

**THE SPECIAL COMMISSIONERS**

**PETER JOHN RAFFERTY**

**Appellant**

**- and -**

**HM REVENUE AND CUSTOMS**

**Respondents**

**Special Commissioners : DR A N BRICE  
JOHN WALTERS QC**

**Sitting in public in London on 7, 8, 9 and 10 February 2005**

**David Goldberg QC, instructed by Messrs Herbert Smith & Co, for the Appellant**

**Bruce Carr of Counsel, instructed by Solicitor of Inland Revenue, for the Respondents**

## DECISION

### The appeal

1 Mr Peter John Rafferty (the Appellant) appeals against an assessment dated 15 April 2002 for income tax of £5,190.82 in respect of the year ending on 5 April 1997. We were informed that this appeal was representative of a large number of others.

2 The Appellant carried on business as a self-employed sales associate of Allied Dunbar and was taxed on an earnings basis. On 13 June 1996 the Appellant sold his business to a subsidiary of Allied Dunbar for a lump sum and after that date the subsidiary received commissions in respect of policies sold by the Appellant before 13 June 1996. The assessment was made because the Revenue were of the view that part of the lump sum received by the Appellant for the transfer of his business was consideration for the right to receive the commissions and that they were taxable as income in the year of the transfer under section 106(1) of the Income and Corporation Taxes Act 1988 (the 1988 Act) because they arose during the period before the discontinuance of the trade within the meaning of section 103.

3. The Appellant appealed because he was of the view that the renewal commissions did not arise during the period before the discontinuance of his trade and so were not taxable under section 106(1). Alternatively, he was of the view that section 106(2) applied and that tax was not chargeable on him but on the transferee because there had been a permanent discontinuance of his trade by reason of a change in the persons carrying on the trade and the commissions had been received by the transferee and brought into the computation of the profits of its trade. The Appellant was also of the view that two of the conditions for making the assessment had not been complied with. The first condition was in section 29(2) of the Taxes Management Act 1970 (the 1970 Act) and he argued that his return had been made on the basis of the practice generally prevailing at the time it was made. The second was in section 29(5) of the 1970 Act and the Appellant argued that the Revenue could reasonably have been expected, on the basis of the information available to them, to have been aware that income which ought to have been assessed to income tax had not been assessed.

### The legislation

#### *Receipts after the discontinuance of a trade*

4. The legislation which applies to receipts after the discontinuance of a trade is found in sections 103 to 110 and 113 of the 1988 Act. We start with section 103 which defines the sums on which income tax is charged. The relevant parts of section 103 provide:

**“(1) Where any trade, profession or vocation the profits or gains of which are chargeable to tax under Case I or II of Schedule D has been permanently discontinued, tax shall be charged under Case VI of that Schedule in respect of any sums to which this section applies which are received after the discontinuance.**

- (2) Subject to subsection (3) below, this section applies to the following sums arising from the carrying on of the trade, profession or vocation during any period before the discontinuance (not being sums otherwise chargeable to tax) –
- (a) where the profits or gains for that period were computed by reference to earnings, all such sums in so far as their value was not brought into account in computing the profits or gains for any period before the discontinuance, and ...”

5. Thus, as a result of section 103(2)(a), the general rule is that tax is charged after the discontinuance of a trade on sums arising from the carrying on of the trade during any period before the discontinuance if they were not previously brought into account.

6. However, special rules apply where rights to payments are transferred on a discontinuance and these are found in section 106, the relevant parts of which provide:

**“106(1) Subject to subsection (2) below, in the case of a transfer for value of the right to receive any sum to which section 103 ... applies, any tax chargeable by virtue of ... [that] section shall be charged in respect of the amount or value of the consideration ... and references in this Chapter ... to sums received shall be construed accordingly.**

**(2) Where a trade ...is treated as permanently discontinued by reason of a change in the persons carrying it on, and the right to receive any sum to which section 103 ... applies is or was transferred at the time of the change to the persons carrying on the trade ... after the change, tax shall not be charged by virtue of ... [that] section , but any sum received by those persons by virtue of the transfer shall be treated for all purposes as a receipt to be brought into the computation of the profits of the trade ... in the period in which it is received.”**

7. Thus section 106(1) provides that, if there is a transfer of value of the right to receive sums to which section 103 applies (that is, sums which arise from the carrying on of a trade during any period before the discontinuance) then the tax chargeable under section 103 is charged on the amount of the consideration. However, section 106(2) goes on to provide that if a trade is “treated as permanently discontinued” by reason of a change in the persons carrying it on, and the right to receive sums to which section 103 applies is transferred at the time of the change to the transferee who carries on the trade after the change, then tax is not charged on the transferor under section 103 but the sums are treated as receipts of the transferee and brought into the computation of the profits of his trade in the periods in which they are received. The business of the Appellant has been treated and taxed as a trade, and we adopt that treatment in this Decision.

8. In order to apply section 106(2) it is necessary to know the meaning of the phrase “treated as permanently discontinued”. Section 110(2)(a) defines the permanent discontinuance of a trade as including the occurrence of any event which, under section 113, is to be treated as equivalent to the permanent discontinuance of a trade. Section 113(1) provides that “where there is a change in the persons engaged in carrying on any trade ... then ... the persons on whom [the income tax] is chargeable,

shall be determined as if the trade ... had been permanently discontinued, and a new one set up and commenced, at the date of the change”.

*Assessments where a loss of tax is discovered*

9. The legislation which applies where a loss of tax is discovered is found in section 29 of the 1970 Act. During the year of assessment 1996-97 the relevant parts provided:

**“(1) If an officer of the Board ... discover, as regards any person (the taxpayer) and a chargeable period-**

**(a) that any profits which ought to have been assessed to tax ... have not been assessed, ...**

**the officer ... may, subject to subsections (2) and (3) below, make an assessment in the amount ... which ought in his ... opinion to be charged in order to make good to the Crown the loss of tax.**

**(2) Where-**

**(a) the taxpayer has made and delivered a return ... in respect of the relevant chargeable period, and**

**(b) the situation mentioned in subsection (1) above is attributable to an error or mistake in the return as to the basis on which his liability ought to have been computed,**

**the taxpayer shall not be assessed under that subsection in respect of the chargeable period there mentioned if the return was in fact made on the basis or in accordance with the practice generally prevailing at the time when it was made.**

**(3) Where the taxpayer has made and delivered a return ... in respect of the relevant chargeable period, he shall not be assessed under subsection (1) above -**

**(a) in respect of the chargeable period mentioned in that subsection ; and**

**(b) ... in the same capacity as that in which he made and delivered the return**

**unless one of the two conditions mentioned below is fulfilled. ...**

**(5) The second condition is that at the time when an officer of the Board-**

**(a) ceased to be entitled to give notice of his intention to enquire into the taxpayer’s return ... in respect of the relevant chargeable period, or**

**(b) informed the taxpayer that he had completed his enquiries into that return,**

**the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above.**

**(6) For the purposes of subsection (5) above, information is made available to an officer of the Board if-**

**(a) it is contained in the taxpayer’s return ... in respect of the relevant chargeable period (the return) or in any accounts, statements or documents accompanying the return; ... or**

**(d) it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection (1) above-**

- (i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above; or  
(ii) are notified in writing by the taxpayer to an officer of the Board.”

### **The issues**

10. We have identified the following issues for determination in the appeal:

- (1) whether the part of the consideration for the transfer of the trade which represents renewal commissions is taxable on the Appellant under section 106(1) because it represents sums to which section 103 applies, namely, sums which arose from the carrying on of the trade during a period before the discontinuance; or alternatively
- (2) whether, even if the renewal commissions were sums which arose from the carrying on of the trade during a period before the discontinuance, the part of the consideration for the transfer of the trade which represents fees and commissions is not taxable on the Appellant, but is taxable instead on the transferee under section 106(2) because the trade was treated as permanently discontinued by reason of a change in the persons carrying it on and the right to receive the fees and commissions was transferred to the transferee; or
- (3) whether the Special Commissioners have jurisdiction to consider an argument about the application of section 29(2) of the 1970 Act; if so
- (4) whether, if there were an error or mistake in the Appellant’s return, the return was made on the basis or in accordance with the practice generally prevailing at the time when it was made within the meaning of section 29(2); or
- (5) whether, when the Revenue eased to be entitled to give notice of their intention to enquire into the Appellant’s return, they could not have been reasonably expected, on the basis of the information made available to them before that time, to be aware that income which ought to have been assessed to income tax had not been so assessed within the meaning of section 29(5) of the 1970 Act.

### **The evidence**

11. There was a statement of agreed facts. Three bundles of documents were produced. Oral evidence was given by the Appellant on his own behalf and oral evidence was also given on behalf of the Appellant by Mr Mark John Cooper, Director of the Franchise Support Division at Zurich Financial Services Limited (which company acquired Allied Dunbar about four or five years ago). Oral evidence was also given on behalf of the Appellant by Mr Robert Anthony Brown, a Partner in the firm of Messrs Ernst & Young and Head of that firm’s Tax Risk Management Group. Mr Brown was previously an Inspector of Taxes and when he left the Inland Revenue he was the Deputy Controller of the Special Compliance Office. Mr Brown’s

evidence expressed his opinion on what constituted “the practice generally prevailing” at the time the Appellant rendered his return for the year 1996/97. Oral evidence was given on behalf of the Respondent by Mr Alan Harvey, the Inspector of Taxes who opened the enquiry into the Appellant’s tax return.

### **The facts**

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

#### *The Appellant and Allied Dunbar*

13. In July 1981 the Appellant became a self-employed financial planning consultant (or sales associate) for Hambro Life. In 1985 Hambro Life became Allied Dunbar. In the course of his trade the Appellant arranged the sale, and provided the servicing, of insurance policies issued by the Allied Dunbar group. The Appellant’s relationship with Allied Dunbar was governed by the terms of a sales associate manual and a financial manual.

#### *The sales associate manual*

14. The sales associate manual set out the contract between the Appellant and Allied Dunbar. It defined the relationship between them which was that the Appellant was self-employed and in business on his own account and would be remunerated by commission only. He was responsible for his own income tax and national insurance contributions. The sales associate manual also provided that the Appellant was obliged to observe all the rules and guidelines laid down in that manual and the financial manual. He had to hold his own consumer credit licence and might need to be registered under the Data Protection Act. He also had to comply with the LAUTRO rules on training and competence. He could only sell Allied Dunbar products and could not act as an independent financial adviser. He had to keep adequate records in respect of the sale and servicing of policies.

15. We accept the evidence of Mr Cooper that the activities undertaken by a sales associate to earn commission included the arranging of sales and the servicing of existing clients and contracts. Servicing included the contacting of clients to ensure that commissions were paid, visiting clients and discussing their policies and providing information as to how a policy was performing. Allied Dunbar did not prescribe a level of servicing and did not pay separately for servicing.

#### *The financial manual*

16. The financial manual set out the various income streams which could be earned by a sales associate. These included:

*Initial commission* which was paid in respect of policies issued by Allied Dunbar as a result of a written application from the sales associate. The rate of initial commission depended upon the type of policy and the age of the life

assured and the rate was applied to the annual premium. Entitlement to initial commission accrued monthly over an initial period. The initial period depended upon the age of the policy holder, and the length of the policy, and sometimes the type of plan, but was normally twenty-four months. Initial commission could be in the order of 50% of the annual premium for each of the first two years. The initial commission was only payable in any month if the monthly premium for that month had been paid;

*Renewal commission* which was calculated at the rate of 2.5% or 5% on the annual premium of a regular premium policy outside the initial period; renewal commission was only payable if the policy was still in force and the annual premiums had been paid;

*Single premium commission* which was paid in respect of the premium paid on a single premium policy. The rate depended on the type of policy. The entitlement accrued on the first day of the month following the issue of the policy, so long as the premium was paid;

*Protected rights commission* which was paid in respect of a protected rights policy issued by Allied Dunbar. Entitlement accrued on the first day of the month following receipt of a contribution;

*Fees* which were payable in respect of the sale of a number of products including mortgages, wills, pension plans and investment bonds. Fees were also payable on certain anniversaries of investment bonds and pension plans etc. Anniversary fees were only due if the bond or pension plan was still in force at the date of the anniversary;

*A persistency bonus* which was a bonus based on productivity and persistence in the previous year.

17. All commissions and fees were paid to the sales associate by Allied Dunbar.

#### *The practice buy-out arrangements*

18. If a sales associate's contract with Allied Dunbar was terminated in the normal way (that is, other than through a practice buy-out) the sales associate's entitlement to initial commissions, renewal commissions at 2.5%, and mortgage or will fees earned but not paid, usually continued. A retired sales associate was not expected to continue to service clients and his continuing entitlement to commissions and mortgage or will fees did not depend upon his continuing to service clients. However, on retirement the entitlement to single premium commission, protected rights commission, fees other than mortgage and will fees, and persistency bonus ceased. Also, on retirement the sales associate was obliged to return his client information to Allied Dunbar and no payment was made to the sales associate for this information.

19. Allied Dunbar issued its sales associates with a document called “Rewarding your achievement – Practice Buy-Out”. That document described the benefits of a practice buy-out in detail. The arrangements have changed since 1996 but we describe those in force in 1996 when the Appellant retired. The practice buy-out document stated that the retirement practice buy-out option gave sales associates “the chance to build a substantial capital asset in a tax efficient way”. It also stated that the purchase of a practice by Allied Dunbar Fortuna Limited (Fortuna) at market value was a contractual entitlement for qualified advisers. Qualified advisers were those age 55 or over with cumulative initial commission of £170,000 or more. The document stated that market value was calculated by taking into account all future commissions and fees entitlements (and not just those which continued to be payable to the retiring sales associate) and also goodwill. The goodwill value was determined by what another sales associate was willing to pay for the practice of the retiring sales associate.

20. The practice buy-out document contained a step by step description of the process. This began with a formal confirmation of the intention of a sales associate to retire, such confirmation being given at least three months in advance of the date of the intended retirement. The document assumed that, during this three month period, the vendor sales associate would identify a purchaser sales associate who would ultimately purchase the goodwill and that, two or three weeks before retirement, the price for the goodwill would be agreed between the vendor sales associate and the purchaser sales associate. Allied Dunbar and Fortuna had the final say over the identity of the purchaser sales associate. On retirement the value of the commissions and fees would be paid to the vendor sales associate by Fortuna. The value of the goodwill would be paid to the vendor sales associate by Fortuna after Fortuna had received the money from the purchaser sales associate and after the end of a period during which the vendor sales associate would act as agent for Fortuna (the agency period).

21. Thus the practice buy-out arrangements allowed a sales associate to obtain a capital value in return for his income streams after retirement.

22. On 2 January 1992 Allied Dunbar issued a newsflash about practice buy-outs. The newsflash stated:

“We have re-structured the new PBO [practice buy-out] contract to ensure that the sale of your practice as a going concern will be treated as a capital transaction eligible for business retirement relief. This structure has been checked and approved by one of the UK’s leading tax counsellors in this field, who is confident that, if the new Allied Dunbar PBO contract wording and procedures are adhered to, capital treatment will be secured.

Even though tax legislation may change over time we are committed to maintaining the tax efficient status of the PBO package and will restructure the contract if necessary to ensure the most favourable tax treatment possible.”

## *Fortuna*

23. The practice buy-out document referred to the purchase of practices by Fortuna which was a subsidiary of, and part of the Marketing Group of, Allied Dunbar. Fortuna did not have any employees. The only activity of Fortuna was the buying, operating and disposal of the practices of sales associates. It did not carry on any other trade and, in particular, it was not authorised to conduct investment business.

24. Fortuna purchased the trades of vendor sales associates for lump sums. In respect of each trade it thereafter retained the continuing commissions and fees but intended to sell the goodwill to another sales associate. When Fortuna had purchased a trade it operated it for the agency period using the vendor sales associate as its agent to run and maintain the trade. During the agency period Fortuna retained the commissions (including initial and renewal commissions) and fees generated by the vendor sales associate before the transfer and paid him an agency fee. The agency fee was 75% of any initial commissions generated during the agency period and was payable at the end of the agency period. Fortuna then sold the goodwill to another sales associate, paying the price of the goodwill to the vendor sales associate but retaining 2.5% of the price of the goodwill for itself. After the sale of the goodwill Fortuna retained the right to receive all the commissions and fees generated by the vendor sales associate and hoped that these would exceed the lump sum amount it had paid to the vendor sales associate.

25. Thus, the price paid by Fortuna to a sales associate for his trade was calculated taking into account two elements. The first element was a best estimate of the value of future commissions and fee entitlements. This valuation was made taking into account the fact that entitlement to commissions was contingent upon the policies remaining in force and the premiums being paid. The second element was 97.5% of the price realised by Fortuna on the disposal of the goodwill to another sales associate. The goodwill element reflected the value of the client lists and contacts built up over time by the vendor sales associate.

26. Fortuna maintained separate internal accounts in respect of each practice. This was done to facilitate the calculation of the agency fee for each agent and to ensure that there were separately identifiable trades available for sale. Each sales associate had a unique code for internal record keeping purposes and all the clients of a sales associate were allocated to his code. During an agency period the clients continued to be identified with the code of the vendor sales associate. When the goodwill had been transferred to another sales associate the clients were re-allocated to the code of the purchaser sales associate. If a purchaser sales associate could not be found by the vendor sales associate then Fortuna would try to find a purchaser. If no purchaser could be found within a year then Fortuna would conclude that there was no goodwill and no payment would be made to the vendor sales associate for the goodwill element of his practice. We accept the evidence of Mr Cooper that he could not recall any occasion when it had not been possible to find a purchaser sales associate.

27. Fortuna brought into the computation of its profits the commission of 2.5% which it received on the sale of the goodwill to the purchaser sales associate; the income streams generated during the agency period; and the receipt of all the commissions and fees transferred to it by the vendor sales associate. The accounts of Fortuna indicated that its turnover consisted of the commissions and fees receivable, and the resale proceeds from the practices. The price it paid to vendor sales associates was recorded as costs of sales. It paid corporation tax on its profits.

*The Appellant's practice buy-out*

28. From about 1991 the Appellant was in poor health and his trade suffered. In November 1995 the Appellant suffered a heart attack and was unable to meet his performance targets. By then he was of the required age and had accrued initial commission of almost, but not quite, £170,000. Accordingly he asked Allied Dunbar if they would exercise their discretion to permit a practice buy-out and they agreed. On 23 May 1996 the Appellant submitted a formal notice confirming that he wished to take up the concessionary offer of a practice buy-out on health grounds and that he intended formally to retire in the week beginning 10 June 1996.

29. In April or May 1996 the Appellant began tentative discussions with two other Allied Dunbar sales associates, Mr Keith Savage and Mr Trevor Fennell, about the possible transfer of the goodwill of his practice. Initially he wanted each of them to acquire a part of his goodwill. However, on 29 May 1996 the Appellant was informed that it was not possible for his practice to be sold to two purchasers.

30. On 11 June 1996 the Appellant was informed that his practice had been valued at £37,868 excluding goodwill. A first instalment of 75% would be payable on signature of the contracts and the final instalment of 25% would be payable in a year's time. The amount for goodwill (less Fortuna's 2.5% fee) would be forwarded when the purchaser of the goodwill had completed his purchase. The Appellant was sent the contract and agency agreements to sign. A valuation was attached and this showed values of £6,780 for initial commissions; £25,491 for renewal commissions; and £5,597 for fees giving a total market value of £37,868. There was a space on the valuation form for the value of goodwill but this was not completed.

31. We accept the evidence of the Appellant that by 13 June 1996 he had still not decided whom he wished to suggest to Fortuna as the purchaser of the goodwill of his practice and we accept the evidence of Mr Cooper that at that date it could not have been known for certain that a purchaser would be identified.

*June 1996 – the Appellant's practice buy-out agreements*

32. On 13 June 1996 the Appellant signed the agreement with Fortuna for the sale of his practice. The terms of the agreement were that the Appellant would retire as a sales associate and would sell to Fortuna the goodwill, the benefit of contracts with all entitlements to commissions and fees, and the records of his trade. The purchase price would be paid in two instalments. The contract provided that the Appellant would

deliver to Fortuna all his papers, documents, records and accounts. We accept the evidence of the Appellant that he kept his papers at home and did not in fact deliver these papers to Fortuna at that time but did deliver them to Allied Dunbar for Mr Savage in October 1996 when the goodwill was transferred to Mr Savage. On 13 June 1996 the Appellant also signed a restrictive covenant in which he covenanted not to compete for two years. Also on 13 June 1996 the Appellant entered into an agency agreement with Fortuna which contained the following recital:

“1.4. Because Fortuna is not authorised to transact investment business under the FSA, Allied Dunbar has agreed to appoint the Agent as an Appointed Representative under the FSA and take responsibility for the activities of the Agent in managing and operating the Practice even though he is operating the Practice as Fortuna’s agent.”

33. The FSA referred to in recital 4 was the Financial Services Act 1986. The agency agreement recorded that the Appellant agreed to become Fortuna’s agent so that Fortuna could carry on the practice. The Appellant agreed to use his best endeavours to sell the products and services of Allied Dunbar and to maintain cordial contacts with clients. The Appellant also agreed to use stationery which denoted that he was an agent of Fortuna and not a sales associate of Allied Dunbar. The agency agreement was to terminate automatically twelve months from the date it was signed or on the earlier sale by Fortuna of the practice.

*13 June 1996 to 24 October 1996 – the agency period*

34. On 14 June 1996 the Appellant received the first (75%) instalment of the price of the commissions and fees of his practice. On 25 June 1996 Allied Dunbar wrote to the Appellant to say that the Allied Dunbar Marketing Group appointed him as its appointed representative under the FSA and each company in the marketing group agreed to accept responsibility for his activities in marketing the products and services of that company. If he did not act in accordance with the terms of the sales associate contract then he would not be acting as an appointed representative and no company would take responsibility for his actions.

35. Between 1 June 1996 and 24 October 1996 the Appellant made forty-nine visits to clients, 54 visits to the local branch of Allied Dunbar and he also attended nineteen other Allied Dunbar functions. The first two of these weeks were before the agency period but we accept the evidence of the Appellant that the majority of these calls and visits were made while he was acting as agent for Fortuna. Despite his ill health the Appellant sold two policies during the agency period.

36. On 27 June 1996 the Appellant prepared a memorandum or prospectus about his practice for sending to persons who might be interested in buying it. He sent copies to Mr Savage and Mr Fennell. The Appellant also knew that any purchaser had to be acceptable to Allied Dunbar and Fortuna. The Appellant then had discussions with Mr Savage and Mr Fennell. On 17 July the Appellant was asked to confirm who he would like the purchaser to be. The Appellant met Mr Savage on 23 July 1996 and they both agreed that the Appellant would propose Mr Savage as the purchaser of his

goodwill. They also both agreed that the value of the goodwill would be £7,000. On 23 July 1996 the Appellant and Mr Savage wrote jointly stating that Mr Savage would buy the goodwill of the Appellant's practice for the sum of £7,000. We accept the evidence of the Appellant that at this stage he still considered that it was open to Fortuna to reject Mr Savage as the purchaser of the goodwill as Fortuna had the final say.

37. On 2 September 1996 Allied Dunbar approved the wording of a letter to be sent by the Appellant to all his clients announcing his retirement and that his practice would be incorporated into that of Mr Savage. The letter stated that the Appellant's practice had been passed to Fortuna and that, as he would be managing the practice for a while on behalf of Fortuna, the clients would in the immediate future continue to deal with him. In the long term the practice would be incorporated into that of Mr Savage. The Appellant sent out a letter in this form to his clients on or about 12 September 1996.

38. On 24 October 1996 Fortuna and Mr Savage entered into an agreement under which Fortuna agreed to sell the practice of the Appellant to Mr Savage for the sum of £7,000. The sale included: the practice of selling the products and services of Allied Dunbar including the right to prospect for trade from the clients; copies of lists of clients; two years' case ownership (which meant that no other sales associate could deal with those clients within the two year period); and the right for Mr Savage to represent himself as carrying on the practice in succession to Fortuna. Appended to the agreement was a twenty page list of the clients of the Appellant. On the same date, namely 24 October 1996, the Appellant's agency arrangement with Fortuna terminated.

39. On 29 October 1996 Fortuna sent the Appellant a cheque in respect of the goodwill sold to Mr Savage. The price was £7,000 from which Fortuna deducted its 2.5% commission leaving the sum of £6,750 due to the Appellant. (Thus the Appellant was paid £37,868 for his commissions and fees and £6,750 for the goodwill making a total of £44,618.) Arrangements were then made to move the clients to Mr Savage and to remove the Appellant's name from the register of the Personal Investment Authority.

40. On 11 December 1996 Allied Dunbar sent the Appellant a cheque for £336.37 for the agency fees due to him under the agency agreement. The letter stated that the agency contract was then terminated.

41. We accept the evidence of the Appellant that the agency period had been useful to him because it enabled him to progress the sale of the goodwill to Mr Savage; it ensured that his practice was maintained until a purchaser was found thus protecting its value; and it meant that he could still be involved with his clients many of whom had become his friends. We also accept the evidence of the Appellant that, although in theory he could have achieved these advantages by remaining a sales associate until the transfer of the goodwill to Mr Savage, in practice his ill health

meant that the agency period relieved him of a lot of pressure about performance targets that he would have had as a sales associate.

42. In December 1996 the Appellant cancelled his consumer credit licence.

43. On 24 June 1997 the Appellant was sent the final (25%) instalment due to him from Fortuna under the practice buy-out agreement. In fact the amount actually paid to the Appellant was slightly less than the balance of the amount due because an amount due from the Appellant to Allied Dunbar was deducted from the total.

44. We accept the evidence of the Appellant that if he had been unable to reach agreement with Mr Savage, Mr Fennell or any other sales associate for the transfer of the goodwill of his practice he would have received nothing at all for the goodwill.

#### *The return for 1996/97*

45. On 31 January 1998 the Appellant sent his tax return for the year ending on 5 April 1997. The letter read:

“I enclose the following:

My 1996/97 Tax Return

Self-Employment Returns – present and previous trade

Capital Gains Tax Return covering cessation of previous trade

Accounts for my previous trade that were “to follow” on my previous tax return.”

#### *The other enclosures*

46. As indicated in the covering letter the Appellant sent four documents with his letter. We consider the return later but now mention the other three enclosures. The first was two sets of self-employment returns. The first set related to the trade “Peter Rafferty Office and Business Services” which was described as a financial advisory trade. In this the Appellant stated that the trade ceased on 31 December 1996 and made a loss of £3,050 including capital allowances. The second set related to the trade Peter Rafferty & Co which was described as a mortgage broking trade. In this the Appellant declared a loss of £1,575 for the period from 1 January 1997 to 5 April 1997.

47. The next enclosure with the letter of 31 January 1998 was a capital gains tax return covering the cessation of the Appellant’s previous trade. On this he stated that his chargeable gains were nil in respect of the disposal of an asset which he described as “life assurance agent business”. He returned the disposal proceeds as £33,843 and claimed retirement relief. He added:

“I received £33,843 for my practice after a heart attack. I am unable to calculate a “gain” as the value of the practice built up gradually since 1981 as

my clients increased in number and they added to their policies. I am, however, claiming business retirement relief as I am 62 years of age.”

48. The third enclosure with the letter of 31 January 1998 was the profit and loss account for the year ending in April 1995. This was headed “Peter Rafferty Office and Business Services” and showed receipts from Allied Dunbar (which was named) as £17,314 and other income as £62 making a total of £17,376. Expenses amounted to £8,804 leaving profit before tax of £8,572.

*The return*

49. The final document sent with the letter of 31 January 1998 was the return for 1996/97. This indicated that the Appellant was self-employed and gave the following additional information:

“I have had to develop my new mortgage broking trade since January 1997 very much on a part-time basis as my long term health problems prevent me working for substantial periods every year. There is no possibility of me making a taxable profit before 5 April 1998. “

50. Later the return stated that the trade of Peter Rafferty Office and Business ended on 31 December 1996 and that figures had been prepared for the final twelve months to the date of the cessation of the trade in accordance with section 388 Taxes Act 1988.

51. The return did not state that the trade had been sold to Fortuna. We accept the evidence of the Appellant that it did not occur to him that the proceeds of the sale of his trade could be taxable income. He was not aware of sections 103 to 106 and it was not mentioned in any of the guides or help sheets that he referred to when completing his return.

*The guidance notes*

52. The return completed by the Appellant was a self-assessment tax return. The guidance notes with the return contained the following paragraph:

*“Post-cessation and similar trade receipts*  
Include any income you receive from a trade in which your involvement has ceased.”

53. The Appellant made no entry in his 1997 return at the relevant points (Boxes 13.3 or 22.5.)

54. The guidance notes also invited taxpayers to request supplementary pages where capital gains had arisen in the year. The Appellant had done this and the guidance notes about capital gains tax contained the following paragraphs:

*“Assets*

Any form of property, wherever it is situated, may be an asset that attracts Capital Gains tax. The most common assets include:  
... trade assets such as goodwill.”

***“What are disposal proceeds?”***

In most cases your calculation should begin with the total amount of disposal proceeds you will receive. This may include:

... the value of a right to receive future payments.”

55. The guidance notes did not mention any need to disclose the identity of the purchaser of any asset.

*The Inland Revenue’s inquiry*

56. On 4 November 1998 Mr Harvey carried out a review of the Appellant’s return to ascertain whether it should be the subject of an enquiry. He concluded that there was no reason to open an enquiry. The time limit for the normal inquiry into the Appellant’s return for 1996/97 expired on 31 January 1999. After that time had expired, on 12 April 1999, the City Large Trade Office, which dealt with the affairs of Fortuna, wrote to Mr Harvey’s office to say that the Appellant had disposed of his trade to Allied Dunbar in 1996 and had received the sum of £37,868. It was likely that part of the sum was paid for the transfer of the right to receive future commissions and so was taxable as income under section 106(1); section 106(2) did not apply relying upon the Decision of the Special Commissioner in *Brewin v McVitie* [1999] STC (SCD) 5. This information was received by Mr Harvey on 20 April 1999. Mr Harvey had not previously heard of the case of *Brewin v McVitie* but he looked again at the Appellant’s tax return and formed the view that the Appellant had been incorrect in treating as a capital receipt an amount which Mr Harvey then thought should be an income receipt. Accordingly, on 28 April 1999 Mr Harvey opened an inquiry under section 29 of the 1970 Act.

57. Mr Harvey gave evidence, which we accept as truthful, that, at the time the enquiry window closed, on 31 January 1999, he had never heard of section 106 and he could not reasonably have been expected to be aware that profits which ought to have been assessed had not been assessed because there was nothing in the Appellant’s return, or in any material accompanying the return, to alert him to the possibility that an income receipt had been returned incorrectly as a capital receipt. He also gave evidence, which we accept as truthful, that at the time the enquiry window closed, he knew that the Appellant was a sales associate of Allied Dunbar and he also knew that the Appellant had disposed of his trade but at that time he did not know that the Appellant had disposed of his trade to Fortuna.

58. On 28 April 1999 the Inland Revenue wrote to the Appellant and referred to the return for the year ended 5 April 1997 and the amount of £33,843 which the Appellant said that he had received for his practice. The letter stated that this payment was in respect both of goodwill and for transferring the rights to future commissions

on policies sold. It was agreed that the amount received for goodwill was a capital receipt but the Revenue were of the view that the payment for transferring rights to future commissions was taxable as income under section 106(1) of the 1988 Act. The Appellant was asked for further information.

59. The assessment the subject of the appeal was made on 15 April 2002 on the basis that the part of the amount received by the Appellant from Fortuna in respect of commissions and fees was taxable as income in the year of assessment 1996/97. The Revenue accepted that the amount paid to the Appellant for goodwill was a capital receipt.

### **Reasons for Decision**

60. We consider separately each of the issues for determination in the appeal.

*Issue (1) – Are the renewal commissions taxable under section 106(1)?*

61. The first issue in the appeal is whether the part of the consideration for the transfer of the trade which represents renewal commissions is taxable on the Appellant under section 106(1) because it represents sums to which section 103 applies, namely, sums which arose from the carrying on of the trade during any period before the discontinuance.

62. For the Appellant Mr Goldberg QC argued that the part of the consideration for the transfer of the trade from the Appellant to Fortuna which represented renewal commissions was not taxable on the Appellant under section 106(1) because the renewal commissions were not sums which arose from the carrying on of the trade before the discontinuance. However, he accepted that initial commissions were sums which arose from the carrying on of the trade before the discontinuance. For the Inland Revenue Mr Carr argued that the renewal commissions did arise from the carrying on of the trade before the discontinuance and so the consideration for them was in principle taxable on the Appellant under section 106(1) (if section 106(2) did not apply).

63. In considering the arguments of the parties we begin with the legislation. Section 106(1) applies where there is a transfer of the right to receive any sums to which section 103 applies and section 103 applies to sums “arising” from the carrying on of a trade before the discontinuance.

64. For the purposes of this issue, we do not see any difference between initial commissions on the one hand and renewal commissions on the other and we are of the view that both arose from the carrying on of the trade before the discontinuance. We accept the evidence of Mr Cooper that initial commission became due on the sale of a policy but was paid over a twenty-four month period whereas renewal commission was due and paid on the renewal. However, we have also found as a fact that entitlement to initial commission accrued monthly over an initial period which was normally twenty-four months and that the initial commission was only payable in any month if the monthly premium for that month had been paid. We have also found that

renewal commissions were paid after the period of the initial commission but again were only payable if the policy was still in force and the premiums had been paid. In our view, if a trade were transferred, say, six months after a policy had been sold, then the entitlement to both the rest of the initial commission and to the renewal commission would depend in each month on the policy remaining in force and the premiums having been paid. Nevertheless both the initial commission and the renewal commissions would be sums arising from the carrying on of the trade before the discontinuance because they both arose from the sale of the policy which sale occurred before the discontinuance.

65. For the Appellant Mr Goldberg argued that section 106(1) only applied to a transfer of the *right* to receive certain sums to which section 103 applied. He went on to argue that, at the date of the transfer of the trade, the Appellant had no immediate existing right to receive renewal commissions; all he had was an expectation or a hope that the renewal commissions would be paid if the policy holders continued to pay their premiums. And it was that expectation or hope, and not any right, which was transferred to Fortuna. There had been no transfer of the right to receive a sum because it could not be known what sums would be payable. All there was, was an estimate

66. We do not accept these arguments. In our view that part of the consideration paid by Fortuna to the Appellant for initial and renewal commissions and fees represented sums earned by the Appellant from the sale of policies before the transfer of the trade. At the date of the transfer of his trade to Fortuna the Appellant did have a right to receive renewal commissions, albeit a right conditional upon the policies still being in force with all premiums paid. There was nothing further that the Appellant needed to do in order to obtain the renewal commissions. And he transferred his right to them to Fortuna.

67. Mr Goldberg also argued that what produced the renewal commissions was the carrying on of the trade by Fortuna after the discontinuance, especially the servicing of the clients. We do not agree. We have found as a fact that if a sales associate's contract with Allied Dunbar was terminated other than through a practice buy-out then the sales associate's entitlement to initial commissions, renewal commissions and mortgage and will fees usually continued. In other words they remained payable to the sales associate even though he did not service the clients after his contract was terminated and so did not carry on the trade after the discontinuance. We accept the evidence of the Appellant that his entitlement to renewal commissions did not depend upon anything he did after the policy had been sold. This confirms our view that the renewal commissions arose from the carrying on of the trade during a period before the discontinuance; that the Appellant had a right to them (subject to the premiums being paid by the policyholders); and that it was not Fortuna's trade which produced the renewal commissions.

68. Mr Goldberg's third argument was that initial commissions only came within section 103 as they were earned and accrued from the carrying on of the trade before the discontinuance and belonged to the period before the discontinuance. He argued

that renewal commissions, on the other hand, arose after the discontinuance of the trade. They were not earned before the discontinuance. They could not have come into the Appellant's tax computations before the discontinuance.

69. We note that the statutory language in section 103(2) only mentions sums arising. Not sums due, not sums accrued, and not sums earned, but sums arising. Section 103 applies to taxpayers taxed on the earnings basis, as was the Appellant. Most sums due, or accrued, or earned before the discontinuance would have been brought into account on the earnings basis. But section 103 is specifically designed to tax sums which are not brought into account on the earnings basis but which nevertheless arose before the discontinuance. And in our view all the sums transferred to Fortuna came within that category including the renewal commissions.

70. We therefore conclude that the part of the consideration for the transfer of the trade which represents renewal commissions is, in principle, taxable on the Appellant under section 106(1) because it represents sums to which section 103 applies, namely, sums which arose from the carrying on of the trade during a period before the discontinuance. We say "in principle" because section 106(1) is subject to section 106(2) to which we now turn.

*Issue (2) – Are the commissions taxable on the Fortuna under section 106(2)?*

71. The second issue in the appeal is whether the part of the consideration for the transfer of the trade which represents fees and commissions is not taxable on the Appellant but is taxable instead on Fortuna under section 106(2) because on the transfer the trade was treated as permanently discontinued by reason of a change in the persons carrying it on and the right to receive all the commissions and fees was transferred to Fortuna who brought them as receipts into the computation of its profits. The Appellant was of the view that section 106(2) applied but the Revenue were of the view that it did not.

72. As argued, this issue raised two questions. The first was whether there was a change in the persons carrying on the trade. The second was whether the transfer of the trade to Fortuna was to be disregarded in construing and applying the statutory provision so that the Appellant would fall to be treated as having transferred his trade to Mr Savage, with the result that section 106(2) could not apply, because the right to receive the commissions and fees was not transferred to Mr Savage who would (on that hypothesis) be the person carrying on the trade after the transfer.

73. We consider these two questions separately.

Question 1 – Was there a change in the persons carrying on the trade?

74. The first question is whether there was a change in the persons carrying on the trade. The relevance of this question is that section 106(2) only applies where a trade is treated as permanently discontinued by reason of a change in the persons carrying it on. As we understand it the argument centres round the sale of his practice by the

Appellant to Fortuna on 13 June 1996 when he sold to Fortuna the goodwill of his practice, the entitlement to all outstanding commissions and fees, and the records of his practice. It was the case for the Appellant that there had been a change in the persons carrying on the trade, namely from the Appellant to Fortuna. It was the case for the Revenue that after the transfer Fortuna did not carry on the same trade as the Appellant, and so there cannot then have been a change in the persons carrying on the trade.

75. In particular, Mr Carr for the Revenue argued that the trade carried on by the Appellant was as a self-employed sales associate of Allied Dunbar selling its products to clients. Fortuna's trade was the buying and selling of practices and not the selling of policies to clients. The Appellant was subject to regulatory requirements and contractual obligations under the sales associate manual and the financial manual. Fortuna on the other hand was not able to conduct the trade of selling policies because it did not have the regulatory authorisation to do so. Fortuna, unlike the Appellant, had no long term interest in the clients and was simply "keeping the trade warm" until the goodwill was sold to Mr Savage. The substance of the trade carried on by the Appellant was not the same as the substance of the trade carried on by Fortuna and was not sufficiently close for the conclusion to be drawn that there was a succession to the trade by reason of a change in the persons carrying on the trade.

76. We are of the view that the Appellant's trade did not cease on the transfer to Fortuna and that there was a succession by Fortuna to the Appellant's trade. *Bell v National Provincial Bank of England Limited* [1904] 1 KB 149 at 161 establishes the principle that a person can succeed to a trade even if he has a trade of his own of a similar kind (although such a person would not succeed to a trade if he purchased it with a view to extinguishing it). In this appeal Fortuna acquired the Appellant's trade not with a view to extinguishing it but with a view to carrying it on with the Appellant as its agent and, in the long term, its sale on as a separate trade.

77. We accept that a trade which is sold to a purchaser could, in certain circumstances, be discontinued if it was so changed or destroyed on acquisition by the purchaser that it no longer existed. In *Laycock v Freeman, Hardy and Willis Limited* [1939] 2 KB 1; 22 TC 28 the issue was whether a parent company had succeeded to the trade of two of its wholly-owned subsidiary companies who went into voluntary liquidation and assigned their businesses to the parent. Before the assignment the subsidiary companies had manufactured footwear all of which had been purchased wholesale by the parent who had sold it to the public in shops owned by the parent. The Court of Appeal held that the businesses of the two subsidiaries had ceased because after the assignment the parent did not carry on the trade of wholesale manufacturing and did not sell the footwear to itself. However, in our view the trade of the Appellant did not cease on the transfer to Fortuna. After the transfer Fortuna carried on the trade of selling policies to clients, albeit through the agency of the Appellant. It was necessary for Fortuna to carry on the trade so that it could be transferred in due course to Mr Savage. We view the evidence as establishing that there was no actual cessation of trade on the transfer from the Appellant to Fortuna, and also that there was then no occasion when the trade went in some way into

abeyance until its revival on the later sale by Fortuna to Mr Savage. In particular, we do not regard the question of Fortuna's status, or the Appellant's status from time to time, with regard to the applicable investment business regulatory requirements, as affecting the question as to whether as a matter of fact the trade ceased or continued on the successive changes in ownership.

78. It is also relevant that, in this appeal, the identity of the trade acquired by Fortuna was preserved. In *Briton Ferry Steel Company Limited v Barry* [1940] 1 KB 463 a parent company made steel bars and sold some to other companies and some to its own subsidiaries who used them to make tinplate. The subsidiaries were wound up and their assets and undertakings were transferred to the parent company. The parent company was assessed to tax on the basis that it was a successor to the trade of the subsidiaries and the assessment was upheld. At 481 Sir Wilfrid Greene MR affirmed the decision of the Special Commissioners that a purchaser of a trade who amalgamates that trade as a department of his own does not prevent there being a succession if in other respects the identity of the trade acquired is preserved. In this appeal we have found as a fact that Fortuna maintained separate internal accounts in respect of each practice it purchased and this ensured that there were separately identifiable trades for resale. Not only did Fortuna preserve the identity of the Appellant's trade but later transferred it to Mr Savage.

79. We were also referred to *Maidment v Kibby* (1993) 66 TC 137 where the issue was whether the vendor's trade was carried on by the purchaser so that the commencement provisions for a new trade applied. The purchasers had run a fish and chip shop in Chepstow and then purchased a fish and chip shop in a town five miles away. The new trade immediately became integrated into the existing trade and the accounts then showed income and expenditure for the combined trade. The Inland Revenue argued that the taxpayers had succeeded to the trade of the new fish and chip shop and had continued to carry on that trade with the result that the statutory provisions relating to the commencement of a new trade applied. The General Commissioners allowed the appeal holding that the taxpayers had continued an existing and enlarged trade rather than succeeding to a new one. The High Court at 143 F stated the principle that there was an assumption that the trade carried on by a former owner continued to be carried on by the successor and upheld the decision of the General Commissioners and held that the question was whether the changes to the acquired trade had been so substantial that the new trade was not the same as its predecessor.

80. We distinguish *Maidment v Kibby* on the facts. In this appeal Fortuna carried on the Appellant's trade in an identifiable form for the purpose of selling it on as a separate trade. In our view the changes to the trade when acquired by Fortuna were not so substantial that it was not the same trade as that carried on by the Appellant.

81. Finally we were referred to *Alongi v Commissioners of Inland Revenue* (1991) 64 TC 304 which established the principle that that the proprietor of a trade was the person who owned and controlled the trade and was entitled to the profits or gains which accrued from it. Such a person therefore is carrying on the trade. We are of the

view that the fact that a proprietor engages employees or agents to assist in the carrying on of the trade does not alter those principles. Accordingly, after the transfer to Fortuna, Fortuna became the proprietor of the Appellant's trade; it owned and controlled the trade; and was entitled to the profits of it. There was a change in the persons engaged in carrying on the Appellant's trade.

82. We conclude that, on the transfer of his trade by the Appellant to Fortuna, there was a change in the persons carrying on the trade. Before the transfer the trade was carried on by the Appellant; after the transfer it was carried on by Fortuna with the Appellant as its agent. The trade was not extinguished on being transferred to Fortuna but was carried on in an identifiable form as policies were sold and commissions collected from which it follows that Fortuna succeeded to and continued to carry on the trade of the Appellant.

Question 2 – Should the transfer to Fortuna be disregarded?

83. The second question arising out of this issue is whether the transfer of the trade to Fortuna is to be disregarded so that the Appellant is to be treated as selling his trade to Mr Savage with the result that section 106(2) could not apply because the right to receive the commissions and fees was not transferred to Mr Savage who was the person carrying on the trade after the change. This question arises out of the argument for the Revenue that this was a pre-ordained series of transactions which had no purpose other than tax mitigation and where there was no practical likelihood that the pre-planned events would not take place in the order pre-ordained, from which it followed that we should link the beginning with the end so as to make a single composite whole to which the fiscal results of the single composite whole were to be applied.

84. The starting point for a consideration of this question is the Decision of the Special Commissioners in *Brewin v McVitie*. The facts and issues in that appeal had some similarity with the facts and issues in this appeal. There the appellant was also a sales associate with Allied Dunbar who on retirement sold her trade to Fortuna. There was an agency agreement at the end of which the goodwill was sold to another sales associate. However, unlike the facts of this appeal it was there agreed that the sale of the trade by the sales associate to Fortuna, and the sale by Fortuna of the goodwill to the purchaser sales associate, were pre-ordained or could be regarded as one single transaction. The Special Commissioners held that the principle of fiscal nullity applied because steps which had no commercial (business) purpose were inserted into a composite transaction. The sale by the appellant to Fortuna had no business purpose and its only object was tax avoidance. Accordingly section 106(2) did not apply because, disregarding the sale of the trade by the appellant to Fortuna and considering only the transfer to the purchaser sales associate, although the appellant's trade was discontinued on its transfer to the purchaser sales associate, the right to receive the outstanding commissions was not transferred to the purchaser sales associate.

85. We distinguish *Brewin v McVitie* in three respects. First, because it was there agreed that the sale of the trade by the sales associate to Fortuna and the sale of the goodwill by Fortuna to the purchaser sales associate were pre-ordained or could be

regarded as a single composite transaction; that was not agreed in this appeal. Secondly, because the taxpayer did not give evidence in that appeal and so the Special Commissioner received very little evidence about how she conducted her operations; in this appeal the evidence of the Appellant was available. And, finally, the law about fiscal nullity, where steps which have no commercial purpose apart from the avoidance of a liability to tax are inserted into a composite transaction, has developed substantially since 1998.

86. Before identifying and applying the legal principles we consider three areas of disputed fact, namely whether Fortuna's purchase of the Appellant's trade was commercial or artificial; whether it had a tax avoidance purpose; and whether there was a pre-ordained scheme.

87. Dealing first with commerciality we find that the practice buy-out arrangements had commercial advantages for all the parties which could not have been achieved in any other way. The arrangements were commercially advantageous for Allied Dunbar and for Fortuna. Allied Dunbar established the arrangements as part of its package to recruit and retain sales associates. The arrangements motivated the sales associates because the entitlement to participate in a practice buy-out depended on the level of cumulative entitlement to initial commissions and the amount received for the practice buy-out depended upon previous performance. Also the arrangements enabled Allied Dunbar to ensure that there was a smooth handover of clients from an outgoing sales associate to a suitable purchaser sales associate. Further, it would have been unrealistic to expect a purchaser sales associate to pay the full capital value of a practice and the arrangements meant that all the purchaser sales associate had to pay was the amount of goodwill. Finally, as Fortuna was not authorised to conduct investment business the retention of the vendor sales associate as agent enabled the trade to be continued during the agency period without any adverse regulatory issues arising. Fortuna made a profit from selling the trades it acquired and operated.

88. We accept the evidence of the Appellant that the practice buy-out arrangement was a valuable option for him as it allowed him to unlock a capital value from his practice. Without it he would have been required to return all his files and records to his Allied Dunbar branch. His clients would have been transferred to the care of the branch and the local branch manager would have distributed them to other sales associates. He would not have obtained any value for this. Also, in his case he had not been entitled to insist on a practice buy-out because he did not have the required amount of initial commission but Allied Dunbar had nevertheless exercised their discretion to permit him a practice buy-out.

89. Thus the business and commercial reality of the transactions was that in June 1996 the Appellant transferred his trade to Fortuna for a lump sum. On that date Fortuna became the owner of the trade. Also on that date the Appellant ceased to trade on his own account and Fortuna began to trade instead of the Appellant. We do not agree that the Appellant transferred his trade to Mr Savage. He never transferred the fees and commissions to Mr Savage and they arose from the trade. And at the time he transferred his trade to Fortuna it was not certain that Mr Savage would ultimately

purchase the goodwill. In any event it was Fortuna who transferred the goodwill to Mr Savage.

90. Turning to the question whether Fortuna's purchase of the Appellant's trade had a tax avoidance purpose, we agree with Mr Carr that the practice buy-out arrangements were designed to be tax efficient, that is to give capital gains tax retirement relief on outstanding commissions and fees instead of their being brought into charge to income tax. That is clear from the statement in the practice buy-out document and from the newsflash of 2 January 1992. We accept that one result of the arrangements was that the Appellant received a capital sum for his commissions and fees against which he could claim retirement relief instead of sums which were chargeable to income tax. But this was a genuine transaction and the result is clearly within the contemplation of section 106(2), which expressly provides exemption from the income tax charge on post cessation receipts where (as here) the right to such receipts is transferred at the time of the (deemed) cessation to the person (Fortuna) carrying on the trade after the (deemed) cessation. We do not consider that a motive of mitigating tax should invalidate the transaction or re-characterise it into another transaction which it was not. We cannot disregard the legal rights and liabilities of the parties and section 106(2) does not require us to do so.

91. On the subject of a pre-ordained scheme we accept that steps were outlined in the practice buy-out document but we regard the fact that the Appellant had not identified Mr Savage as the purchaser of his goodwill until after the agency period had begun as negating the proposition that there was a pre-ordained scheme in this case.

92. Turning now to the legal principles it was the Revenue's case that the introduction of Fortuna during the agency period was an artificial process because Fortuna did not service clients or sell policies, and was not authorised to do so, and the use of the Appellant as agent to undertake these functions was artificial. The agency period had only been interposed to enable the Appellant to achieve a tax advantage. It did not matter that in fact Mr Savage was not identified until after the date of the sale to Fortuna as the key events were the sale to Fortuna, the agency agreement and then the sale to Mr Savage. Mr Carr relied upon the evidence of Mr Cooper that he could not think of any case where a purchaser of the goodwill could not be found, although Mr Carr accepted the outside possibility that that might occur. He relied upon *Craven v White* [1989] 1 AC 398 at 489 G.

93. For the Appellant Mr Goldberg treated us to a lengthy and fascinating dissertation about the development of the law relating to fiscal nullity beginning with *IRC v Duke of Westminster* [1936] AC 1 and ending with *Barclays Mercantile Business Finance Limited v Mawson* [2004] UKHL 51; [2005] STC 1 taking in some United States and Hong Kong authorities along the way. He argued that the present principle was that the statute must be interpreted in accordance with its purpose and applied to the facts. That involved ascertaining what question the statute posed in the light of its purpose and then analysing the particular circumstances of the case in the light of that purpose. There was no free standing principle of fiscal nullity and re-

characterisation was not permitted. The statutory question in this appeal was whether Fortuna was carrying on the trade after the transfer, as that was the question posed by section 113. He argued that there was nothing in the language of section 106(2) which permitted the transfer of the trade to be ignored. The purpose of section 106(2) was to prevent the same receipts being brought into the tax computations of two persons, the transferor and the transferee. Fortuna brought the commissions into the computation of its profits from which it followed that they should not be brought into the computation of the Appellant's profits as well.

94. We have adopted the guidance of House of Lords in *Barclays Bank v Mawson* at [32] which is that we should decide, on a purposive construction, exactly what transaction would answer to the statutory description and then we should decide whether the transaction in question does so.

95. We start by looking at the purpose of section 106(2) and we begin with its statutory context. The subsection appears in a group of sections (sections 103 to 110) the purpose of which is to charge tax on sums received after a trade has ceased, which sums (a) arose from the carrying on of the trade and (b) were not brought into account in computing the profits of the trade. Section 106(1) applies where the trade is transferred for a consideration and provides that tax is chargeable not on the sums received but on the consideration paid for them. Section 106(2) then provides that tax is not chargeable if the transferee of the trade brings the sums into the computation of its profits. Thus the statutory purpose is quite clear and is that tax shall be paid by the owner of a trade on sums received after the end of a trade but that he is not chargeable if he transfers the right to receive the sums to his successor in the trade who pays tax on the same sums.

96. In our view the purpose of section 106(2) is to preclude the same receipts being brought into computations of profits twice, once into the computation of the profits of the transferor under section 106(1) and 103 and again into the computation of the profits of the transferee; and also to determine that the charge to tax on such receipts falls on the transferee and not the transferor. After the transfer in this appeal the renewal commissions belonged to the person to whom the trade had been transferred and were the profits of its trade, namely Fortuna. It would not be in accordance with the statutory purpose if the Appellant had to bring the sums into his income tax computation and if Fortuna effectively had to do the same. Nor would it be in accordance with the statutory purpose to impose a tax charge in these circumstances on the Appellant, and not Fortuna.

97. From this it follows, in our view, that the transaction which would answer the statutory description is any transfer of the right to receive sums which arose from the carrying on of the trade before the transfer so long as the transferee treated the same sums as receipts to be brought into the computation of the profits of his trade. In our view the transfer to Fortuna was a transaction which met that statutory description. The facts we have found are that Fortuna purchased the trade of the Appellant and thereafter carried it on as a distinct trade bringing the receipts which had arisen when the Appellant carried on the trade into the computation of its profits. After about four

months Fortuna sold the goodwill to Mr Savage but retained the right to receive the commissions and fees and continued to bring the commissions and fees into account for tax purposes.

98. *Craven v White* at 514F is authority for the principle that an interval of time between two transactions in an artificial tax avoidance scheme is irrelevant except as evidence to be taken into account when deciding whether the two transactions were independent of each other or whether they formed part of a pre-planned tax avoidance scheme. At 532 H it is authority for the principle that in relation to a pre-ordained series of transactions which had no purpose other than tax mitigation, and where there was no practical likelihood that the pre-planned events would not take place in the order pre-ordained, and where they did take place in the pre-ordained order, the court is justified in linking the beginning with the end so as to make a single composite whole, to which the fiscal results (of the single composite whole) are to be applied. In our view those principles are not applicable in this appeal because the transactions undertaken by the Appellant had commercial and business purposes other than tax mitigation and the series of transactions was not in the above sense to be viewed as a composite whole, because there was, at the time of the transfer of the trade by the Appellant to Fortuna, the possibility that a purchaser of the goodwill would not be found.

99. We conclude that the transfer of the trade to Fortuna is not to be disregarded and that the Appellant is not to be treated for tax purposes as having sold his trade to Mr Savage.

100. On the second issue in the appeal we conclude that the part of the consideration for the transfer of the trade which represents fees and commissions is not taxable on the Appellant but is taxable instead on Fortuna as transferee under section 106(2).

101. That conclusion means that the appeal is allowed and that we do not have to consider the other issues in the appeal. However, as arguments were put to us we briefly express our views.

*Issue (3) – Do the Special Commissioners have jurisdiction to consider section 29(2)*

102. The third issue in the appeal is whether the Special Commissioners have jurisdiction to consider an argument about the application of section 29(2).

103. Both parties agreed that we did have jurisdiction but such consent cannot give us jurisdiction if we do not have it.

104. We were referred to section 29(8) which provides that “an objection to the making of an assessment on the ground that neither of the two conditions mentioned above was fulfilled shall not be made otherwise than on an appeal against an assessment”. The two conditions referred to were the conditions mentioned in section 29(3) which were fully set out in section 29(4) and (5). Thus section 29(8) specifically

gives jurisdiction to the Special Commissioners to consider arguments about section 29(3), (4) and (5) but there is no mention of section 29(2). It could, therefore, be argued that an assessment made in breach of section 29(2) would be void and so there would be no assessment to appeal and the Special Commissioners would have no jurisdiction to rule on the question of the validity of the assessment. We were informed that the Appellant had commenced judicial review proceedings for a declaration that the assessment was void or to quash the assessment but that those proceedings had been stayed pending the outcome of this appeal.

105. However, both parties were of the view that section 31 gave us jurisdiction. Section 31(1)(c) of the 1970 Act (in its form effective at the time relevant to this appeal) provides that an appeal may be brought against an assessment to tax which was not a self-assessment, and that provides us with jurisdiction, if the assessment was valid until declared void. Mr Goldberg for the Appellant also referred to section 34(2) which provided that any objection to the making of an assessment on the ground that the time limit for making it had expired should only be made on an appeal against the assessment. Alternatively, he cited *Mercury Communications Limited v Director General of Telecommunications* [1996] 1 WLR 48 at 57 B to E and *Pawlowski v Dunnington* [1999] STC 550 for the principle that statutory tribunals had jurisdiction to deal with public law matters as a necessary adjunct to their appeal functions.

106. Neither of the authorities cited to us is of direct application in this appeal. In our view it is clearly the intention of section 31 that there should be a right of appeal against an assessment. If an assessment is not appealed then it stands good. Accordingly, there is a presumption that an assessment is valid until there has been a determination otherwise. It is open to an appellant, in any appeal against an assessment, to argue that the assessment does not meet a statutory requirement. Specifically, with regard to section 29(2), we regard it as open to the Appellant in this appeal to argue that his return was made on the basis of the practice generally prevailing at the time it was made, and that the assessment is accordingly invalid.

107. We conclude that the Special Commissioners do have jurisdiction to consider an argument about the application of section 29(2).

*Issue (4) – Was the return made in accordance with prevailing practice?*

108. The fourth issue in the appeal is whether, if there were an error or mistake in the Appellant's return, the return was made on the basis or in accordance with the practice generally prevailing at the time when it was made within the meaning of section 29(2) of the 1970 Act.

109. In view of our conclusion on issue (2) there was, of course, no error or mistake in the Appellant's return. However, we have to consider this issue on the hypothetical basis that there was an error or mistake, namely that the Appellant treated the lump sum he received from Fortuna in respect of his commissions and fees as a capital receipt when it should have been treated as an income receipt.

110. For the Revenue Mr Carr argued that a practice generally prevailing had to be a practice, or agreement, or acceptance over a long period whereby (for present purposes) the Revenue agreed that the tax treatment of sums arising in circumstances such as those of this case, was capital and not income. Merely because the guidance notes did not go into sufficient detail, and because the Appellant did not realise that the receipt was chargeable as income, did not mean that there was a prevailing practice. Section 29(2) was not meant to protect an unsophisticated taxpayer from a discovery assessment.

111. For the Appellant Mr Goldberg argued that the practice referred to in section 29(2) was the practice generally prevailing in relation to the making of returns not the practice of the Revenue. He relied upon the evidence of Mr Brown and Statement of Practice SP8/91 which applied to the predecessor of the version of section 29 at issue in this appeal. He also relied upon Tax Bulletin 23 published in 1996.

112. Mr Brown gave it as his opinion that the Appellant had fully complied with all that could be expected from a taxpayer in accordance with the practice generally prevailing at the time the return was made. In particular there was no requirement at that time to state the name of a purchaser when there had been a disposal of a capital asset. He accepted that a practice generally prevailing would be something that was agreed and understood between the Revenue and tax practitioners. However, the Appellant had completed his return himself and had relied upon the guidance put before him. Mr Brown accepted that guidance had to be at a general level and could not deal with every eventuality but went on to express the opinion that most people who received a lump sum for the sale of a trade would include it as a capital and not an income receipt.

113. We consider Tax Bulletin 23 below within the context of issue (5). In considering the arguments of the parties relevant to this issue we first note that the decision of the Special Commissioners in *Brewin v McVitie* was not published until November 1998 and the Appellant's tax return was submitted on 1 January 1998. Accordingly, the Appellant could not have been aware of that decision when compiling his return.

114. The condition in section 29(2) is whether "the return was in fact made on the basis or in accordance with the practice generally prevailing at the time when it was made". What we have to ask is whether, on the hypothetical basis on which we consider this issue, the Appellant's return of his receipts from Fortuna as capital was in accordance with a practice generally prevailing. We construe section 29(2) as a protection to the taxpayer from an assessment where the Revenue have changed their mind on a doubtful point in a sense adverse to the taxpayer. It would in our judgment go too far to construe it, as Mr Goldberg urged us to do, as a bar on the Revenue from raising a discovery assessment in particular circumstances where they had not publicly adopted a practice. We agree that a practice generally prevailing has to be a practice, or agreement, or acceptance over a long period whereby the Revenue agreed or accepted a certain treatment of sums in particular circumstances. In the circumstances of this case, for there to have been such a practice, the Revenue would

have had to have agreed or accepted that a consideration such as that received by the Appellant from Fortuna was to be treated for tax purposes as having been capital and not income. There was no evidence of such a practice.

115 We conclude that, if there were an error or mistake in the Appellant's return, the return was not made on the basis or in accordance with the practice generally prevailing at the time when it was made within the meaning of section 29(2) of the 1970 Act.

*Issue (5) – Should the Revenue have been aware that income had not been assessed?*

116. The fifth issue in the appeal is whether, when the Revenue ceased to be entitled to give notice of their intention to enquire into the Appellant's return, they could not have been reasonably expected, on the basis of the information made available to them before that time, to be aware that income which ought to have been assessed to income tax had not been so assessed within the meaning of section 29(5) of the 1970 Act. Again, we approach this issue on the hypothetical basis that we had decided issue (2) in a sense favourable to the Revenue.

117. We have already found that the Revenue ceased to be entitled to give notice of their intention to enquire into the Appellant's return on 31 January 1999.

118. For the Appellant Mr Goldberg argued that the burden of proof was on the Revenue to establish that they could not reasonably have been expected to know that they might want to raise an enquiry about sums arising before the discontinuance of the trade. He distinguished *Langam v Veltema* [2004] EWCA Civ 193; [2004] STC 544 where the issue was how much was taxable; the issue in this appeal was whether the amount of consideration received by the Appellant from Fortuna was taxable as income at all. In the present appeal the Revenue were given all the material facts, namely that there had been the sale by the Appellant of his trade for a price. From that information the inspector could have been aware that he might want to claim that some of the price was sums arising before the discontinuance of the trade under section 106(1) and, after the publication of the decision in *Brewin v McVitie* in November 1998, he would have been aware of the relevance of the Appellant's connection with Allied Dunbar as that information was contained in the Appellant's return or in the accounts accompanying the return within the meaning of section 29(6)(a).

119. For the Revenue Mr Carr argued that the inspector knew that the Appellant was a sales associate for Allied Dunbar and that he had sold his trade and was claiming retirement relief. But the inspector did not know who the purchaser of the trade was and he did not know what the amount received for the trade represented and whether it included sums taxable under sections 103 and 106. The statutory wording referred to the officer's awareness that income which ought to have been assessed had not been assessed not to his awareness that an enquiry might be made. Accordingly, in this case, at the relevant time, the inspector could not have been aware that there were profits which had not been assessed to tax. He relied upon *Langham v Veltema*.

120. We record the evidence of Mr Brown which was that in his view there was ample information contained in the return to enable an inspector to decide whether or not he wanted to enquire into the capital asset disposal to see whether there was any income which might be liable to tax.

121. We also now refer to Tax Bulletin 23 which was reproduced in a Press Release dated 31 May 1996. The introduction refers to the paper and states:

“It [the paper] makes it clear that where a taxpayer has made a self-assessment for the relevant chargeable period, the Revenue may raise an assessment if there would otherwise be a loss of tax resulting from the taxpayer’s failure to make a complete disclosure of all the relevant facts relating to his liability to tax.”

122. The paper itself contained the following paragraphs:

“The foundation of the principle of discovery is that the Inland Revenue should be able to recover tax which has been under-assessed (or over-relieved) where there is fraudulent or negligent conduct or where the Inland Revenue Officer could not be reasonably expected to be aware of the under-assessment (or excessive relief) from the information provided in or within the tax return.

...

Where all relevant facts are disclosed to the Revenue, taxpayers can be certain (except in the case of fraud or neglect) that they have gained finality at the end of the enquiry period. ...

A change of opinion on information that has previously been made available to the Inland Revenue will not be grounds for a discovery assessment....

The new return is designed to enable full disclosure to be made without the need to send in computations and accounts in most cases. ...

The self-assessment return requires comprehensive information regarding each taxpayer’s affairs. ... separate accounts and computations are not required to be submitted with the return.

The majority of income tax cases involve reasonably straightforward accounts. In these cases the fully completed return and SAI [standard accounts information] will enable a full and fair picture of a taxpayer’s affairs, including any trade, to be presented. In otherwise straightforward cases there may be the odd point of difficulty which needs further explanation. Such aspects may be dealt with by providing extra information within the areas provided on the return.”

123. Finally we have referred to *Langham v Veltema* which concerned the transfer of a house in March 1998 by a company to the taxpayer for no consideration. The

house was valued at £100,000. In July 1998 the company sent a return to the Inland Revenue showing the transfer at a value of £100,000. The taxpayer's self assessment received in July 1998 contained the same information. Later the District Valuer valued the house at £160,000 and the taxpayer's inspector was told on this in January 2000. The inspector's general power to enquire into the return expired on 31 January 2000. In November 2000 he made an additional assessment under section 29(5). Auld LJ, at [33] to [35], held that there was no obligation on the Revenue to conduct an immediate scrutiny of self-assessment returns when they did not disclose an insufficiency although they might disclose circumstances where further investigation might show insufficiency. The statutory test in section 29(5) was that the tax inspector could have been reasonably expected to be aware of the insufficiency not that he could reasonably have been expected to enquire into it.

124. Applying those principles to the facts of this appeal we conclude that there was no obligation on the inspector to make further enquiries on receipt of the Appellant's return. The return did not make it clear that the Appellant was claiming capital gains tax retirement relief in respect of sums which ought to have been, or might have been, subject to income tax under section 106(1).

125. We conclude that, when the Revenue ceased to be entitled to give notice of their intention to enquire into the Appellant's return, they could not have been reasonably expected, on the basis of the information made available to them before that time, to be aware that income which ought to have been assessed to income tax had not been so assessed within the meaning of section 29(5) of the 1970 Act.

## **Decision**

126. Our decisions on the issues for determination in the appeal are:

(1) that the part of the consideration for the transfer of the trade which represents renewal commissions is, in principle, taxable on the Appellant under section 106(1) because it represents sums to which section 103 applies, namely, sums which arose from the carrying on of a trade during any period before the discontinuance; however, section 106(1) is subject to section 106(2) on which we conclude:

(2) that, even if the renewal commissions were sums which arose from the carrying on of a trade during any period before the discontinuance, the part of the consideration for the transfer of the trade which represents fees and commissions is not taxable on the Appellant but is taxable instead on Fortuna under section 106(2) because the trade was treated as permanently discontinued by reason of a change in the persons carrying it on and the right to receive the renewal commissions was transferred to Fortuna; that conclusion means that the appeal is allowed but as arguments were put to us on the other issues we express our views which are:

(3) that the Special Commissioners have jurisdiction to consider an argument about the application of section 29(2);

(4) that, if there was an error or mistake in the Appellant's return, the return was not made on the basis or in accordance with the practice generally prevailing at the time when it was made within the meaning of section 29(2) of the 1970 Act; and

(5) that, when the Revenue ceased to be entitled to give notice of their intention to enquire into the Appellant's return, they could not have been reasonably expected, on the basis of the information made available to them before that time, to be aware that income which ought to have been assessed to income tax had not been so assessed within the meaning of section 29(5) of the 1970 Act.

127. The appeal is allowed as a result of our decision on issue (2).