for their assistance in accepting he could become an employee.

22. It seems that Mr Shannon prepared the letters himself. He said that he showed them to Mr Fellerman who had confirmed that Mr Shannon was employed on the basis of the letters. Unfortunately, Mr Fellerman died some years ago so it was not possible to obtain any confirmation.

23. Mr Shannon had misplaced his copy of the exchange of letters and by the time Regis were asked if they had a copy, none was available. He recalled that the

correspondence was sent to a Mr Bert Gross who was Regis' general counsel and company secretary and who was involved with the sale transaction. We do not know whether Mr Gross discussed the letters with anyone else at Regis but as set out below, we infer that he did not.

24. Mr Shannon was unable to recall the contents of the letters. We recognise that the events occurred more than 17 years ago, so that it would perhaps be surprising if he did remember the terms in detail. He said that it was a letter of employment with "the normal terms and conditions". When pressed, he suggested that that would include the parties, the work to be carried out and the salary. He then confirmed that the letter did set out the work to be carried out. He was unable to remember whether he had signed the letter and sent it to Regis so as to form a contract, but assumed he must have done.

25. Mr Shannon could not remember whether there were any clauses amending the SPA but he recalled there was a clause providing that the Change of Control Payments would be stopped and replaced by employment income.

26. It is clear there was no formal agreement by the parties to the SPA to amend the SPA in this respect. Mr Shannon thought that he might have mentioned the implications of the letters to Mr Leslie. In response to an email from Mr Shannon, Mr Leslie wrote to him on 16 July 2012 saying:

> *"I vaguely remember at the time of the acquisition there was a reason you wished your change of control payments to be changed to be an employment payment. I think this was tax driven but was only discovered on the day of completion or just before. Since the final document had been prepared ready for signing I believe you dealt with this by separate correspondence with Regis which I obviously never saw. …Incidentally I have found a copy of the completion documents and enclose the relevant pages* [this was clause 12 referred to above] *which we decided not to change at the time."*

27. In fact, the request happened after completion but nothing turns on that. We do not know whether there were any other parties to the SPA besides Mr Shannon, Mr Leslie and Regis and if there were, whether they were aware of any changes.

28. Mr Shannon did not show the letters to Mr Convisser and Mr Convisser did not ask to see them. Mr Convisser said that Mr Shannon had told him that he had changed the arrangements so that he was treated as an employee and he did not enquire further as "nothing much rode on it".

29. We digress for a moment to mention that the proposal to mitigate the potential capital gains tax on future disposals by qualifying for BATR was very much a "Plan B". Mr Shannon had implemented the Second Hand Insurance Policy ("SHIP") and Capital Redemption Policy ("CRP") tax schemes which, had they worked, would have generated substantial losses which could be set against the gains on the subsequent disposals of the Regis shares.

30. In 2002-3, Mr Shannon sold a large tranche of his Regis shares realising a gain of £9,584,924. In 2003-4, he sold the rest of the shares realising a gain of £2,766,758. No taper relief was claimed. Instead, loss relief was claimed, resulting in overall losses for the year and so no liability for capital gains tax. In 2011, following the failure of the SHIP and CRP schemes, the losses were disallowed and, as mentioned, the jeopardy assessments were raised in relation to the capital gains tax which now appeared to be due. On 9 September 2011, Gerrald Edelman appealed these and for the first time raised the matter of Mr Shannon's employment with Regis. On 25 October 2011, they claimed business assets taper relief in respect of the gains.

31. Returning to the evidence about the employment, Mr Shannon and Mr Convisser gave evidence that in 2000, a few months after the sale, Mr Convisser asked Mr Shannon whether he had followed up the advice and asked Regis for an employment contract. Mr Shannon explained about the exchange of letters and Mr Convisser suggested that Mr Shannon ask them for a Service Agreement so there could be no doubt. Mr Shannon did not think this was necessary, but decided to ask anyway.

32. We had a draft Service Agreement in our bundle. There was a handwritten date; 17 November 1999 which Mr Shannon confirmed he had inserted. The document was unsigned. Mr Shannon had drafted the document himself based on a number of Service Contracts he had had in the past. The employer was, in different places stated to be Regis International Limited, the UK subsidiary, and Regis Corporation, the US parent. Mr Shannon confirmed the employer was Regis Corporation. The draft agreement stated it was governed by English law, despite the employer being a US person. The draft agreement provided for its termination on one month's notice without compensation. Clause 4.1dealing with salary stated *"With effect from 17 November 1999 the Company shall pay to the Executive a salary as agreed between the Company and the Executive by the end of the month following the month in which the work was performed in accordance with the normal practice of the Company from time to time…"* The document ran to 14 pages. Mr Shannon gave evidence that the agreement was intended to formalise the exchange of letters, but there were clearly many features of it which were inconsistent with the intention that Mr Shannon should have an entitlement to £100,000 a year for the full five years and that he was not required to do any specific work. Mr Shannon admitted he did not expect Regis to sign it as it was and thought they might want a different form but had sent it as a starting point.

33. Mr Shannon wrote to Paul Finklestein, an executive of Regis on 6 September 2011. We will consider this correspondence in more detail below, but the email stated "I am unable to find the Service Agreement *we signed* and can only find a draft…". (our emphasis). In a subsequent letter (not a reply to that email) Bert Gross set out his recollections concerning the employment and went on "…from memory, about a year after our purchase, Mr Shannon wanted, in addition to the existing documentation, a formal Service Agreement. We were sent a draft which I don't believe we ever signed". There was no further evidence presented from the Regis side about the Service Agreement. Mr Shannon could not recall when

he sent Regis the Agreement. In his witness statement, he said "I…sent a draft Service Agreement to Regis for review but they said after talking to their accountants it was not necessary since the exchange of letters was sufficient". The only evidence we had was the letter from Mr Gross referred to above and there is no indication that Regis did in fact make such a statement.

34. In any event, we find that no Service Agreement was ever signed so the only documentation was the exchange of letters.

35. It was submitted for Mr Shannon that there was no requirement for him actually to carry out any duties under the employment contract. It was sufficient if he could be required to do work if asked. It was also submitted that he did in fact carry out some duties in that he had some discussions with Paul Finkelstein on the telephone and he had a few meetings with Mr Duke, who was the UK Managing Director of Regis to discuss plans for growth etc. Mr Shannon said that he was asked to meet Mr Duke because Mr Finklestein had reservations about his management ability.

36. Mr Shannon wrote to Mr Duke on 12 January 2013 saying "…when I sold Supercuts to Regis, I agreed with Bert Gross I would become an employee for five years…HMRC have asked me to provide further confirmation from the UK…". Mr Duke replied that he had retired from Regis in 2008 "However, I do recall that we met a few times after we acquired Supercuts UK and discussed the progress of the UK business…".

37. The basis of these calls and meetings was not put to Mr Shannon although he was asked whether there were any provisions in the SPA or in relation to the change of control payments which required the Vendors to assist the Purchaser, but Mr Shannon could not remember. It was submitted that it had not been suggested that Mr Shannon had done this "out of the goodness of his heart" and that these activities constituted the performance of duties under Mr Shannon's employment with Regis. Whilst the activities are consistent with their being duties of the employment, there was nothing to show, one way or the other, that that was the case.

38. In any event, Regis made payments of £100,000 a year to Mr Shannon (and to Mr Leslie) for each of the five tax years from 1999-2000 to 2003-4 inclusive. We note that the full £100,000 was paid for the year ended 5 April 2000 even though the agreement had only been in force for 4 months of that year.

39. The payments were all declared on Mr Shannon's tax returns, prepared by Mr Convisser, as employment income received from Regis.

40. The payments were made gross. No US tax was paid on them. No PAYE was deducted and no National Insurance Contributions ("NICs") were paid. As Regis was a non-UK company, it would not have had any obligation to operate PAYE or to pay employers' NICs. Mr Shannon should, however, have paid the employee's NICs. He did not pay any NICs on the payments. Mr Convisser said that although NICs were within his remit, he was not asked to advise on them and did

not do so. Mr Shannon also stated that following the sale of Supercuts he did not have any full time employment but remained involved with other investments. It therefore seems likely that Mr Shannon had earnings below the upper earnings limit for NIC purposes and should have made contributions if he had received employment income.

41. As mentioned above, Mr Shannon had entered into tax schemes designed to generate losses which he could set against the gains made on the sale of his Regis shares. He was advised on these schemes by Simon McKie of Mckie & Co. Mr Mckie asked Mr Shannon for information about the shares in order to advise on the SHIP scheme. In response, Mr Shannon sent an email to Mr Mckie on 9 February 2003, during the period when the employment contract was supposed to be subsisting, in which he said: "*As part of the sale I was given a payment of £83333.33 a month (£100,000 p.a.) for five years. This is declared as employment income on my return but I don't believe I am really an employee. In fact I did ask Regis for an employment contract and after taking advice from their accountants refused* (sic). *It is therefore a consultancy arrangement but in reality no consultancy is performed"*

42. As also mentioned above, HMRC were enquiring into other tax returns of Mr Shannon. On 15 January 2003, HMRC wrote to Mr Convisser about the opening of an enquiry into Mr Shannon's 2000-1 return. They raised queries about a number of matter including the salary declared from Regis and asked about the nature of the duties performed and where they were carried out. Mr Convisser replied on 25 March 2003 stating in response *"A payment made by Regis Corporation to Mr Shannon represented a "change of control payment" and it would appear that the income should not have been reported on the employment pages but is nevertheless taxable without any credit for US taxes."*

43. On 15 June 2005 HMRC wrote to Mr Convisser. They referred to the email to Mr Mckie of 9 February 2003 and noting that the payments of £8,333.33 per month had been entered as employment income on Mr Shannon's tax return, asked for further information about the nature of the payments. Mr Convisser's reply on 28 September 2005 stated *"The payment was agreed during the completion meeting with lawyers and although it was declared as employment income, it was defined as a change of control payment and it was felt simpler to report this as employment income on our client's tax return rather than anywhere else"*.

44. In oral evidence it was explained that Mr Convisser would almost always discuss letters with Mr Shannon before they were sent to HMRC and that where factual questions were involved to which he did not have the answer, he would pass them to Mr Shannon for his comments. Mr Shannon had said he did not have an employment. As set out in the email to Mr McKie, Mr Shannon did not believe he "really" had an employment and both of Mr Convisser's letters in 2003 and 2005 were based on Mr Shannon's comments to this effect.

45. Two explanations were given for this. In Mr Convisser's letter of 23 November 2015 setting out arguments to be considered in the independent review, he explains that Mr Shannon had a medical condition which required him to take statins and that one of the side effects of this medication can be to affect the individual's memory. It was asserted that the statins caused Mr Shannon to fail to remember that the change of control payment had been changed to a payment in respect of a service agreement in November 1999. A printout from the NHS Choices website was included in the bundle which indicated that a rare side effect of statins is memory problems, but there was no evidence that Mr Shannon suffered such side effects.

46. The letter continued *"Our letters of 25 March 2003 and 28 September 2005 were written on the basis of what had been understood from the original sale agreement on the sale of Supercuts. Due to the reasons mentioned in paragraph 2 above* [about the statins] *Mr Shannon had forgotten to advise us of the employment agreement he had entered into in 1999.*" This directly contradicts Mr Convisser's witness statement in which he states that Mr Shannon had confirmed to him that he had followed Mr Convisser's advice and had become an employee by way of exchange of letters and that Mr Convisser had suggested that he should ask Regis for a Service Agreement further to support his employment. Mr Shannon could not recall whether he had told Mr Convisser about the exchange of letters, but concluded that he must have done because his tax returns had consistently reported the payments as employment income and Mr Leslie's tax returns had not.

47. In his witness statement and in oral evidence, Mr Shannon offered a different explanation for his statement in the email to Mr McKie which Mr Convisser relied on in writing his 2003 and 2005 letters: he made an error of law. He had assumed that, in order to be an employee, he actually had to perform some work and, as he had done little work for Regis and was not doing any work for them by 2003, he thought he could not be an employee. He subsequently discovered that it was sufficient that he was obliged to do work if asked and that he could be an employee even though little or no work was carried out.

48. Despite the fact that, at the time, Mr Shannon told Mr Convisser that he was not an employee, the payments continued to be declared as employment income throughout the five year period.

49. It was only after the failure of the SHIP scheme in 2011 that BATR became relevant as, until then, there were no gains to be relieved. Mr Shannon then asserted that he was an employee. The first reference to this is in Mr Convisser's letter to HMRC of 9 September 2011when he says that Mr Shannon contends that he was an employee of Regis and was trying to find documentation to prove it. It stated "*Mr Shannon believes that in his email to Mr McKie of 9 February 2003 he may have confused his employment"*. It was put to Mr Shannon that it was not credible that he was more certain of his employment status many years after the event than he was at the time of the supposed employment. Mr Shannon denied this. Mr Shannon did not refer to receiving advice, but Mr Convisser, in his evidence, said

that in 2011 (he was not sure when) Mr Shannon had obtained external advice which indicated that he could be an employee even though he did not perform any duties. We do not know when this advice was obtained, nor who gave it. Mr Convisser merely said that Mr Shannon had told him in a telephone conversation that he had spoken to someone.

50. Mr Shannon then set about finding documentation to support his contention that he was employed by Regis. This was over ten years since the sale. He did not have a copy of the SPA. He did not have a copy of the exchange of letters. He therefore sought confirmation of the position from Regis.

51. On 6 September 2011, Mr Shannon emailed Mr Finkelstein in the following terms:

> *"…when I sold Supercuts UK to you at the end of 1999, I agreed with Bert Gross that the £100k change of control payment we agreed would also include my consulting as an employee with you for the 5 years as this would considerably reduce the payments of tax. …when I eventually sold my shares. In return, if you remember I agreed to vote my shares with you in a resolution you were proposing at the time.*
>
> *"Why I need your help? I am unable to find the service agreement we signed and can only find a draft and Bert has, I believe, now retired. The UK Revenue Service …require ideally the Agreement or a statement from you confirming I was an employee (which I can draft)…"*

52. Whilst we hesitate to put too much weight on an email written more than ten years after the event there are several points we note. Mr Shannon stated he had agreed with "Bert Gross" rather than "you" or "Regis". We infer he had already tried to contact Mr Gross but had discovered he had retired and Mr Shannon said in evidence that he might have phoned Regis to see if Mr Gross was still an employee. Mr Shannon's position is that the change of control payments were replaced by the employment agreement. The email suggests that the change of control payment provisions remained but *"would also include my consulting as an employee".* We also note that Mr Shannon did not ask for the exchange of letters, but for the Service Agreement which he said had been signed when other evidence suggests he knew it had not been signed.

53. Mr Gross wrote to Mr Convisser on 25 October 2011, in response to Mr Shannon's email, on Regis Corporation headed notepaper in unequivocal terms:

> *"We can confirm that Mr Shannon approached us at this time to employ him to be available to help us if required on any matters that may arise following our acquisition of Supercuts. We can also confirm that Mr Shannon was employed by us for 5 years following the date of acquisition i.e. until November 2004."*

54. It is curious that Mr Gross, rather than Mr Finkelman, to whom the email had been addressed, replied and that he replied apparently on behalf of a company for which he no longer worked.

55. HMRC queried this and Mr Shannon sent a further email to Regis on 13 Jul 2012 stating that HMRC wanted more information about the employment and *"they…discovered Bert retired a few years ago and are surprised he wrote the recent letter. Perhaps this can be explained?"*

56. Mr Gross replied on 18 July, on his own business paper this time. After such a long period he was unable to locate the documents, but he recalled that Mr Shannon had asked for his change of control payments *"to be changed to an employment payment".* As the request was made late in the day [in fact after completion] they did not change the main agreement but dealt with it by side correspondence. He also recalled Mr Shannon sending him a formal Service Agreement about a year later which he believed was not signed. He further said that he had been asked to respond on behalf of Regis as he was, at the time of the acquisition, General Counsel and Secretary for Regis and had dealt personally with the completion of the transaction. Mr Gross noted that he believed that Mr Shannon had met with the UK team *"during the period of his employment to discuss various matters and was available at all times to assist with any queries we had following our acquisition"*

57. HMRC continued to seek information about the employment and with Mr Shannon's authority wrote to a Mr Eric Bakken at Regis on 25 July 2013. Again Mr Gross replied, from what appeared to be a Regis email address, confirming his personal involvement in the transaction but stating that he had no further information in addition to that provided in his two letters to Mr Convisser. He went on to say *"No one else at Regis has any information or documents related to the acquisition or Mr Shannon's employment. Therefore neither I nor anyone now employed by Regis is in a position to respond further to your requests*."

58. Mr Shannon also sought confirmation of his employment position from his co-director Mr Leslie and from his successor, Mr Duke. This correspondence is referred to in paragraphs 26 and 36 above. Neither Mr Leslie nor Mr Duke were able to confirm the existence of the employment contract.

The Appellant's submissions

59. Mr Sherry submits that the cumulation of the evidence from both Mr Shannon and third parties points to the original arrangement having been varied and a contract of employment having been entered into. That evidence is provided by the correspondence with Regis, Mr Gross, Mr Leslie and Mr Duke, Mr Shannon's and Mr Convisser's oral evidence and the treatment of the payment shown in Mr Shannon's tax return.

60. Mr Shannon's statement in the email to Mr McKie that he was not employed has been explained in a credible and cogent way.

61. It is unnecessary for an employee to carry out out duties under a contract of employment, provided he is obliged to do so if asked.

62. The cumulative weight of the evidence is sufficient to discharge the burden of proving the existence of the employment contract on the balance of probabilities and there is no evidence sufficient to displace that conclusion.

The Respondent's submissions

63. HMRC contend that the requirements established in case law for the existence of an employment relationship are not satisfied.

64. The email to Mr McKie and two emails sent by Mr Convisser to HMRC state that Mr Shannon was not an employee.

65. The evidence submitted about the exchange of letters and the correspondence with third parties does not discharge the burden of proof.

66. There was no mutuality of obligation between Mr Shannon and Regis in that there was no credible evidence that Mr Shannon was obliged to undertake any services in return for the payments he received.

67. Mr Shannon was not employed by Regis and that attempting to re-label a change of control payment as an employment payment would not create an employment and in any event, there was no change in the nature of the payments and HMRC submit that there was not even any relabelling.

Discussion

68. The essential elements of an employment were set out by MacKenna J in the case of *Ready Mixed Concrete (South East) Limited v Minister of Pensions and National Insurance* 1968 1All E R 433.

> *"A contract of service exists if the following three conditions are fulfilled: (i) The servant agrees that in consideration of a wage or other remuneration he will provide his own work and skill in the performance of some service for his master. (ii) He agrees, expressly or impliedly, that in the performance of that service he will be subject to the other's control in a sufficient degree to make that other master. (iii) The other provisions of the contract are consistent with its being a contract of service. "*

69. It is common ground that this involves a mutuality of obligation: the employer must be obliged to pay the worker and the worker must be obliged to perform services in return.

70. Mr Sherry submits that it is sufficient to establish that mutuality if the worker is obliged to carry out services if asked, whether or not he is in fact required to perform any services. He finds support for this in *Weight Watchers (UK) Ltd and others v Revenue and Customs Commissioners* [2011] UKUT 433 (TCC). The case involved the employment status of meeting "leaders" of the well known

weight loss organisation. The Upper Tribunal set out the test in *Ready Mixed Concrete* and discussed the endorsement of the passage quoted above in the Supreme Court case of *Autoclenz Ltd v Belcher* [2011] UKSC 41 before reviewing other authorities on mutuality of obligation:

"This appeal requires me to say a little more about each of MacKenna J's three conditions but, before leaving Autoclenz Ltd v Belcher, it is necessary to note that the Supreme Court also resolved an issue which had emerged in previous decisions about whether in the employment context the court was constrained by an apparently complete written contract to conclude that its terms represented the true agreement, unless the application of the traditional doctrine of sham (which required proof that both parties intended the written contract to paint a false picture) permitted a different conclusion. The Supreme Court held that no such constraint is rigidly to be implied in the employment context because of the normally superior bargaining position of the employer, and its consequential ability to dictate the terms to be included in the written contract: see per Lord Clarke at paras 20 – 35. In passing, he approved the following passage in the judgment of Elias J in Consistent Group Ltd v Kalwak [2007] IRLR 560, at paras 57 – 59:

"57. The concern to which tribunals must be alive is that armies of lawyers will simply place substitution clauses, or clauses denying any obligation to accept or provide work in employment contracts, as a matter of form, even where such terms do not begin to reflect the real relationship. Peter Gibson LJ was alive to the problem. He said this (p.697)

*"**Of course, it is important that the industrial tribunal should be alert in this area of the law to look at the reality of any obligations.** If the obligation is a sham it will want to say so."*

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*58. In other words, if the reality of the situation is that no one seriously expects that a worker will seek to provide a substitute, or refuse the work offered, the fact that the contract expressly provides for these unrealistic possibilities will not alter the true nature of the relationship. **But if these clauses genuinely reflect what might realistically be expected to occur, the fact that the rights conferred have not in fact been exercised will not render the right meaningless.***

59. ... Tribunals should take a sensible and robust view of these matters in order to prevent form undermining substance ..."

21. Lord Clarke concluded, at para 35 as follows:

*"So the relative bargaining power of the parties must be taken into account in deciding whether the terms of any written agreement in truth represent what was agreed and **the true agreement will often have to be gleaned from all the circumstances of the case, of which the written agreement is only a part**. This*

may be described as a purposive approach to the problem. If so, I am content with that description."

Mutuality of Obligation

22. The first of MacKenna J's three conditions is commonly labelled mutuality of obligation. In any particular case it may serve one or both of two distinct purposes. The first is to determine whether there is a contractual relationship at all between the relevant parties. ...

23. There are however numerous cases (and the present is one of them) where there is no doubt that the relevant parties had a contractual relationship with each other, but the question is whether the mutual obligations are sufficiently work-related. That is a central issue in the present appeal.

24. MacKenna J's original formulation of the mutuality of obligation condition was that it was necessary to show that the worker agreed to "provide his own work and skill in the performance of some service for his master". He added that: "Freedom to do a job either by one's own hands or by another's is inconsistent with the contract of service, although a limited or occasional power of delegation may not be".

25. In Cable & Wireless plc v Muscat [2006] IRLR 354, at para 32 Smith LJ said that:

"In the context of statutory employment rights, such as those now granted by the Employment Rights Act 1996, it has been said on more than one occasion that the irreducible minimum of mutuality of obligation necessary to support a contract of employment is the obligation on the 'employer' to provide work and the obligation on the worker to perform it."

But in Cotswold Developments Construction Ltd v Williams [2006] IRLR 181, Langstaff J said, at para 55 (in the Employment Appeal Tribunal), referring to the mutuality of obligation condition, that:

"It does not deprive an over-riding contract of such mutual obligations that the employee has the right to refuse work. Nor does it do so where the employer may exercise a choice to withhold work. The focus must be upon whether or not there is some obligation upon an individual to work, and some obligation upon the other party to provide or pay for it.""

71. We have highlighted some important passages in the above extract, from which we derive the following principles. (1) one has to consider the reality of the obligations (2) One must look for the substance of the transaction and not merely accept the form. (3) in order to establish the true nature of the agreement, one must look at all the circumstances and not merely the written agreement. (4) There can be the necessary mutuality of obligation even if the employer does not provide work if the "employee" is obliged to work if asked and in return the employer must either provide work *or* pay for it.

72. Mr Sherry relies in particular on the last highlighted passage and Mr Bracegirdle did not deny that an obligation to work if asked can be sufficient to establish an employment relationship. He commented that actual performance of duties goes a long way to establishing the existence of an employment contract. Mr Sherry submits that the meetings between Mr Shannon and Mr Duke and his telephone conversations with Mr Finkelstein were such duties.

73. The authorities emphasise that we must consider all the circumstances and look at the substance of the obligations. The mere "relabelling" of an agreement is not sufficient to turn it from one transaction into another which might have a different tax treatment. As Lord Greene MR put it in *Henriksen v Grafton Hotel Ltd* [1942] 1 K.B. 82 (CA):

> *"It frequently happens in Income Tax cases that the same result in a business sense can be secured by two different legal transactions, one of which may attract tax and the other not. This is no justification for saying that a taxpayer who has adopted the method which attracts tax is to be treated as though he had chosen the method which does not, or vice versa."*

74. So what was the nature of the agreement between Mr Shannon and Regis?

75. The starting point is the SPA which provided that Regis would pay £100,000 a year to each of Mr Shannon and Mr Leslie for five years in consideration of them releasing the Company from its obligation to make the "change of control payment". It seemed from the limited extract of the SPA before us that these payments were intended to be capital in nature. Regis undertook to indemnify Mr Shannon and Mr Leslie against income tax and National Insurance Contributions if HMRC treated the payments as income, but only so far as those liabilities exceeded the capital gains tax which would have been payable on the footing they were capital receipts. In addition, if Regis failed to make those payments, they were liable to pay interest on unpaid amounts at 5% over base rate. There were thus significant financial obligations on Regis, under the SPA, in addition to the obligation to make the payments themselves.

76. After completion of the transaction, it was suggested to Mr Shannon by Mr Convisser that it might be a good idea if he were to ask Regis to make him an employee as this might help his capital gains tax position in the event that the SHIP scheme failed.

77. It is clear from the correspondence and the oral evidence that there was a post-completion exchange of letters. What is less clear is what that correspondence contained and what the effect of it was.

78. Mr Shannon contends that the exchange of letters constituted an employment contract for five years and that the payments from Regis amounting to £100,000 a year for five years was employment income paid in substitution for the change of control payment.

79. Mr Gross confirmed in his 25 October 2011 letter that "Mr Shannon was employed by us for five years following the date of acquisition". "Us" in this context was Regis, on whose notepaper he wrote, although Mr Gross had retired from Regis some years earlier. He explained this in his July 2012 letter (on his own notepaper) saying "I was at the time of the acquisition of Supercuts, General Counsel and Secretary for Regis and dealt personally with the completion of this transaction. That is why when Mr Shannon asked for confirmation of his employment…I was asked to respond on behalf of Regis." This still does not explain why he wrote on Regis notepaper or why no-one from Regis responded at all, even to say they had passed the `matter to Mr Gross.

80. Neither Mr Shannon nor Regis had copies of the exchange of correspondence, which is not perhaps surprising, at least in Regis' case, given the length of time which has elapsed. Nor could Mr Shannon recall the terms of the letter other than that it contained the "usual terms and conditions". He was unable to elaborate on what these might be although he said he was certain that he was an employee.

81. We consider it important that the employment payments were intended to replace the obligation in the SPA to make the change of control payment. That is, it was intended to amend the SPA. Regis would have been concerned to ensure that this was properly done as they would otherwise have continuing indemnity obligations and a liability to pay interest on unpaid amounts. There was no evidence as to if or how the exchange of letters amended the SPA. Mr Shannon said that he could not remember exactly what the letter said about the SPA but thought that there was a clause saying the change of control payments would be stopped and replaced by an employment.

82. The agreement of the other parties to the SPA was not sought. Mr Shannon thought he might have "mentioned" it to them. Mr Leslie said in his letter of July 2012 that he "vaguely remembered" that Mr Shannon wanted to change the change of control payment to an employment payment. He added "Incidentally, I have found a copy of the completion documents and enclose the relevant pages, which we decided not to change at the time". This is consistent with Mr Gross's July 2012 letter which used very similar wording: "Mr Shannon asked if his change of control payment could be changed to an employment payment and he would be employed by us for the same period…Since this request was made late in the day, we did not change the main agreement, but dealt with this by side correspondence…".

83. Mr Shannon's request was made after completion of the transaction, so it is not surprising that the SPA itself was not changed as, at that point, it would have been an executed document. In order to change the nature of the payments to be made to Mr Shannon, the exchange of correspondence would, in addition to creating an employment, need to have amended the SPA if Regis was to be relieved of its obligation to make the change of control payments and liability under the indemnity and late payment provisions. The SPA was a formal commercial document effecting a transaction involving many millions of pounds. The change of control provisions were on pages 29 and 30 (the only pages we had) of the SPA and there

were further provisions after that. Together with appended leases, the completion documents filled two lever arch files. It is not credible that a commercial agreement of this nature could be changed without the agreement of all the parties and it would be normal commercial practice for any such amendments to be in writing. There does not appear to have been any such agreement and we are not satisfied that the SPA was validly amended and we do not consider that Regis would have agreed to pay half a million pounds in salary under an employment contract unless it had effectively been relieved of its obligations under the change of control provisions.

84. It would perhaps have been possible for Mr Shannon to have released Regis from their liability, but we simply do not know how or if the issue was dealt with.

85. Mr Shannon stated that the exchange of letters was between him and Mr Gross. We acknowledge that Mr Gross was Regis' in-house lawyer and company secretary, but there was nothing to show that this gave him the authority to change the commercial arrangements entered in to by Regis and to enter into an employment contract on the company's behalf. Although the gross amount of the change of control payments were the same as the "salary" under the alleged employment contract, an employment relationship imposes other obligations on an employer and one would have expected some involvement of Regis's human resources department or, at least, confirmation of the arrangements by other senior people involved with the transaction.

86. It is notable that Mr Shannon and HMRC wrote to individuals at Regis to seek further information and in each case a reply was received from Mr Gross who, though involved in the transaction, was no longer employed by Regis. No-one at Regis, even Mr Finkelstein who was involved in the Supercuts sale and appears still to have been at Regis, responded. This suggests to us that Mr Gross alone agreed the exchange of letters and Regis were reluctant to become involved.

87. Mr Shannon was clearly an experienced businessman who was accustomed to seeking professional advice and routinely employed lawyers and accountants. It is remarkable that Mr Shannon dealt with the employment issue apparently without professional advice or input. Mr Convisser suggested the possibility of an employment to him, but he drafted the letter to Mr Gross himself. Although he showed it to his lawyer he did not seek advice about it. He did not seek any advice from Mr Convisser about the exchange of letters or ask what the new BATR rules were following the initial announcement. He did not tell Mr Convisser about the exchange at the time. When Mr Convisser asked whether he had obtained the employment contract (which he confirmed), he followed up by sending a Service Agreement to Regis to "formalise" the exchange of letters which he again drafted, without professional assistance, from past agreements he had entered into himself. The draft contained a number of terms which were clearly inappropriate in the context of the purported agreement with Regis and could not possibly be regarded as formalising the exchange of letters. Although Mr Shannon sent the draft to Regis, he did not pursue the matter and it was not signed.

88. There was no evidence of any other incidents of an employment. As Regis is a US company, it may not have had to operate PAYE or employers' national insurance contributions, but Mr Shannon should have paid employees' NICs and he admitted he had not. The matter was not considered by Mr Convisser. There was no suggestion that Mr Shannon was provided with a P60 to enable him to complete his tax returns nor, so far as we are aware, did Regis provide anything else which would corroborate employee status.

89. Mr Shannon's statement in the email to Mr McKie that he was not "really" an employee was initially attributed to the side effects of medication causing Mr Shannon to forget about the employment contract. That email also stated that he had asked Regis for an employment contract and that after taking advice from their accountants, they refused. We heard that Mr Convisser's two statements to HMRC in 2003 and 2005 to the effect that although the payments from Regis were shown on the tax return as employment income, they were really change of control payments, were derived from the McKie email and were not an independent assessment of the position. Mr Convisser said he was not concerned about this as nothing turned on it at the time as the capital gains tax liability was to be dealt with through the loss schemes. We find this very surprising. It was Mr Convisser who had suggested that Mr Shannon seek to become an employee as a "back up" to the schemes, to make him eligible for BATR, and he had been told by Mr Shannon that he had entered into the exchange of letters. Mr Convisser had completed Mr Shannon's tax returns on the basis that the payments were employment income and it seems odd that he simply accepted Mr Shannon's statement in the McKie email that he was not an employee without making further enquiries. The first statement, in 2003, was made when the employment was supposed to exist and at that point, the exchange of letters may still have been available.

90. Mr Shannon, in his witness statement said that his statement that he was not an employee was made because of a mistake of law; he did not realise one could be an employee without performing duties. He said he realised he was an employee when he received advice in 2011. We do not know who gave the advice or in what circumstances. We were informed the advice was given in a phone call. It is unclear whether any written advice was given. None was produced to us. Yet by this time, Mr Shannon's employment status did matter as the tax scheme had failed and BATR had become relevant.

91. The Supreme Court in *Autoclenz* tells us that in considering the nature of a contract a tribunal must look at the reality of the obligations created by it and must not allow form to triumph over substance. We must also take account of all the circumstances and not just the written agreement.

92. In the present case, we do not even know what the written agreement says. The only document we do have is the extract from the SPA which says that the payments which Mr Shannon was to receive were the "change of control" payments. There was an exchange of letters, but we do not know what the contents were other than that Mr Shannon intended them to create an employment. For the reasons set out above, we do not consider that the exchange of letters amended the

SPA. Nor are we are convinced that *Regis* agreed to replace the change of control payments with a genuine employment contract (albeit one involving little or no work) although it appears that Mr Gross agreed to change the change of control payment to an "employment payment"- the expression used by both Mr Gross and Mr Leslie. It seems to us that there was little reality to the employment obligations.

93. We have carefully considered all the circumstances and weighed the evidence before us including Mr Gross's confirmation of the employment, the course of that correspondence, the letters from Mr Leslie and Mr Duke, the meetings and conversations Mr Shannon had with Regis post completion, the McKie email and Mr Convisser's statements in 2003 and 2005 that there was no employment, the explanations of those statements, the oral evidence and the documents and correspondence in our bundles. Having taken all that into account, we find it difficult to see any substance in the purported contract of employment and conclude, on the balance of probabilities, that Mr Shannon was not employed by Regis and that the payments he received from Regis were the change of control payments under the SPA and not employment income.

Decision

94. For the reasons set out above, we conclude that Mr Shannon was not employed by Regis and accordingly, is not entitled to Business Assets Taper Relief in respect of his sales of Regis shares.

95. We therefore dismiss the appeal.

96. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

MARILYN MCKEEVER
TRIBUNAL JUDGE

RELEASE DATE: 9 January 2018