[2015] UKFTT 0638 (TC)

TC04771

Appeal number: TC/2013/01210, 01212, 01213, 01214, 01216

INCOME TAX – pension scheme - paragraph 10 Schedule 29A Finance Act 2004- whether a residential property was "taxable property" – alternative tests- whether property occupied by employees who were required to occupy it as a condition of employment – whether property was used in connection with business premises held as an investment – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

J&A YOUNG (LEICESTER) LIMTED **Appellants**
JR YOUNG
AJ YOUNG
JJ YOUNG
DPR YOUNG

- and -

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

TRIBUNAL: JUDGE GUY BRANNAN
MRS CATHERINE FARQUHARSON

Sitting in public at the Royal Courts of Justice, the Strand, London on 28 and 29 September 2015

Richard Vallat, Counsel, instructed by Freeths LLP solicitors for the Appellant

Kate Balmer, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal under section 49G Taxes Management Act 1970 against HMRC's assessments to a scheme sanction charge (issued against the First Appellant, as the administrators of a pension fund, J & A Young (Leicester) Limited) ("the Company") in respect of the years ended 5 April 2007 to 5 April 2010) and unauthorised payment charges for the year ended 5 April 2007 (issued against the Second to the Fifth Appellants, Mr JR Young ("Mr Young"), Mrs AJ Young, Mr JJ Young and Mr DPR Young, respectively) (collectively, "the Appellants"). The pension fund is the J & A Young (Leicester) Limited Retirement Fund ("the Fund") of which the Company is the administrator.

2. The scheme sanction charges assessed against the First Appellant were in the following amounts: 5 April 2007, £59,980 assessed under section 174A Finance Act 2004 ("FA 2004") and £1205 assessed under section 185A FA 2004. The unauthorised payment charges assessed under section 174A FA 2004 were as follows: against the Second Appellant, £30,763, against the Third Appellant, £15,828, against the Fourth Appellant £6903 and against the Fifth Appellant, £6483.

3. It was common ground that these appeals turned on the question whether a residential property in Loughborough ("the Property") purchased by the Fund on 19 October 2006[1] was "taxable property" for the purposes of Schedule 28 FA 2004.

4. At the start of the hearing Mr Vallat for the Appellants made a formal application to amend the Appellants' grounds of appeal to enable the issue raised under Condition B in paragraph 10 (3) Schedule 29 A Finance Act 2004 to be argued. Ms Balmer on behalf of HMRC raised no objection. The Appellants had first indicated that they wished to advance arguments based on Condition B in November 2014 and in February 2015 HMRC indicated that they had no objection to this course of action. There was no prejudice to HMRC and skeleton arguments had been prepared on the basis that Condition B was in dispute, no additional witness evidence was required and the prejudice to the Appellants of not being able to argue this issue would be significant. Taking all these matters into account, we considered that it was fair and just to grant permission for the grounds of appeal to be amended.

The evidence

5. Three witnesses provided witness statements on behalf of the Appellants and were cross-examined. The witnesses were Mr Young, Mr James Kearsey, the finance

[1] There was some confusion concerning the date of purchase of the Property. Initially, the evidence of Mr Young was that the Property had been purchased in January 2007. It was, however, recognised in the course of the hearing that the January date related to the date of registration of the purchase at the Land Registry and the October 2006 date referred to above was accepted by both parties as the actual date on which the Property was purchased by the Fund.

director of the Company since September 2013 and Mr Balraj Limbu an employee of the company since March 2013. In addition, we were provided with a bundle of documents and correspondence.

The facts

6. The Company, at all material times, operated a plastic recycling and reprocessing business from various sites in the UK. One of these sites was located in Loughborough. The Loughborough site comprised of a factory building ("the Factory") and a large adjoining yard ("the Yard").

7. The operations in the Yard comprised of unloading used plastic materials from lorries, sorting the plastic, baling and reloading the plastic, which was then exported. The work took place entirely outdoors and in all weathers. The Factory contained machines which processed recycled plastic into various products e.g. plastic bags.

8. As already noted, the Fund purchased the Property on 19 October 2006. The Property, a three-bedroom semi-detached house, was located in Loughborough about a mile away from the Factory and the Yard.

9. The Fund is a small self-administered occupational pension scheme registered with HMRC for the benefit of certain of the Company's employees (members of the Young family). At all times relevant to these appeals, the Fund owned the Yard but did not own the Factory.

10. The Yard was acquired by the Fund as an investment on or around 4 February 1999 and the Yard was leased to the Company. The Factory was initially acquired by the Company but was transferred to the Fund as an investment on or around 15 December 2010 (after the periods relevant to these appeals).

11. It was common ground that the Yard was used as business premises by the Company.

12. The evidence of Mr Young and Mr Kearsey, which we accept, was that the Property had been purchased to provide living accommodation for Polish employees who were working in the Yard.

13. Mr Young told us that in or around 2005/6 the Company had started recruiting workers from Eastern Europe, mainly Poland, to work in the Yard because the Company found it difficult to recruit employees from the UK to do outdoors manual labour. For convenience, we will refer to these Eastern European workers as the "Polish employees". The Company encountered difficulties in finding accommodation for its Polish employees. Initially, these workers slept in sleeping bags in the Factory. Subsequently they were fixed up with temporary bed-and-breakfast accommodation. There were also difficulties in the Polish employees finding rented accommodation because of the lack of credit histories etc. Mr Kearsey's evidence was that the difficulties in finding suitable local accommodation had the result that the ability of

the Polish employees to work in the Company's business was compromised because they turned up late and in poor condition or not at all.

14. The evidence of Mr Young was that, in order to address this accommodation problem, the Fund acquired the Property to accommodate the Polish employees and required them to live there as a term of their employment. We will come back to the terms of employment later in this decision because Mr Young's evidence has to be seen in the light of the terms of the contract of employment that the Polish employees actually signed. There was no evidence that anyone other than Polish employees or that any persons who worked otherwise than in the Yard occupied the Property in the periods material to these appeals.

15. Mr Young's evidence was that the Polish employees were employed to work in the Yard. They wore high visibility jackets and boots. They were not employed to work in the Factory. Operating the machinery in the Factory was a skilled job which required a significant period of training.

16. In cross-examination it was put to Mr Young that the sample contracts of employment of the Polish employees referred to them as "General Factory Operatives" and did not refer to them as working in the Yard rather than the Factory. Mr Young was, however, adamant that the Polish employees worked only in the Yard and were not employed and did not work in the Factory. We saw no reason to doubt Mr Young's evidence on this or any other point (save as regards the terms of the contract of employment – see below). Mr Young and Mr Kearsey both seemed to us to be entirely straightforward and honest witnesses.

17. In this connection, HMRC relied on correspondence from the Appellants' advisers, Berkeley Burke, which described the Polish employees as "General Factory Operatives, who were employed to move materials around the factory, bale recycled materials and to undertake other general duties." Whilst this was not, in our view, a misleading description of the functions of the Polish employees, we considered that Mr Young's more specific description of their duties, delivered from his first-hand knowledge, was more accurate and reliable. It also seemed to us that that when Berkeley Burke used the word 'factory' it they merely used it in a more generic way to refer to the whole site.

18. Mr Young was asked whether Polish employees working in the Yard ever moved on to work in the Factory. Mr Young said this happened only very occasionally – the Polish employees did not want to work in the Factory but rather preferred to work outside in the Yard. They were, in Mr Young's view, tough hard-working people.

19. Approximately four to five Polish employees lived in the Property at any one time. Between 2007 and 2009 approximately 23 different people resided at the Property.

20. Where it was agreed that an individual employee would reside at the Property a term was inserted into the individual's contract of employment relating to the

provision of accommodation. We saw fifteen sample contracts of employment and the following Clause was common to the samples we saw (except for one contract which made no mention of the provision of accommodation). As far as material, Clause 4 of the individual's contract of employment provided as follows:

> "You are required to work a five-day week; Monday to Friday. No additional increment is made in the hourly rate for working overtime. You may be required to work Saturdays if requested by your Manager. Your basic hours will be 12 hours per day for a minimum of five days per week.
>
> (a) Your pay entitlement is as follows:
>
> - £5.35 per are for the first 8 weeks training period or until you have passed the internal training programme, increasing to £5.45 after the initial 8 weeks
> - £6.00 per hour once you are fully trained.
>
> (b) Accommodation
>
> Will be provided for you, (excluding food) at a weekly charge of £50 per week, which, will be deducted from your net weekly wage. The accommodation provided is a term of your employment and if that ceases it will no longer be available and must be vacated immediately. The £50 charge includes an allowance of £10 per document per week contribution towards heating, lighting, electricity and rates and if this is exceeded the average overspend will be charged equally to all the occupants. In addition an initial contribution of £200 per occupant will be deducted from the net wages over the first four weeks (£50 per week) to cover any damage to the property which is refundable at the end of the occupants employment."

21. Not all Polish employees were required to live at the Property. Sometimes an employee would find accommodation with friends or relatives either at the outset of his employment or after living initially in the Property. If an employee wished to move out of the Property the contract of employment was varied by a letter which provided as follows:

> "This letter ends your Contract of Employment and removes the term and condition 4b Accommodation.
>
> It is no longer a term of your employment that you reside in the accommodation provided for you, with effect from [date].
>
> …."

22. More recently, and outside the periods covered by these appeals, the Company has employed security staff from Nepal – they were mainly ex-Gurkhas. Initially the Polish employees shared the Property with some Gurkhas, but this did not work well. The Polish employees moved out and found their own accommodation and, because the Polish community in Loughborough had grown, it was now easier for Polish employees to find accommodation with family and friends. Polish employees were still working in the Yard at the date of the hearing.

23. Mr Limbu's evidence indicated that he understood the contract that he had signed with the Company required him to live in the Property. It became clear in the course of his evidence that Mr Limbu's witness statement had largely been written for him and it seemed to us that his understanding of the statement was limited. In any event, it related to a period after the periods relevant to this appeal and we therefore attach little weight to his evidence.

The law

24. The Fund is an "investment-regulated pension scheme" for the purposes of paragraph 2 Schedule 29 A FA 2004 i.e. it is a pension scheme with 50 or fewer members where the members (or connected persons) can influence the Fund's investments.

25. The statutory framework underpinning these appeals can be described as follows. If an investment-regulated pension scheme buys and retains "taxable property", three distinct charges become relevant:

(a) An investment-regulated pension scheme is treated as making an unauthorised payment (and also a scheme chargeable payment) if it acquires an interest in taxable property (section 174A FA 2004). This results in a charge to income tax on those members for whose benefit the taxable property is held.

(b) An investment-regulated pension scheme is treated as having made a scheme chargeable payment to the members of the scheme if the pension scheme holds taxable property in a tax year (section 185A FA 2004).

(c) Where a registered pension scheme makes, or is deemed to make, either of these scheme chargeable payments, there will also be a "scheme sanction charge" on the administrator of the scheme (i.e. the Company) (FA 2004).

26. As we have explained above, it is common ground that the dispute in these appeals relates to the question whether the Property is "taxable property" for the purposes of Schedule 29A FA 2004 during the periods under appeal.

27. Paragraph 6 Schedule 29A FA 2004 provides that "residential property" is taxable property. Paragraph 7 Schedule 29A defines residential property as including "a building that is used or suitable for use as a dwelling…." It is common ground that the Property constituted "residential property" for these purposes, subject to the provisions of paragraph 10 Schedule 29A.

28. Paragraph 8 (1) excludes from the definition of "residential property" the following buildings:

> (a) a home or other institution providing residential accommodation for children;
>
> (b) a hall of residence for students;

(c) a home or other institution providing residential accommodation with personal care for persons in need of personal care by reason of old age, disability, past or present dependence on alcohol or drugs or past or present mental disorder;

(d) a hospital or hospice;

(e) a prison or similar establishment."

29. Again, it was common ground that these appeals turned on the interpretation and application of paragraph 10 Schedule 29A FA 2004 which excludes certain types of residential property from the definition of taxable property. Paragraph 10 provides:

"(1) Residential property is not taxable property in relation to a pension scheme if Condition A or B is met.

(2) Condition A is met if the property is (or, if unoccupied, is to be) occupied by an employee who –

(a) is neither a member of the pension scheme nor connected with such a member,

(b) is not connected with the employer, and

(c) is required as a condition of employment to occupy the property.

(3) Condition B is met if the property is (or, if unoccupied, is to be) –

(a) occupied by a person who is neither a member of the pension scheme nor connected with such a member, and

(b) used in connection with business premises held as an investment of the pension scheme.

(4) Section 839 of ICTA (connected persons) applies for the purposes of this paragraph."

30. It was also common ground that paragraph 10(2)(a) and (b) were not in issue in relation to Condition A and that paragraph 10(3)(a) was also not in issue - the Polish employees were not members of the Fund, were not connected with the members of the Fund and were not connected with the Company. Therefore, the argument before us concentrated on whether the Appellants could show either, as regards Condition A, that paragraph 10 (2) (c) or, as regards Condition B, paragraph 10(3)(b) was satisfied.

31. It was also common ground that the burden of proof lay upon the Appellants to show that the assessments had been wrongly made: section 50(6) Taxes Management Act 1970.

Arguments for HMRC

32. In relation to Condition A, Ms Balmer submitted that a "condition of employment" within the meaning of paragraph 10(2)(c) should be narrowly construed and applied only to cases where the occupation of the property in question was an essential requirement of the job. The mere inclusion of a term relating to the provision of accommodation in an individual's contract of employment was not sufficient to satisfy Condition A. The words "a condition of employment" required that the

employment in the specific role was *conditional* upon occupation at a particular property.

33. Secondly, Ms Balmer submitted that this interpretation was consistent with the purpose of the statutory provisions and legislative background to Schedule 29A which was to prevent potential abuse of tax privileges afforded to registered pension schemes.

34. Thirdly, Ms Balmer submitted that HMRC's interpretation was consistent with other provisions which narrowly limited any tax exceptions to living accommodation for employees to circumstances where the occupation was necessary in order for the employee to perform his/her role. Living accommodation provided by an employer to an employee would usually be a benefit chargeable to income tax. An exception, which Ms Balmer cited as an example, was section 99 Income Tax (Earnings and Pensions) Act 2003 ("ITEPA") which provides:

> "Accommodation provided for performance of duties
>
> (1) this Chapter does not apply to living accommodation provided for an employee if it is necessary for the proper performance of the employee's duties that the employee should reside in it.
>
> (2) this Chapter does not apply to living accommodation provided for an employee if –
>
> (a) it is provided for the better performance of the duties of the employment, and
>
> (b) the employment is one of the kinds of employment in the case of which it is customary for employers to provide living accommodation for employees."

35. It was not sufficient simply for an employee's contract of employment to make reference to the provision of accommodation, but rather the provision of the accommodation had to be necessary for the proper performance of the duties.

36. Finally, as a matter of practicality and common-sense, HMRC's interpretation was correct. The Appellants' interpretation allowed the legislative restriction on pension funds investing in residential property to be easily side-stepped by the insertion of a written term in a contract of employment. That could not have been Parliament's intention and would open the door to wide-scale abuse.

37. As regards Condition B, Ms Balmer argued that the exemption only applied where there was a connection between *the use* of the residential property and *the use* of the business property owned by the Fund. The connection had to be greater than that of an individual living in one property and working in another property. The connection had to relate to the carrying on of the business.

38. First, HMRC argued that this limited interpretation of Condition B was justified by the statutory language which stated that the residential property must be "used in connection with" the business premises. Ms Balmer submitted that this suggested a

nexus of association between the use of the Property and the use of the business premises.

39. Secondly, Ms Balmer submitted that HMRC's interpretation of Condition B was consistent with the legislative background (including the previous wording contained in Regulations dating from 1991 and 2001) and policy aims behind Schedule 29A. Condition B was a narrow exception from a general anti-avoidance rule which was intended to apply to self-employed individuals. In other words, it was intended to be an extension of Condition A, which applied only to employees, to self-employed individuals. Thus, in the statutory context (the importance of which was emphasised by the Court of Appeal in *HMRC v Barclays Bank Plc* [2008] STC 476), the words "used in connection with" should be given a narrow construction.

40. Finally, Ms Balmer submitted that HMRC's narrow interpretation of Condition B was the only practical interpretation of legislation. Otherwise, the intended restriction on investing in residential property would be too easily met in many cases.

Arguments for the Appellants

41. In relation to Condition A, Mr Vallat argued that the plain wording of the statute merely asked whether the Polish employees were required to occupy the Property as a condition of their employment i.e. it asked a question about the employment contract. The statute did not ask whether that occupation was necessary or, indeed, even beneficial for the performance of their duties. Parliament, in paragraph 10, could have imposed this further requirement but simply did not do so. This was to be contrasted with section 99 of ITEPA, which, far from supporting HMRC's arguments, indicated the restrictions which Parliament could have imposed but chose not to do so.

42. Mr Vallat referred to the decision of MacNaghten J in *Blackwell v Mills* 26 TC 468, [1945] 2 All ER 655 which he submitted distinguished between the performance of a condition of employment and the performance of the duties of employment. In that case the costs of a student laboratory assistant attending certain classes were held to be not part of the performance of the student's duties of employment even though they were required as a condition of employment.

43. In the same vein, Mr Vallat referred to the decision of the Special Commissioners in *Snowdon v Charnock* [2001] STC (SCD) 152.

44. Mr Vallat also submitted that his interpretation of paragraph 10 was consistent with the published purpose of the legislation and referred to a Technical Note published by HMRC in December 2005 which stated:

> "From A Day, the Government will remove the tax advantages for investing in residential property or certain other assets such as fine wines, classic cars and art and antiques from registered pension schemes which are self-directed. This is to prevent people benefiting from tax relief in relation to contributions made into self-directed pension schemes for the purpose of funding purchases of holiday or

> second homes and other prohibited assets for their or their family's personal use."

45. The Explanatory Notes to the Finance (No 2) Bill referred to this Technical Note in paragraph 293 in the following terms:

> "The Government announced this measure in the 2005 Pre-Budget Report on 5 December. HMRC published a Technical Note giving details of the proposed changes on that date."

46. Mr Vallat submitted that there was no question of the Property being used by the Appellants or their families for personal use.

47. As regards Clause 4(b) of the contracts of employment of the Polish employees, Mr Vallat accepted that the first sentence, read in isolation, could be ambiguous, meaning that accommodation would be made available rather than requiring the employee to occupy it. He submitted, however, that the reference in the second sentence to "a term of your employment" was more naturally read as a requirement to use the accommodation. Furthermore, there was no provision to opt out of the accommodation or avoid the £50 deduction; this was more consistent with obligatory rather than optional occupation. Finally in practice, the contract of employment was amended to remove the term where necessary and this would have been unnecessary if the occupation was optional rather than mandatory. Mr Vallat accepted that a later amendment could not change the meaning of the contract but this later practice of amendment was part of the factual matrix against which the contract should be construed. For these reasons, Mr Vallat submitted that Clause 4(b) should be read as imposing a contractual requirement to occupy the Property.

48. As regards the issue whether Clause 4(b) was a "condition" of employment, Mr Vallat submitted that a condition of employment was simply an important term of the contract of employment.

49. As an alternative submission in relation to Condition A, Mr Vallat argued that the Property was used by the employees for the better performance of their duties.

50. In relation to Condition B, Mr Vallat argued that "in connection with" was a broad test and merely required some connection between the use of the residential property and the business premises (the Yard). Any limitations on the breadth of the statutory language used had to derive from the statutory context: *HMRC v Barclays Bank plc* [2008] STC 476 at [30]. There was no reason to impose a limitation on the words used in paragraph 10 in the statutory context.

51. Secondly, the relevant connection had to be to "the business premises". There was no reason to require a broader or different connection to a business carried on at the Yard. It was sufficient to show a connection to a business carried on at the Yard.

52. Mr Vallat referred to the decision of this Tribunal (Judge Berner and Mr Law) in *Talisman Energy (UK) Ltd v HMRC* [2009] UKFTT 356 in relation to the construction of the words "in connection with"[2]. In context, the Tribunal said [49]:

> "In our view s 3 OTA 1983 and s 12 (2) OTA 1975, should be construed according to their plain words and accorded their ordinary and natural meaning. We consider that in the context of legislation which provides for a formulary approach to the ascertainment of profits, it must be intended that the meaning of the provisions describing the elements of that calculation must be capable of being understood according to their plain words, and that those words themselves will have been carefully crafted to give effect to Parliament's intentions as regards any particular component part of the profits calculation. The legislation is closely articulated and in our view is unambiguous and requires no gloss to discern its meaning."

53. At [50] the Tribunal held that on the plain words of the statute it was not appropriate to read in a requirement for use in the particular capacity and at [52] it was not appropriate to read in any particular geographical or physical connection.

54. The Yard was held as an investment by the Fund and used as business premises by the Company. Therefore, Mr Vallat submitted that there was a sufficient connection between the use of the Property (as accommodation for the Polish employees) and the Yard because the Polish employees who occupied the Property worked at the Yard. This was the purpose behind the acquisition of the Property. This was a sufficiently close connection for the purposes of Condition B and there was nothing in the legislation requiring any particular type or closeness of connection. Mr Vallat, therefore, submitted that Condition B was satisfied.

Discussion

55. The only issues in dispute in this appeal are the applicability of Conditions A and B contained in paragraph 10 Schedule 29A FA 2004.

Condition A

56. Taking Condition A first, we accept that the Property was occupied by the Polish employees. We also accept that in the material periods the Property was used only by Polish employees who worked solely at the Yard. The only issue in dispute between the parties relates to paragraph 10(2)(c) i.e. whether the Polish employees were "required as a condition of employment to occupy [the Property]."

57. This gives rise to two different issues. First, did the provisions of Clause 4 (b) of the employees' contract of employment contain a requirement that the employees

[2] s 3(1)(a) OTA 1983 referred to "an asset… which, at the end of the relevant claim period is being or is expected to be used in connection with the field." This had to be construed in accordance with s 12 (2) OTA 1975 which provided that the reference in s 3(1)(a) was a reference to its use in connection with that field for one or more of the purposes mentioned in s 3(1) OTA 1975.

occupied the Property, viewing the matter in the context of all the facts? Secondly, was Clause 4 (b) "a condition of employment"?

58. In our view, Clause 4 (b) did not contain a requirement that the employee to whom the Clause related must occupy the Property. The Clause contained a promise that the employer would provide accommodation at a specified price and gave the employee a right to require that accommodation would be so provided. There was, however, no requirement that the employee should occupy the Property. We consider that the evidence of Mr Kearsey and Mr Young to the effect that the understanding of the parties (i.e. the Company and the Polish employees) was that there was a requirement imposed on the Polish employees to occupy the Property cannot override the written terms of the contract of employment. The fact of the matter is that the contract was defectively drafted if its intention was to achieve this result.

59. Similarly, as Mr Vallat accepted, we do not consider that subsequent amendments to the contract of employment removing Clause 4 (b) when the employee left the Property can alter the terms of the original contract.

60. Paragraph 10 (2) (c) states that the employee must be "required as a condition of employment to occupy the property." Read in context, "the property" means the property which the employee is occupying. But Clause 4 (b) of the contract of employment specifies neither that the employer will provide the Property (as opposed to any other property) as accommodation nor does it require the employee to occupy that particular property. Indeed, the location and identity of the Property was not specified in the specimen contracts of employment produced to us.

61. Accordingly, in relation to the first issue concerning Condition A, it seems to us that Condition A is not met.

62. As regards the second issue concerning Condition A (i.e. whether Clause 4 (b) is a "condition of employment"), the real question is what is meant by the word "condition". A "condition" in a contract can mean many different things. The position is well-explained in *Chitty "On Contracts"* 31st Edition at paragraph 12-025 and 026:

> "[12-025] The word "condition" is sometimes used, even in legal documents, to mean simply "a stipulation, a provision" and not to connote a condition in the technical sense of that word. Even within the sphere of the technical meaning attached to the word "condition", the terminology employed is, unfortunately, not uniform. There may, for example, be conditions, the failure of which gives no right of action, but which merely suspends the rights and obligations of the parties. The most commonly used sense of the word "condition" is that of an essential stipulation of the contract which one party guarantees is true or promises will be fulfilled. Any breach of such a stipulation entitles the innocent party, if he so chooses, to treat himself as discharged from further performance of the contract, and notwithstanding that he has suffered no prejudice by the breach. He can also claim damages for any loss suffered.

> [12-026] The use of the word “condition” in this sense appears to have originated in the seventeenth century: a stipulation might be regarded as so vital to the contract that its complete and exact performance by one party was a condition precedent to the obligation of the other party to perform his part. In the modern law, the reason why a breach of a condition entitles the innocent party to treat himself as discharged has been said to be that conditions:
>
> “ … go so directly to the substance of the contract or, in other words, are so essential to its very nature that their non-performance may fairly be considered by the other party as a substantial failure to perform the contract at all.””

63. Mr Vallat argued that "a condition of employment" was any important term of the contract of employment. Whilst that is a possible reading of the word "condition" we do not think that that was what Parliament intended. Parliament deliberately used the word "condition" and must be taken to have known and intended that a condition of the contract was usually regarded as a fundamental term of a contract i.e. a term so important that it usually gives one party the right to repudiate a contract if the obligation is breached. We bear in mind that, in reaching this conclusion, Parliament was intending to limit the range of residential properties which fall outside the definition of "taxable property". This is, therefore, essentially an exemption from tax. This suggests to us that a more restrictive interpretation of the word "condition" is appropriate.

64. Applying this more restrictive interpretation, it seems to us that that Clause 4 (b) cannot correctly be described as a "condition" i.e. as an essential term of the contract. As we have noted, there was no obligation requiring an employee to live in the Property, which one would have expected if the obligation was of fundamental importance to the contracting parties. Moreover, it was clear that not all Polish employees were required to live at that particular property and, if they chose to leave the Property having occupied it initially, that did not seem to be a problem. We note also, that Clause 4(b) described the provision as a term of the contract rather than a condition. Whilst the label applied to the contractual provision is not, in our view, determinative it does support the conclusion that neither party regarded it as a fundamental term of the contract. For these reasons, we do not consider that Clause 4 (b) could correctly be described as a "condition of employment" in the sense discussed above.

65. As regards Ms Balmer's argument that the term "condition of employment" in Condition a must be even more narrowly construed as applying only to circumstances in which occupation at the Property (as opposed to any other property) is an essential requirement of the job, we consider that test to be too narrow and restrictive. Certainly we agree with Ms Balmer’s submission that there must be a contractual obligation to occupy the residential property and, further, to occupy that property rather than any other property.

66. We do not, however, agree that it is implicit in the wording used in Condition A that there is also a requirement that occupation of the property in question must be an essential requirement of the job. It seems to us this requires reading into paragraph 10

(2) (c) words which are simply not there. If Parliament had wished to limit the relief afforded by Condition A in a manner analogous, for example, to section 99 of ITEPA it could and would have done so. There is no requirement in the wording of paragraph 10 (2) (c) that the occupation should be "necessary" to the employment or that it be for the better performance of the employee's duties and we decline to read into this provision such limitations. It may well be that in many cases, where an occupation condition (in the sense we have described above) is imposed, the employer would regard occupation of a specified property as necessary for the performance of the employee's duties, but "necessity" is not the correct test.

67. We accept Ms Balmer's submission that Parliament was intending to limit the range of residential properties that would fall outside the concept of "taxable property". But there is a limit to purposive interpretation of clear words used in a statute. The limits on the type of residential properties which qualify for relief under Condition A are to be found in the words of the provision itself and are not to be found by this Tribunal using those words as empty vessels into which it can pour any meaning which it conjectures Parliament might have used.

68. As regards Mr Vallat's alternative argument that the occupation of the Property by the Polish employees enable them to "better perform" their duties, we do not consider this to be the correct test. The test is simply whether the requirement to occupy the Property was a condition of employment.

69. Our conclusion, therefore, is that Condition A is not satisfied. We must, however, now turn to Condition B in paragraph 10 (3), which is an alternative to Condition A (see paragraph 10 (1)).

Condition B

70. As was the case with Condition A, in relation to Condition B there is only one statutory requirement which is in dispute i.e. paragraph 10 (3) (b): that the [Property] is "used in connection with business premises [i.e. the Yard] held as an investment of the pension fund."

71. It is common ground that the Yard constituted business premises held as an investment of the Fund. The issue is whether the occupation by the Polish employees of the Property means that the Property is "used in connection with" the Yard.

72. There are many authorities which consider the words "in connection with" in a variety of different statutory contexts. It is a phrase commonly used by in statutes and delegated legislation, as well as in commercial contracts. The phrase is very frequently used in tax statutes. For example, the words "in connection with" occur over 30 times in the Finance Act 2015 alone. The words are often used in charging and anti-avoidance provisions to extend the scope of the charge to tax. For example, section 401 ITEPA charges to income tax payments made "in connection with" the termination of employment. Another example, in this case an anti-avoidance provision, is section 686 (3) Income Tax Act 2007 where the provision applies in circumstances where an abnormal amount by way of dividend is received "in

connection with" certain transactions in securities. It is fair to say, however, that the use of the phrase "in connection with" to extend the scope of a relieving provision, as in this case, is less common. In these appeals, HMRC is in the slightly unusual position of having to argue that the words "in connection with" should be narrowly construed when more frequently HMRC is wont to urge this Tribunal and the higher courts that the same phrase should be given an expansive meaning when used in a charging provision.

73. We will examine some of the authorities on the words "in connection with" shortly, but we think the two propositions can be derived from the dozens of authorities which have considered those words in different contexts. First, the words "in connection with" generally have a very broad meaning. Secondly, the degree of connection – the remoteness, proximity and type of connection – required by the use of that phrase in a particular statute must be identified from the particular statutory context in which it is used.

74. As regards the proposition that the words "in connection with" usually have a very wide meaning, there are many authorities to this effect, e.g. in the non-tax context of exclusive jurisdiction clauses, see *per* Peter Gibson LJ [33] in *DSM Anti-Infectives BV & Anor v Smithkline Beecham Plc & Anor* [2004] EWCA Civ 1199.

75. In the context of tax legislation, the prepositional phrase “in connection with” was considered by the Court of Appeal in *HMRC v Barclays Bank plc* [2007] EWCA Civ 442. Barclays had made payments to pensioners and surviving spouses to compensate for withdrawal of free assistance in preparing tax returns and executor and trustee services. In determining whether the payments were taxable as 'relevant benefits' the Court of Appeal decided that the payments were made 'in connection with past service' for the purposes of sections 596A(1), 612(1) Income and Corporation Taxes Act 1988 and that Parliament intended the charge to tax to extend to an indirect as well as to a direct “connection”. Arden LJ recognised the breadth of the phrase "in connection with", saying [30]:

> "Parliament has used a broad expression, namely the expression "in connection with"."

76. David Richards J, whose decision in the High Court was affirmed by the Court of Appeal in *Barclays,* ([2007] STC 747) also drew attention to the breadth of the expression "in connection with":

> "69. I accept that the term 'in connection with' does not pose a causal test. Contrast the terms 'by reason of' [employment] and 'therefrom' [that is, 'from' an employment] which were the terms in issue in *Wilcock (Inspector of Taxes) v Eve* [1995] STC 18. These latter terms clearly postulate a causal test. They ask whether the employment relationship caused, that is, gave rise to, the receipts under scrutiny.
>
> 70. The phrase 'in connection with' is much wider. This phrase does not pose a causal test. So authorities such as *Wilcock v Eve* are of no assistance. Rather the phrase 'in connection with' simply asks whether

there is a link ('connection') between past services and the benefits referred to in s 611(1). The test is one of fact and degree. However, it is not limitless. The quality and strength of the nexus which must be satisfied to establish the requisite 'connection' between two items depends on the context of the statutory provision which is being construed. Here s 612(1) which defines 'relevant benefits' is defining 'benefits' which have a sufficient connection to 'past services' of employees to be characterised as effectively deferred emoluments (using the language of Sch E)."

77. On appeal, Arden LJ also considered the wide meaning of the words "in connection with" and the particular need to consider their meaning in their statutory context, as follows:

"[18] The primary question in this case is the proper meaning of the words 'in connection with past service' in s 612(1) of ICTA. The expression 'in connection with' could describe a range of links. In *Coventry and Solihull Waste Disposal Co Ltd v Russell (Valuation Officer)* [1999] 1 WLR 2093 at 2103, Lord Hope held that in this situation the court must look closely at the surrounding words and the context of the legislative scheme:

'The majority in the Court of Appeal held that it was a sufficient answer to the appellant's argument to construe the words "in connection with" as meaning "having to do with". This explanation of the meaning of the phrase was given by McFarlane J in [*Re Nanaimo Community Hotel Ltd* [1944] 4 DLR 638]. It was adopted by Somervell L.J. in [*Johnson v Johnson* [1952] P 47 at [50–51]. It may be that in some contexts the substitution of the words "having to do with" will solve the entire problem which is created by the use of the words "in connection with." But I am not, with respect, satisfied that it does so in this case, and Mr. Holgate did not rely on this solution to the difficulty. As he said, the phrase is a protean one which tends to draw its meaning from the words which surround it. In this case it is the surrounding words, when taken together with the words used in the Amending Order of 1991 and its wider context, which provide the best guide to a sensible solution of the problem which has been created by the ambiguity.'

[19] Accordingly, the other parts of the definition of 'relevant benefits' and the surrounding provisions of the legislative scheme, will inform the court as to the extent of the link required by any particular provision. Thus the court must examine the function or purpose of the definition of 'relevant benefits'. Here, the purpose of the definition is to identify the chargeable payments under a retirement benefits scheme. At the very least, Parliament is unlikely to have intended to limit connections to direct connections. That would have left the possibility that taxpayers could easily circumvent the charging provisions. Furthermore, it must have been foreseen that, over the life of the scheme, changes might be made to benefits. The changes would not simply involve a straight exchange or substitution of one benefit for another, but, on occasion, the loss of a benefit and the rendering of some monetary recompense. The charging provisions could only fairly apply if they applied to the giving of the new benefits, or recompense, as much as to the giving of the benefit originally provided by the

> scheme. It is also significant that Parliament did not limit itself to payments in consideration for services.
>
> [20] Thus I conclude that a connection may be indirect for the purpose of the definition of relevant benefits."

78. Arden LJ continued at [30]:

> "There is no doubt that the court should, when interpreting a statutory provision, examine not just that provision but also the context in which it appears in the legislation in question. It may then be able to form a view as to the purpose of the provision in question and that knowledge may inform its thinking as to the choice of meaning to be offered where choices are available. The context of the provision in question, however, will not of itself justify the court in limiting the provision to that context, and thus reducing its apparent scope, unless there is some indication in the legislation that this is what Parliament intended. The effect of Mr Peacock's submission, is that the court should read down the definition of 'relevant benefits' to conform with the concept of a conventional 'retirement benefits scheme'. In my judgment, there is nothing in the legislation to justify this course. Indeed, the indications are the other way. Parliament has used a broad expression, namely the expression 'in connection with'. Having cast the net widely, Parliament has drawn it in particularly by imposing a limit that there should be a connection with service. The limitations prescribed by Parliament are the limitations that the court should apply. The context of occupational pension schemes cannot be used to narrow the phrase 'in connection with past service' yet further."

79. Finally, we should mention the judgment of the Court of Appeal in *Ideal Life Assurance Company Ltd v H J Hirschfield and A H Hirschfield* [1943] K.B. 442 where du Parcq LJ, delivering the judgment of the Court, stated (at page 446) that the phrase "in connection with" was not a term of art and had to be construed in accordance with its ordinary meaning.

80. In this case the statutory wording of Condition B (paragraph 10 (3) (b) Schedule 29A FA 2004) provides that "residential property" is not "taxable property" if it is used in connection with business premises held as an investment of the pension scheme. The only question in dispute in relation to this provision is whether the Property was used in connection with the Yard.

81. The wording of Condition B requires us to look at the use of the residential property: that use must be "in connection with", in this case, the Yard.

82. It is common ground that the Property constituted "residential property" within the meaning of paragraph 7 (1) (a) because the Property was used "as a dwelling." There was no other use to which the Property was put during the periods material to these appeals.

83. The question, therefore, is whether the use of the Property as a dwelling was connected with the Yard.

84. Ms Balmer submitted that it was not necessary for any particular Polish employee to live at the Property. Indeed, some employees continue to work at the Yard after they had moved out of the Property and some other employees worked at the Yard but did not live at the Property. Secondly, Ms Balmer submitted that occupation of the Property had to be for the better performance of the employees' duties. We do not consider "necessity" to be the correct test nor do we consider that there is a requirement that the occupation should be for the better performance of employees' duties. There is no justification in the statutory language for imposing these further restrictions.

85. Ms Balmer also argued that the use of the Property must be connected with the use of the Yard. We do not agree. If this is what Parliament intended then Parliament could have said so, but it did not. It is only the use of the Property that is relevant and that use must be connected with business premises (the Yard) not its use. Ms Balmer's suggested interpretation requires us to read in words which Parliament did not use and we see no justification for doing so.

86. Ms Balmer further submitted that Condition B was an exception to an anti-avoidance provision and therefore should be construed narrowly. She also asserted that Condition B was intended to extend the exception in Condition A to self-employed individuals. These were people who needed to occupy particular premises by lease in order to carry on their business.

87. The difficulty with this interpretation is that the wording of the statute appears to provide no justification for it. As for the proposition that Condition B was intended to benefit self-employed persons, there is no restriction contained in Condition B which would exclude use of residential property by employees. Certainly, we were provided with no support for this interpretation in the legislative history of Condition B (although we will discuss the statutory forerunners of paragraph 10 (3) (b) Schedule 29A FA 2004 below). We therefore reject this submission with its implicit limitation on the meaning of the statutory language.

88. Ms Balmer gave the example of a pension fund buying a car park which was used to enable employees to park and walk to their office (the office being business premises also owned by the pension fund). If the Appellants' submissions were accepted then the car park would be "used in connection with" the office. Parliament cannot have intended this result. Again, we do not agree with the submission. Paragraph 10 Schedule 29A is limited in its application to residential property. It would have no application whatsoever to a car park.

89. We should also note that the wording of Condition B in Schedule 29 A represented a relaxation from the previous version of the legislation from which Condition B was evidently derived. Paragraph 13 of the Personal Pension Schemes (Restriction on Discretion to Approve) (Permitted Investments) Regulations 2001 (SI 2001/117) ("the 2001 Regs") provided so far as material:

> "A freehold or leasehold interest in any residential property which is –
>
> …

> (B) a property which is, or is to be, occupied by a person who is neither a member of the self-invested personal pension scheme nor connected with a member of the scheme *in connection with the occupation by that person of business premises held as an investment by the scheme*." (Emphasis added)

90. It will be seen that Regulation 13 required that the person occupying the residential property also had to occupy the business premises held as an investment by the scheme. Paragraph 10 (3) (b) Schedule 29A FA 2004 represents of relaxation of this requirement with the result that the business premises do not have to be occupied by the same person who occupied the residential property. It seems to us that this is consistent with the intention of Parliament to permit a looser form of "connection" between the use of the residential property and the business premises held by the scheme.

91. Is the fact that the Property was acquired for the purpose of providing accommodation for Polish employees working in the Yard and was used solely by such employees for this purpose sufficient to establish the nexus which Condition B requires? In our view it is sufficient.

92. By using the words "used in connection with", Parliament intended to give a broad meaning to the exception contained in Condition B. The authorities demonstrate that "in connection with" is a wide expression. If Parliament had wanted to give a restrictive meaning to Condition B it would not have used a phrase which is well-recognised as being one of great breadth: indeed it is inconceivable that it would have done so. It could, for example, have required the connection between the residential property and the business premises be a direct one or one which conferred a direct benefit upon the business premises or required that the occupation of the residential property was required or necessary for the better enjoyment of the business premises. Parliament did not do so – it did not draw the net tightly, to use Arden LJ's expression – and it is not for this Tribunal to read into legislation restrictions which Parliament refrained from imposing.

93. What, then, can we glean from the legislation or its legislative history that would enable us to understand Parliament's purpose when it framed Condition B?

94. As we have already noted, Condition B is a relieving provision. The statutory context is that residential property is taxable property unless the property in question falls within certain exemptions, of which Condition B is one. The obvious intent of Parliament was therefore to identify the types of residential property that would escape a charge to tax. That said, we cannot ignore the fact that, in framing an exemption to the limitation in respect of residential property, Parliament chose to use the very wide expression "used in connection with".

95. Mr Vallat referred us to a Technical Note produced by HMRC on 5 December 2005. HMRC's Technical Notes, of course, reflect HMRC's views and intentions. These may or may not necessarily be the same as those of Parliament. In this instance, however, the Technical Note of 5 December 2005 was expressly referred to in the Explanatory Notes to Clause 159 Schedule 21 Finance (No. 2) Bill 2006 i.e. the

proposed legislation which became, by amending the Finance Act 2006, Schedule 29A FA 2004. In the Explanatory Notes[3], at paragraph 293, there is a "Background Note" which states as follows:

> "The Government announced this measure in the 2005 Pre-Budget Report on 5 December. HMRC published a Technical Note giving details of the proposed changes on that date."

96. We can therefore assume, by virtue of this cross-reference, that Parliament had in mind the contents of the 5 December 2005 Technical Note. The Technical Note stated as follows in relation to residential property:

> " **Residential Property and Other Assets**
>
> From A Day, the Government will remove the tax advantages for investing in residential property or certain other assets such as fine wines, classic cars and art & antiques from registered pension schemes which are self-directed. This is to prevent people benefiting from tax relief in relation to contributions made into self-directed pension schemes *for the purpose of funding purchases of holiday or second homes and other prohibited assets for their or their family's personal use.*
>
> Background
>
> The new pensions tax regime, in Chapter 4 of the Finance Act 2004, takes effect from A-Day and provides a single investment regime for all registered pension schemes. As part of this single set of investment rules registered pension schemes were given the right to invest in residential property and other tangible moveable assets. This rule extended to self-directed pension schemes which are, under the current rules prohibited from investing in certain assets. Details of the current rules are set out in regulations at SI 1991/1614 and 2001/117." (Emphasis added)

97. We also observe that, in addition, the Technical Note indicated the Government's intention to apply restrictions not only to direct investment in residential property but also to indirect investment in residential property. The purpose was to ensure that the restrictions on direct investment in residential property could not be side-stepped by investing indirectly through an investment vehicle. The Technical Note continued:

> "This type of indirect investment vehicle will allow genuine commercial investment by a self-directed pension scheme without the risk of abuse of the generous tax advantages by *scheme members being*

[3] As to the propriety of having recourse to Explanatory Notes as an aid to interpretation, see: *Westminster City Council v National Asylum Support Service* [2002] UKHL 38 where Lord Steyn said at [5]: "Insofar as the Explanatory Notes cast light on the objective setting or contextual scene of the statute, and the mischief at which it is aimed, such materials are therefore always admissible aids to construction."

> *able to enjoy personal or non-commercial use of the assets held in the investment vehicle*. There will also be rules to prevent the use of such vehicles as a means to facilitate investment in prohibited assets with continue scope for personal use of those assets."

98. The rules on indirect investment were enacted in paragraph 16 *et seq* of Schedule 29 A.

99. As will be seen, the Technical Note indicates an intention to restrict the investment residential property (e.g. holiday homes and second homes) by a pension scheme in circumstances where the members of the scheme or their families (i.e. those enjoying the benefits of tax relief) would derive personal benefit from the property or the property would be used for non-commercial purposes. The restriction on indirect investment is intended to achieve a similar objective.

100. The Property in this case was not used by the members of the Fund in such a way that they (or persons connected with them) derived personal benefit from its occupation. The only direct financial benefit was the rent paid by the Polish employees and any capital appreciation in the value of the Property, which would be benefits to be expected from holding any property as an investment.

101. The drafting of paragraph 10(3) Schedule 29A FA 2004 is consistent with this objective. Paragraph 10(3)(a) prohibits occupation by members of the pension scheme and by persons connected with such members. Paragraph 10(3)(b) then imposes an additional requirement that the use of the residential property must be connected with business premises held by the pension scheme. In context, therefore, it seems that Parliament was intending to exclude from beneficial tax treatment residential property which, broadly, the members or their families occupied or properties which had no commercial connection to other scheme assets. This is at least consistent with the statutory purpose referred to in the Technical Note which was itself referred to in the Explanatory Notes to the relevant Finance Bill. We put it no higher than that because the reference to Technical Note of December 2005 was indirect and the Technical Note was simply illustrating the type of avoidance which was being counter-acted.

102. Accordingly, we conclude that Parliament, by using the broad expression "used in connection with" in Condition B, was not intending to give a restrictive interpretation of type contended for by HMRC in these appeals. We consider that the use of the Property to provide accommodation for Polish employees working in the Yard is a sufficient connection for the purposes of paragraph 10 (3) (b). The Property was purchased for this purpose. The Property was used for this purpose, and for no other purpose, and was used only by such employees. There was no element of personal use or benefit to members of the Fund or persons connected with them. Finally, there was no artificiality about or manipulation involved in these arrangements. In our view, this establishes a sufficiently direct nexus (“connection”) between the use of the Property and the Yard. We therefore consider that Condition B was satisfied.

Conclusion

103. We have decided that Condition B was satisfied and that this appeal should therefore be allowed.

104. Finally, we would like to express our gratitude for the careful and insightful submissions made by Ms Balmer and Mr Vallat, which have been of great assistance to the Tribunal.

105. 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.

GUY BRANNAN

TRIBUNAL JUDGE
RELEASE DATE: 07 DECEMBER 2015